

The background of the slide features a large, light blue watermark of the City of Vancouver's coat of arms. The crest includes a crown with four maple leaves, a shield divided into four quadrants (top-left: saltire, top-right: stag's head, bottom-left: sailing ship, bottom-right: eagle), and a banner at the bottom with the motto 'A NE FOR A'.

Agenda Item 7

Treasury Management – Interim Review 2018/19

Falkirk Council

Title: Treasury Management – Interim Review 2018/19
Meeting: Executive
Date: 27 November 2018
Submitted By: Director of Corporate & Housing Services

1. Purpose of Report

- 1.1 As part of the Treasury Management Code of Practice, reporting requirements make provision for an interim review of the Treasury Management function to be considered by the appropriate Committee and full Council. The purpose of this report is to comply with these requirements.

2. Recommendations

2.1 The Executive is asked to:-

- (1) Note the progress of the Council's Treasury Management Strategy for 2018/19.**
- (2) Note the reduction in the long term borrowing requirement for 2018/19.**
- (3) Refer the report to Council for consideration.**

3. Background

- 3.1 This report is one of three Treasury Management reports to Members during the course of the year. The Treasury Management Strategy report for 2018/19 was considered by the Executive on 10 April 2018 and thereafter approved by Council on 9 May 2018. This report provides an update on the progress of Treasury Management activities at the half year point. There will be a final annual review report to the Executive in June 2019, following the financial year end.

4. Considerations

4.1 Economic and Interest Rate Outlook

- 4.1.1 The UK economy has grown modestly in the first half of the year with the expectation that it will be around 1.5% for 2018, picking up to 1.8% in 2019. Inflation rose from 2.4% in June to 2.7% in August but is expected to fall back to the target rate of 2% over the next couple of years. Unemployment is at an all-time low of 4%

- 4.1.2 The U.S. economy continues to grow with growth of 4.2% in the second quarter to June 2018. The Federal Reserve increased interest rates from 2% to 2.5% in September. This is the fourth increase in 2018, with the expectation that it will increase a further four times by the end of 2019. Within the Eurozone, growth was unchanged at 0.4% in quarter 2 and is currently below early forecasts for a stronger economic performance in 2018. The US has imposed tariffs on the importing of manufactured goods e.g. cars, and this could impact negatively on Germany. Although Eurozone growth is still expected to be around 2% for 2018, this may not be as certain as previously thought because of the US tariffs.
- 4.1.3 In the Strategy Report, there was an expectation that the Bank Base Rate would start to increase and on 2 August, the Bank of England (BoE) announced an increase in the rate from 0.5% to 0.75%. Given the value of fixed rate loans that the Council has in its portfolio, this rate increase won't have a material impact on the Council. The bank base rate is expected to remain at 0.75% until September 2019, with gradual increases of 0.25% until it reaches 1.5% in March 2021. Clearly the uncertainty over Brexit is a significant backcloth.
- 4.1.4 The latest interest rate forecast as supplied by Link Asset Services, the Council's treasury advisers, is as follows:

AVERAGE ANNUAL %							
Year	Bank Rate	MONEY RATES		PUBLIC WORKS LOAN BOARD RATES (PWL B)			
		3 Months	1 Year	5 Year	10 Year	25 Year	50 Year
2018/19	0.63	0.67	0.93	1.92	2.35	2.76	2.55
2019/20	0.88	0.98	1.18	2.20	2.63	3.10	2.90
2020/21	1.25	1.43	1.63	2.43	2.90	3.38	3.18

4.2 Borrowing Strategy

- 4.2.1 Capital Investment plans and Treasury Management are intrinsically linked (see Capital Programmes Update 2018/19, a separate agenda item). The 2018/19 Treasury Strategy Report detailed the estimated long term borrowing requirement for 2018/19. It is calculated in January 2018 and takes into account the estimated borrowing for capital programme purposes (including the likely slippage for 2017/18), service repayment of debt, borrowing for TIF and the replacement of any short term or long term loans that are due to mature in 2018/19. As such it will inevitably change as the year progresses.
- 4.2.2 The Capital Programmes Update 2018/19 reported to the September Executive, advised that the Council's estimated longer term borrowing requirement was forecast to be £49.3m, which is £4.3m less than the £53.6m approved as part of the 2018/19 Treasury Strategy. The forecast has been

further reduced to £48.2m. Details of the budgeted long term borrowing requirement and updated forecast borrowing requirement are shown in the following table:

	2018/19 Original Estimate £m	2018/19 Revised Estimate £m	2018/19 Movement £'m
Capital Programmes (net of receipts incl; TIF)	39.4	33.7	(5.7)
Service Payments	(15.3)	(15.0)	0.3
Long Term Loans maturing in year	1.0	1.0	-
Short Term Loans maturing in year	28.5	28.5	-
Total Longer Term Borrowing Requirement	53.6	48.2	(5.4)

