AGENDA ITEM 5

FALKIRK COUNCIL

Subject: **TREASURY MANAGEMENT STRATEGY 2012/13**
Meeting: **FALKIRK COUNCIL**
Date: **14 March 2012**
Author: **CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 The Code of Practice for Treasury Management requires that an Annual Strategy Report be prepared and submitted to Council for approval. This strategy outlines the framework for the expected treasury activities in the following financial year (2012/13).

2. ECONOMIC AND INTEREST RATE OUTLOOK

2.1 The outlook for the global economy remains uncertain with the UK economy struggling to generate sustained recovery that offers solid optimism for 2012 or possibly even into 2013. Much of the uncertainty centres around the ongoing Eurozone sovereign debt crisis which has intensified, rather than dissipated throughout 2011. The main problem has been Greece, which despite a Eurozone bailout package, could still exit the Eurozone in 2012. There is also growing concern about Portugal and Italy whilst elections due in Germany and France in 2012 and 2013 also add to the uncertainty of the Eurozone. Although there has been an improvement in the weak rate of growth in the US, high levels of unemployment, a declining housing market and high levels of consumer indebtedness will adversely impact on the ability to generate a consistent rate of growth.

2.2 In the UK, the economy remains weak and performance has been downgraded in 2011. Given the extensive Quantitative Easing programme (£325bn), the Bank Base Rate remains at 0.05% and is not expected to rise until quarter 3 of 2013. Inflation currently stands at 4.8% which is well above the 2% Bank of England target, albeit the Monetary Policy Committee expects that it will reduce to the target level within 2 years.

2.3 The latest medium-term interest rate forecast as supplied by Sector, the Council's treasury advisers, is as follows:-

		MONEY RATES		PWLB RATES			
Annual Average %	**Bank Rate**	**3 Months**	**1Yr**	**5Yr**	**10Yr**	**25Yr**	**50Yr**
2011/12	0.5	0.7	1.5	2.7	3.8	4.7	4.7
2012/13	0.5	0.7	1.6	2.4	3.4	4.3	4.4
2013/14	1.0	1.1	2.1	2.8	3.8	4.6	4.8
2014/15	2.0	2.2	3.0	3.4	4.5	5.0	5.2

3. DEBT OUTSTANDING AT 01/04/12

The Council's estimated debt position at 01/04/12 is:

	£'m	
LONGER TERM FUNDING		
- Maturing loans in 2012/13	20.6	(12.8%)
- Loans with Maturity > 1 year	127.6	(79.5%)
	148.2	
SHORT TERM FUNDING	12.3	(7.7%)
TOTAL ESTIMATED DEBT	160.5	

4. LONGER TERM BORROWING REQUIREMENT 2012/13

4.1 The expected longer term borrowing requirement for 2012/13 is £43m, as set out below:

	£'m
Capital Programme (net of capital receipts)	40.5
Service Payments	(18.1)
Longer term loans maturing in 2012/13	20.6
TOTAL LONGER TERM BORROWING REQUIREMENT	43.0

4.2 In addition to the borrowing requirement identified at para 4.1, there is potential for Market Loans up to the value of £26m to be repaid during the year should any of the lenders invoke a rate change clause as per their individual contracts. Given the current level of interest rates, the risk of early repayment of any of the loans is assessed as low.

4.3 The Council's main source for longer term funding remains the Public Works Loan Board (PWLB) from which it can access all of its borrowing requirement or alternatively funding can be accessed through the London Money Market.

5. BORROWING STRATEGY

5.1 There remains uncertainty over the timing of future interest rate increases but it is anticipated that the trends in both short term and longer term interest rates, as outlined in para 2.3, are considered to be the most probable outcome.

5.2 The longer term borrowing requirement (c£43m) is higher than in previous years because of PWLB borrowing of £20m which matures in 2012/13. The next few years indicate a significant interest rate differential in favour of short term rates, it is planned however to consider the complete range of borrowing periods as and when we need to borrow.

5.3 In the event that any of the £26m of Market Loans, as outlined at para 4.2, are repaid during the year, a judgement will have to be made at that time on the benefit of replacing the loan(s) on either a variable rate or fixed rate basis.

5.4 With the likelihood of long term rates increasing, potential debt restructuring opportunities are likely to focus on switching from longer term fixed rate PWLB loans to cheaper shorter term debt. The Treasury Section, in conjunction with Sector, will closely monitor prevailing rates to identify any opportunities during the year.

6. INVESTMENT STRATEGY

6.1 The new regulatory framework provides greater autonomy for local authorities but makes clear that the onus is on local authorities to act prudently with regard to their investment and treasury management activities. Local authorities are required to manage their investments in a way that minimises the risk to the capital sum and optimises the return on the funds consistent with those risks.

6.2 The primary objectives of the Council's investment strategy is 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.

