AGENDA ITEM 7 (ii)

FALKIRK COUNCIL

Subject: **TREASURY MANAGEMENT ANNUAL REVIEW 2010/11**
Meeting: **POLICY & RESOURCES COMMITTEE**
Date: **31 May 2011**
Author: **CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 Consistent with regulations issued under the Local Government in Scotland Act 2003 and the CIPFA Code of Practice on Treasury Management, an annual review of the Treasury Management Strategy must be prepared and submitted to the Policy and Resources Committee for scrutiny and thereafter considered and approved by full Council.

2. ECONOMIC AND INTEREST RATE REVIEW

2.1 The Treasury Management Strategy 2010/11, approved by Council in April 2010, noted that accommodative monetary policies adopted by central banks had provided the foundation for recovery in the global economy. As the year progressed, economic growth in the UK faltered, hampered by domestic factors such as the government fiscal austerity measures and severe weather and globally, a surge in commodity prices and sovereign debt issues particularly in the peripheral Euro-zone countries.

2.2 There was an expectation in the Strategy Report that the Bank of England would maintain its loose monetary policy and indeed Bank Rate was held at 0.5% throughout the year. Despite rising inflationary concerns, there still seems little prospect of a rise in short term rates until such time as economic growth is on a more sound footing.

2.3 The Strategy Report recognised that long-term interest rates were expected to rise towards 5% as the year progressed. Further pressure on this rising trend followed an announcement by the Chancellor, as part of his October Spending Review, that the Public Works Loan Board (PWLB) would raise the interest rate on all new loans made to local authorities by an average of 1%. As the year drew to a close, this resulted in PWLB rates of 2.5% to 3.5% for periods of up to 5 years and in excess of 5% for loan periods beyond 12 years.

3. BORROWING STRATEGY 2010/11 – OUTCOME

3.1 The Council's longer term borrowing requirement for the year is set out below:

	2010/11 Original Estimate £m	2010/11 December Estimate £m	2010/11 Actual £m
Capital Programme (net of receipts)	22.5	24.0	19.6
Service Payments	(16.8)	(16.9)	(17.0)
Longer Term Loans maturing in year	0.5	0.5	0.5
Total Longer Term Borrowing Requirement	6.2	7.6	3.1

The reduction in the anticipated borrowing is due to the slippage in both the General and Housing Capital Programmes, as a result of the severe weather over the winter period. The expenditure and related borrowing will now fall into the current financial year.

3.2 In the Strategy, it was noted that the Council's longer term borrowing requirement for the year would be relatively minor. As such, it was planned to take advantage of the significant rate differential in favour of funding linked to short term rates and/or longer term fixed rate periods of up to 5 years. The report also highlighted the potential for four Market Loans, up to a value of £26m, to be repaid during the year should any of the lenders invoke a rate change clause as per their contracts. Finally, it was recognised that significant cash outflows of £24m were required at the end of the financial year in respect of the Council's NPDO projects to provide four new high schools.

3.3 The interim report to Council on 8 December 2010 advised that the Council's estimated borrowing requirement remained outstanding. Having regard to this position and recognising the large end of year cash flow requirement, a decision was taken to finance most of the shortfall from a mixture of borrowing from the PWLB and the London Money Market, as follows:

Date of Advance	Principal	Interest Rate	Maturity
14 March 2011	£ 3.0m	1.35%	March 2012
16 March 2011	£ 5.0m	1.10%	December 2011
18 March 2011	£ 2.5m	0.75%	September 2011
31 March 2011	£10.0m	2.75%	March 2014
	£20.5m		

The Market Loans referred to in para 3.2 remain on existing terms as lenders elected not to invoke contract break clauses.

3.4 There was no debt rescheduling activity during the year given the structure of long-term interest rates persisted throughout the year.

4. INVESTMENT STRATEGY

4.1 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 those counterparty risks.

4.2 Consistent with the requirement of the investment regulations and as part of its Strategy Report, Council approved a list of "Permitted Investments" setting out the types of investments to be used and monetary/time limits applied to each type of investment. It is confirmed that the Council did not breach any of the approved limits during the financial year.

4.3 There was no change to the counterparty selection criteria nor the list of eligible counterparties as advised in the Strategy Report to Council in April 2010.

4.4 The Council held £10.4m of investments, available on instant access in two UK Banks at 31 March 2011. An element of the total investments relates to pension fund monies which under new pensions legislation, will be redirected to a new Pension Fund bank account with effect from 1 April 2011. This will have the effect of reducing the amount of future Council funds for investment.

5. TREASURY INDICATORS

5.1 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 indictors. The purpose of the 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.

5.2 The three treasury indicators are set out at Appendix 1 and show comparison with the Council's actual exposure as at 31 March 2011. This confirms that the Council's treasury operations were operating well within the set parameters during financial year 2010/11.

6. MEMBER TRAINING

6.1 It was previously advised that the new Investment Regulations provide for increased scrutiny by members of treasury management issues. Consistent with this requirement, training for Council Members has been arranged for Monday 13 June 2011.

7. CONCLUSION

7.1 Treasury objectives consistent with the Strategy have been met in terms of both borrowing and investment. The legacy of the financial crisis means that market conditions remain challenging.

8. RECOMMENDATIONS

8.1 Committee notes the contents of the Annual Review 2010/11.
8.2 Refers the report to Council for consideration, consistent with regulations.

Acting Chief Finance Officer

Date: 18 May 2011

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LIST OF BACKGROUND PAPERS

NIL

APPENDIX 1

TREASURY MANAGEMENT PRUDENTIAL INDICATORS

1. INTEREST RATE EXPOSURE

These limits set the maximum for fixed and variable interest rates based on the debt position net of investments and seeks to control the level of debt exposed to short term movements in interest rates.

	2010/11	
	UPPER LIMIT	**POSITION (31/03/11)**
Fixed Interest Rates	100%	94%
Variable Interest Rates	40%	6%

2. MATURITY STRUCTURE ON FIXED INTERST RATE BORROWING 2010/11

These gross limits are set to control the Council's level of exposure to loans expiring in any one period.

	Lower %	**Upper** %	**Position (31/03/11)** %
Under 12 months	0	25	0
12 months – 2 years	0	25	7.4
2 years – 5 years	0	50	13.8
5 years – 10 years	0	75	2.3
10 years – 20 years	0	75	14.4
20 years – 30 years	0	75	11.6
30 years – 40 years	0	75	20.1
40 years – 50 years	0	75	30.4
			100.0

3. PRINCPAL SUM INVESTED > 364 DAYS

The Council does not place investments for periods longer than 364 days.