- 4.2.3 The long term borrowing requirement for Capital Programme purposes is forecast to be less than the original estimate for a number of reasons. These are as follows:-

	2018/19 £'m	2018/19 £'m
Original Estimate - Capital Programme (net of receipts & including TIF)		39.4
Less:		
Re-profiled TIF projects	(4.6)	
Slippage Allowance General Fund Capital Programme 2018/19 (£3.4m Budgeted Allowance Less £2.5m Forecast)	0.9	
Re-scheduled General Fund Projects to 2019/20	(6.4)	
Re- profile of General Fund Receipts	1.6	
Re-profile of New Build Housing Grant	3.1	
Additional Housing Revenue Contribution	(2.2)	
Slippage in Housing Capital Programme	(3.3)	
Variance in estimated 2017/18 Slippage for General Fund/Housing/TIF	5.2	
Total Movement		(5.7)
2018/19 Revised Estimate - Capital Programme (net of receipts & including TIF)		33.7

- 4.2.4 In the Strategy Report, it was noted that the Council's longer term borrowing requirement for the year would be significant. With this in mind, it was agreed to consider the complete range of borrowing periods as and when the Council needed to borrow. The table at paragraph 4.2.2 includes long term borrowing of £1m and short term borrowing of £28.5m that is due to mature during 2018/19. These loans may be replaced on a short term or long term basis depending on prevailing interest rates at the time borrowing is undertaken. Note that depending on cash flow balances, the replacement of these loans might not necessarily be undertaken at the date of maturity. Officers will

continue to engage with the Council's treasury advisers to determine the best mix of borrowing periods and the best time to borrow based on available interest rates.

- 4.2.5 As previously reported, the Council has been in an under-borrowed position for some time i.e. cash balances have been used to fund capital expenditure in place of borrowing. This has been beneficial as the loans fund interest rate has remained lower as a result. Previous Strategy reports proposed to translate some of this under-borrowing into long term loans on a gradual and managed basis. Consequently, an element of borrowing may be undertaken in addition to that required to fund the 2018/19 capital programmes (see paragraph 4.2.3). Actual borrowing might therefore exceed the forecast of £48.2m, to address the Council's under-borrowed position. Any such borrowing will be included in the annual review of Treasury activities reported to the Executive in June 2019.
- 4.2.6 The Council has four Market Loans valued at £26m in totality. The Strategy Report highlighted the potential for two of these Market Loans, up to a value of £13m, to be repaid during the year should any of the lenders invoke a rate change clause as per their contracts. This has not occurred. These Market Loans are held with Dexia Credit (£8m) and KA Finanz AG (£5m). KA Finanz AG wants to dispose of this type of loan granted towards the UK Public Sector. Consequently there will be a sale of this loan during 2018/19, with the loan of £5m being taken over by another lender. The remaining two Market Loans (£13m) are held with Barclays Bank and as previously advised they have waived their right to change the applicable interest rate of these loans. Given the current level of interest rates, the risk of early repayment of any of the remaining loans is assessed as low.
- 4.2.7 The PWLB has extended the "PWLB Certainty Rate" by a further year. This facility enables eligible local authorities to access discounted PWLB borrowing at 0.02% below standard PWLB rates. This reduced rate is applicable to all borrowing that is undertaken. Falkirk Council's application for this facility has been submitted and a decision on eligibility is due in November. Members will be advised in due course.
- 4.2.8 In addition to the "PWLB Certainty Rate", the Council has submitted an application to access further discounted borrowing under the "PWLB Local Infrastructure Rate". The initiative is aimed at encouraging new infrastructure and enables eligible local authorities to access PWLB borrowing at 0.04% below standard PWLB rates. A preliminary borrowing limit of £2.678m has been allocated to Falkirk Council, subject to review and approval of the Council's application. The closing date for applications was 30 September 2018 and Scottish Government will advise on eligibility. Members will be advised in due course.
- 4.2.9 Given the latest outlook for the future direction of interest rates, as outlined in paragraph 4.1.4, it's possible that funding of the longer term borrowing requirement will continue to be linked to short term rates. However this will be discussed in detail with the Council's Treasury Advisers.