6.3 In order to assess counterparty risk prior to investing, the Council will make use of credit rating information for specific institutions as published by the three credit rating agencies, Fitch, Moody's and Standard and Poors. Recent announcements have seen the downgrading of a number of institutions and indeed a number of Eurozone countries have also been downgraded. Consequently, any investments will be short term for the time being, taking account of the current rating for the specific institution where the investment is to be placed. The counterparty criteria for 2012/13 has been reviewed to ensure it is robust enough to enable the Council to manage its investments effectively.

6.4 It is estimated that the Council will have on average £10m of surplus funds available for investment from time to time during 2012/13. The source of surplus funds is expected to arise largely from availability of internal balances held by Council accounts.

6.5 The Local Government Investments (Scotland) Regulations 2010 requires <u>Council</u> approval of <u>all</u> the types of investments, known as "Permitted Investments", to be used and set limits, where appropriate, for the amount and time that can be held in each type of investment.

6.6 The Permitted Investments which may be used in the forthcoming year are:

- CASH TYPE INSTRUMENTS
    - Deposits with other local authorities
    - Deposits with UK Government including Deposits with the Debt Management Account Facility (DMADF), treasury bills and gilts
    - Instant Access or On-Notice deposit accounts with financial institutions (banks and building societies)
    - Term deposits with financial institutions (banks and building societies)
    - Money Market Funds

- OTHER INVESTMENTS
    - Investment Properties (none currently held by the Council)
    - Shareholdings in a local authority company (refer Appendix 1)
    - Loans to third parties, including soft loans (refer Appendix 3)
    - Loans to a local authority company (none currently held by the Council)
    - Non-local authority shareholdings (none currently held by the Council)

6.7 The Investment Regulations also require the investment position of the Common Good fund(s) to be made explicit. Surplus funds are invested in the Council's loans fund on which interest is earned. There is also a property asset (Kilns House) which attracts a rental yield.

6.8 Details, as appropriate, of the risks, mitigating controls and limits associated with each of the Permitted Investments are attached at Appendix 1.

6.9 For permitted cash type investments, the Council maintains a counterparty list in compliance with the relevant counterparty selection criteria. Appropriate extracts from the Council's Treasury Management Practices (TMPs) are attached for Members' information at Appendix 2.

6.10 The Regulations make clear that the Council must not borrow more, or in advance of its capital financing requirement as determined under the Prudential Code purely to profit from the investment of the extra sums borrowed. It is confirmed that the Council has no plans to borrow in advance of need in the forthcoming financial year.

7. TREASURY INDICATORS

7.1 The Code requires that a number of treasury indicators are incorporated within this Strategy Report. The purpose of the indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates.

7.2 The Council is asked to approve the undernoted Treasury indicators:

	2012/13 Upper	**2013/14 Upper**	**2014/15 Upper**
1) INTEREST RATE EXPOSURE			
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%
2) MATURITY STRUCTURE ON FIXED INTEREST RATE BORROWING 2012/13			
	LOWER	**UPPER**	
	%	%	
Under 12 months	0	25	
12 months – 2 years	0	25	
2 years – 5 years	0	50	
5 years – 10 years	0	75	
10 years – 20 years	0	75	
20 years – 30 years	0	75	
30 years – 40 years	0	75	
40 years – 50 years	0	75	
3) MAXIMUM PRINCIPAL SUMS INVESTED > 364 DAYS			
The Council does not envisage having sums available for investment for periods longer than 364 days.			

8. FALKIRK COUNCIL COMMUNITY TRUST

8.1 Falkirk Community Trust was set up on 1st July 2011 to deliver culture, library, recreation and sports services on behalf of the Council. The Council provides a full treasury management service to the Trust, the framework for which is contained within the Council's Annual Strategy Report.

9. TREASURY MANAGEMENT ADVISERS

9.1 The Council has appointed Sector as its treasury management advisers. 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

9.2 It is important to recognise under the terms of the revised Code, that regardless of the input from Sector, the final decision on treasury matters always rests with the Council.

10. MEMBER AND OFFICER TRAINING

10.1 There is a requirement under the Treasury Management Practices (TMPs), that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. This is achieved by in-house training supplemented by staff attending training courses/seminars organised by the Council's Treasury Advisers or other institutions in the field of Treasury Management or CIPFA (Scotland) Treasury Management Forum.

10.2 Consistent with the requirements of the Investment Regulations, the increased Member consideration of treasury management issues and the local election in May 2012, the Chief Finance Officer has to ensure that those tasked with such responsibilities have access to training relevant to their needs and responsibilities. Arrangements will be put in place to provide this training during the course of 2012/13.

11. CONCLUSION

11.1 It is largely accepted that interest rates will rise but there is still uncertainty over the timing and extent of such rises. The prospects for both short term and longer term interest rates will clearly be influenced by the ongoing Quantitative Easing programme, future inflationary expectations and the pace of the economic recovery. A mid-year review of the treasury management function will be submitted to the Policy & Resources Committee and then Council in November as required by the Regulations.

