

FALKIRK COUNCIL

Subject: TREASURY MANAGEMENT – INTERIM REVIEW 2011/12
Meeting: FALKIRK COUNCIL
Date: 23 January 2012
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

- 1.1 As part of the new regulatory framework for Treasury Management, reporting requirements make provision for a mid-year review of the Treasury Management function to be considered by full Council.

2. ECONOMIC AND INTEREST RATE OUTLOOK

- 2.1 At the time the Treasury Management Strategy for 2011/12 was approved by Council in April, it was noted that western economies continued their recovery from recession throughout 2010 but that there were indications that growth was slowing in the early part of 2011. More recent economic data confirms that growth prospects in the US, UK and Euro Zone are lower than expected. In addition, political difficulties in the US over their plans to address the budget deficit has led to a cut in their AAA credit rating and made for an uncertain outlook in the world economy.
- 2.2 In the Strategy Report, there was an expectation that the Bank Rate would remain at 0.5%, at least until the end of the financial year, however recent economic data is suggesting that the rates will remain low for a prolonged period of time possibly as far out as mid 2013. In addition long term rates have fallen considerably from those rates included in the Strategy Report, albeit these rates continue to be unpredictable.
- 2.3 The latest medium-term interest rate forecast as supplied by Sector, the Council's treasury advisers, is as follows:

Annual Average %	Bank Rate	MONEY RATES		PWLB RATES			
		3 months	1 Yr	5 Yr	10 Yr	25 Yr	50 Yr
2011/12	0.50	0.70	1.50	2.30	3.30	4.20	4.30
2012/13	0.50	0.71	1.58	2.38	3.40	4.30	4.40
2013/14	1.00	1.08	2.08	2.75	3.78	4.65	4.75
2014/15	2.25	2.60	3.30	3.40	4.50	5.05	5.15

3. BORROWING STRATEGY

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

	2011/12 Original Estimate	2011/12 Revised Estimate
	£m	£m
Capital Programme (net of receipts)	26.7	26.4
Service Payments	(16.9)	(17.4)
Longer Term Loans maturing in year	<u>0.5</u>	<u>0.5</u>
Total Longer Term Borrowing Requirement	<u>10.3</u>	<u>9.5</u>

3.2 In the Strategy Report, it was noted that the Council's longer term borrowing requirement for the year would be relatively minor. With this in mind, it was planned to concentrate funding linked to short term rates and/or longer term fixed rates for periods of up to 5 years thereby taking advantage of the significant interest rate differential available from these periods. 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.

3.3 Given the latest outlook for the future direction of interest rates, as outlined in Section 2, it remains the case that funding of the longer term borrowing requirement will continue to be linked to short term rates and/or fixed rate periods of up to 5 years. The potential for repayment of any of the Market Loans identified in para 3.2 still remains low given the current structure of long-term interest rates.

3.4 There has been no longer term borrowing in the year to date. Also, debt rescheduling activities remain on hold given the current structure of long-term interest rates. This position is likely to persist until such time as the premature repayment rates for PWLB loans rise from their current levels.

3.5 The primary periods of the Council's window lease contract start to conclude in financial year 2011/12 and negotiations are currently underway with the lessor to conclude best value terms.

3.6 The Strategy Report also highlighted significant cashflow implications on 31 March and 1 April when aggregate payments of £24m were made under the terms of the Council's NPDO projects to provide four new high schools. This was funded from a mixture of short term maturities and internal balances, details of which were incorporated in the Treasury Management Annual Review 2010/11.

4. INVESTMENT STRATEGY

4.1 Members are reminded that the primary objectives of the Council's investment strategy remains 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.

4.2 The Council held £0.158m of investments, available on instant access, in two UK Banks at 31 December 2011.

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

5. TREASURY MANAGEMENT PRUDENTIAL 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 indicators.

5.2 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.

(1) <u>Interest Rate Exposure</u> 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.			
	<u>Position</u> <u>(01/01/12)</u>	<u>2011/12</u> <u>Limit</u>	
Limits on fixed interest rates based on net debt	90%	100%	
Limits on variable interest rates based on net debt	10%	40%	
(2) <u>Maturity Structure on Fixed Interest Rate Borrowing</u> These gross limits are set to control the Council's level of exposure to loans expiring in any one period.			
	<u>Position</u> <u>(01/10/11)</u>	<u>Lower</u>	<u>Upper</u>
	%	%	%
Under 12 months	2	0	25
12 months – 2 years	14	0	25
2 years – 5 years	7	0	50
5 years – 10 years	5	0	75
10 years – 20 years	12	0	75
20 years – 30 years	12	0	75
30 years – 40 years	20	0	75
40 years – 50 years	30	0	75
(3) <u>Maximum Principal Sum Invested > 364 Days</u> As indicated in the Strategy Report, the Council does not place investments for periods longer than 364 days.			

6. TREASURY MANAGEMENT ADVISERS

- 6.1 The Strategy Report confirmed the appointment and services provided by Sector Treasury Services as the Council's adviser on Treasury Management. An annual contract has been agreed up to 30 September 2012.
- 6.2 It is important to recognise under the terms of the Treasury Management Code, that regardless of the input from Sector, the final decision on treasury matters rests with the Council.

7. MEMBER TRAINING

- 7.1 The Investment Regulations provide for increased scrutiny by Members of treasury management issues. To this end, a training session took place in June to which all Members were invited. This training session was tailored towards the needs and responsibilities of Members.

8. CONCLUSION

- 8.1 While a further £75bn package of quantitative easing was announced in October there is the potential for increasing the programme even further in the months ahead. Inflation in the UK will also be a key driver which determines the future direction of long-term interest rates. As such, the timing of any interest rate rises and monitoring the significant gap which currently exists between short and longer term rates, remain the key focus for the Treasury Section at this time.

9. RECOMMENDATION

- 9.1 **Council notes the progress of the Council's Treasury Management Strategy for 2011/12.**

Chief Finance Officer

Date: 12 January 2012

Contact Officer: Carole McGhee

LIST OF BACKGROUND PAPERS

- 1. Treasury Management Strategy 2011/12 submitted to Council on 18 April 2011.

Any person wishing to inspect the background papers listed above should telephone Falkirk 01324 506340 and ask for Carole McGhee.