4.3 Investment Strategy

- 4.3.1 Members are reminded that the primary objectives of the Council's investment strategy remain first and foremost to ensure timeous and full repayment of principal and interest, then securing adequate liquidity of funds invested and finally optimising investment returns consistent with counterparty risks.
- 4.3.2 The Council's credit and counterparty policies together with the specific counterparties that the Council engages with in terms of investments, are detailed in Appendix 1.
- 4.3.3 The Council held £46.3 of investments at the end of September 2018. Details are as follows:

Institution	Investment (£'m)	Maturity
UK Banks	9.94	Instant Access
UK Banks	8.00	November 2018
Money Market Funds	6.17	Instant Access
Local Authority	22.20	October 2018
Total Investments	46.31	

- 4.3.4 As detailed in paragraph 4.2.4, £29.5m of loans mature during 2018/19 (£1m long term and £28.5m short term), £20m of which are due to mature between October 2018 and February 2019. The significant level of investments shown in the table above will dissipate as these loans mature and the cash flow requirements of the Council change over the course of the coming months e.g. salary payments, creditors payment etc.

4.4 Treasury Management Prudential Indicators

- 4.4.1 Financing of the Capital Programme is a key driver of Treasury Management activities which in turn is managed by a series of Treasury Management prudential indicators.

- 4.4.2 The purpose of these indicators is to contain the activity of the treasury function within specified limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. The budgeted Treasury indicators and the position at 30 September, are noted below:

	Position	2018/19	2018/19
1) MATURITY STRUCTURE	30/09/18	LOWER	UPPER
	%	%	%
Fixed Interest Rate Borrowing 2018/19:			
Under 12 months	8	0	25
12 months – 2 years	1	0	25
2 years – 5 years	7	0	25
5 years – 10 years	27	0	35
10 years – 20 years	14	0	35
20 years – 30 years	18	0	35
30 years – 40 years	19	0	35
40 years – 50 years	6	0	35
Variable Interest Rate Borrowing 2018/19:			
Under 12 months	0	0	5
12 months – 2 years	0	0	5
2 years – 5 years	0	0	5
5 years – 10 years	0	0	5
10 years – 20 years	0	0	5
20 years – 30 years	0	0	5
30 years – 40 years	0	0	5
40 years – 50 years	0	0	5
2) MAXIMUM PRINCIPAL SUMS INVESTED > 365 DAYS			
The Council does not place investment for periods longer than 365 days.			

4.5 Banking Contract

- 4.5.1 The Council's banking contract with the Royal Bank of Scotland is now fully operational with the majority of the Clydesdale Bank accounts now closed. Some accounts remain open to capture residual transactions, but the volume has decreased significantly since the contract start date of 1 April 2018.

4.6 Treasury Management Advisers

- 4.6.1 The Council's current 2 year contract with Link Asset Services expires on 31 March 2019. The renewal of the contract will be considered by officers in January 2019. The contract is subject to regular review and comprises:

- Technical support on treasury and capital finance issues

- Economic and interest rate analysis
- Advice on debt rescheduling
- Borrowing and investment advice on interest rates, timing and financial instruments
- Credit ratings/market information service accessing the three main credit rating agencies

4.6.2 It is important to recognise under the terms of the contract, that regardless of the input from Link, the final decision on treasury matters always rests with the Council.

4.7 Member Training

4.7.1 The Investment Regulations provide for increased scrutiny by Members of treasury management issues. Training sessions have been arranged in the past and going forward, further training sessions will be scheduled to ensure that Members are fully aware of their scrutiny role for treasury management activities.

4.8 Benchmarking

4.8.1 It was recognised by Members that benchmarking information will vary across Authorities because of the size of capital programmes, grant levels, capital receipts etc. and that there may be limitations to the comparisons that can be made. However, Members did suggest that future Treasury Strategy reports include benchmarking information. Appendix 2 therefore provides details of investment balances held by Scottish Local Authorities as at 31 August 2018 (September 2018 not available - figures provided from external source). The data includes information for 31 out of 32 Scottish Authorities and Falkirk Council is positioned 18 out of 32, so relatively average in terms of investment levels and consistent with our position in 2017/18.

5. Consultation

5.1 There is no requirement to carry out a consultation based on the report recommendations.

6. Implications

Financial

6.1 Assumptions made on both borrowing and investment are an integral part of the Revenue Budget setting process. As such the Revenue Budget and Capital Programmes for both General Fund and Housing reflect the financial consequences of the proposed Borrowing and Investment Strategies within this report.

Resources

- 6.2 There are no resources implications arising from the report recommendations.

Legal

- 6.3 There are no legal implications arising from the report recommendations.

Risk

- 6.4 Although interest rate assumptions are considered after discussion with Link, the Council's treasury advisors, there is always the risk that they could change, which would impact on the level of interest payable by the Council. The Council's prudent approach to lending as noted at paragraph 4.3.1 protects the Council's risk.

Equalities

- 6.5 An equality and poverty impact assessment was not required.

Sustainability/Environmental Impact

- 6.6 A sustainable assessment was not required.

7. Conclusion

- 7.1 The short term interest rates continue to remain low relative to the long term PWLB rates. Given the borrowing requirement the Council must remain vigilant to the factors affecting the movement in rates e.g. inflation, UK growth and fallout from Brexit, and work closely with the treasury advisers to ensure that any borrowing is undertaken at the most advantageous rate possible.

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Appendices

Appendix 1 – Credit and Counterparty Policies.

Appendix 2 – Investment Levels at 30 September 2018.

List of Background Papers:

The following papers were relied on in the preparation of this report in terms of the Local Government (Scotland) Act 1973:

Treasury Management Strategy 2018/19 submitted to Council on 9 May 2018

APPENDIX 1

CREDIT AND COUNTERPARTY POLICIES

Criteria to be used for creating/managing approved counterparty lists/limits.

- Chief Finance Officer in conjunction with the treasury management advisers, will formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list comprising period, type, sector and specific counterparty limits.
- To qualify for use, a counterparty must meet the minimum rating criteria with at least one of the three credit rating agencies.
- The Council will also have regard to additional operational market information such as negative rating watches/outflows before selecting the relevant counterparties.
- The Council's approved counterparty list will extend to selected counterparties from the following sectors:

UK Banks

Overseas Banks (but with UK authorisation) Minimum Sovereign rating of AA

Building Societies

UK Local Authorities

UK Government

- The minimum level of credit rating for an approved counterparty per Fitch or equivalent ratings will be as undernoted, with particular reference to the short term rating but having regard to the long term rating.

SHORT TERM	F1	Indicates the strongest capacity for timely payment of financial commitments within a 12 month timeframe
LONG TERM	A-	High Credit Quality. A low expectation of credit risk with a strong capacity for timely payment of financial commitments

- The Council's own banker (Royal Bank of Scotland) will continue to be used for investment purposes even if the bank falls below the above criteria, because it is part nationalised. Balances will also be held on a Call basis too.
- Investments in Nat West, which is also part nationalised with the Royal Bank of Scotland, can be included if they continue to be part nationalised or if they meet the ratings above.

- The maximum period for investments will be 1 year unless an alternative period is recorded against a specific counterparty.
- The maximum value for any one investment transaction will be £8 million unless a lesser amount is recorded against a specific counterparty.

Full individual listings of counterparties and their limits are shown below.

APPROVED COUNTERPARTIES AND COUNTERPARTY LIMITS

Investments in the form of Temporary Deposits may be placed with the institutions noted below subject to the limit per institution indicated.

<u>UK BANKS</u>		
<u>INSTITUTIONS</u>	<u>LIMIT</u>	<u>MAX PERIOD</u>
Royal Bank of Scotland *		
Royal Bank of Scotland	£8m	1 year
Nat West	£8m	1 year
* A maximum combined monetary limit of	£8m	
Santander UK	£8m	1 year
Barclays Bank	£8m	1 year
HSBC	£8m	1 year
Standard Chartered	£8m	1 year
Sumitomo Mitsui Banking Corporation	£8m	1 year
Europe		
Lloyds Banking Group *		
Lloyds TSB	£8m	1 year
Bank of Scotland	£8m	1 year
* A maximum combined monetary limit of	£8m	
Goldman Sachs International Bank	£8m	1 year
<u>BUILDING SOCIETIES</u>		
Nationwide	£5m	1 year
Leeds	£5m	1 year
Coventry	£5m	1 year
Yorkshire	£5m	1 year
Skipton	£5m	1 year
<u>UK LOCAL AUTHORITIES</u>	£8m per LA	1 year
<u>UK GOVERNMENT</u>	Unlimited	6 months
<u>MONEY MARKET FUNDS</u>	£8m per fund	Call

By Council	Total Sum Investment
Misc 1	£388,342,428.19
Misc 3	£145,350,000.00
Misc 27	£138,874,104.44
Misc 28	£82,424,419.21
Misc 5	£80,570,000.00
Misc 2	£79,714,311.99
Misc 11	£78,998,000.00
Misc 8	£66,596,500.00
Misc 12	£64,798,522.69
Misc 7	£64,545,000.00
Misc 14	£62,541,183.00
Misc 10	£59,683,661.00
Misc 18	£51,304,990.77 FC
Misc 9	£43,852,036.93
Misc 4	£43,368,000.00
Misc 16	£41,685,221.59
Misc 17	£41,069,837.00
Misc 6	£37,173,146.51
Misc 15	£32,806,700.58
Misc 22	£30,950,000.00
Misc 13	£28,839,519.31
Misc 21	£28,508,355.87
Misc 30	£26,204,569.76
Misc 23	£15,313,348.69
Misc 20	£15,200,000.00
Misc 31	£14,500,000.00
Misc 25	£10,410,000.00
Misc 19	£6,885,610.07
Misc 32	£4,000,000.00
Misc 24	£2,160,000.00
Misc 29	£711,216.81
Misc 26	£0.00

Falkirk £51,304,990.77