12. RECOMMENDATIONS

12.1 That Council:

- **i) adopts the Borrowing Strategy for 2012/13 as set out in Section 5 of this report**
- **ii) adopts the Investment Strategy for 2012/13 and approves the list of "Permitted Investments" as set out in Section 6 of this report**
- **iii) approves the Treasury Indicators as set out in Section 7 of this report**
- **iv) instructs the Chief Finance Officer to arrange training for Members as outlined in Section 10 of the report,**

Chief Finance Officer

Date: 29 February 2012

Contact Officer: Carole McGhee

<u>LIST OF BACKGROUND PAPERS</u>

NIL

APPENDIX 1

FALKIRK COUNCIL PERMITTED INVESTMENTS, ASSOCIATED CONTROLS AND LIMITS

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
(a) Deposits with other local authorities or public bodies **(very low risk)**	These are considered quasi UK Government debt and as such counterparty risk is very low and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty and penalties can apply. Deposits with other non local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non local authority deposits will follow the approved crediting rating criteria.	£5m per LA and maximum 1 year
(b) Deposits with the Debt Management Account Facility (UK Government) **(very low risk)**	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment, the monetary limit is unlimited to allow for a safe haven for investments.	£unlimited, maximum 6 months
(c) Money Market Funds (MMFs) **(very low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs are Constant Net Asset Value (CNAV) and the fund as a "AAA" rated status from all of Fitch, Moody's or Standard & Poors.	£5m per fund and on Call
(d) Instant Access or On-Notice deposit accounts with financial institutions (banks and building societies) **(low risk depending on credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. There is little risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard & Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing, use of the selection criteria will be further strengthened by additional market intelligence.	£8m and on Call subject to individual institution criteria

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
(e) Term deposits with financial institutions (banks and building societies) **(low to medium risk depending on period and credit rating)**	This tends to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is little risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty and penalties may apply.	The counterparty selection criteria restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard & Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. On day to day investment dealing, use of the selection criteria will be further strengthened by additional market intelligence.	£8m and maximum 3 month subject to individual institution criteria
(f) Investment Properties (The Council does not currently hold, nor does it plan to hold any investment properties)	These are non-service properties which are being held pending disposal or for a longer term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids)	In larger investment portfolios, some small allocation of property based investment may counterbalance/compliment the wider cash portfolio. Property holding will be re-valued regularly and reported annually with gross and net rental streams.	N/A
(g) Loans to third parties, including soft loans	These are service transactions either at market rates of interest or below market rates (soft loans). These types of transactions may exhibit credit risk and are likely to be highly illiquid.	Each third party loan and each application is supported by the service rationale behind the loan and the likelihood of partial or full default.	Consistent with the particular scheme
(h) Loans to a local authority company (the Council currently has no such loans)	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each loan to a local authority company and each application is supported by the service rationale behind the loan and the likelihood of partial or full default.	N/A

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
(i) Shareholdings in a local authority company. (The Council has an investment of £13.190m as at 31/03/11 in Falkirk Community Stadium Ltd represented by a range of assets at Westfield, Falkirk)	These are service investments which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company requires Member approval and each application will be supported by the service rationale behind the investment and the likelihood of loss	£15m
(j) Non-local authority shareholdings (The Council currently has no such shareholdings)	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be illiquid.	Any non-service equity investment will require separate Member approval and each application will be supported by the service rationale behind the investment and the likelihood of loss.	N/A

The Monitoring of Investment Counterparties – The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Sector, from which counterparties are checked promptly. On occasion, ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Finance Officer and, if required, new counterparties which meet the criteria will be added to the list.

APPENDIX 2

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 a 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.

- The rating criteria will use the lowest common denominator method (across Fitch, Moody's and Standard & Poors) of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution.

- 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 ratings will be as undernoted, with particular reference to the short term rating but having regard to other ratings.

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
VIABILITY (Fitch)/ Financial Strength (Moody's)	bb-/C-	An assessment of a bank's ability to meet its obligations in the absence of support and its capacity to maintain ongoing operations whilst avoiding failure.
SUPPORT	1/2/3	An assessment of whether a bank would receive outside support if it ran into financial difficulties that it could not cope by itself

- Part nationalised UK banks – Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings above.

- The maximum period for investments will be 3 months 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.

- The Council's own banker (Clydesdale) will continue to be used for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised where possible and maintained in an instantly accessible call account.

Full individual listings of counterparties and their limits are shown at Schedule 1 below.

SCHEDULE 1

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.

UK BANKS

INSTITUTIONS	**LIMIT**	**MAX PERIOD**
Santander UK	£8m	Call
Barclays Bank	£8m	3 Month
Clydesdale Bank	£8m	Call
HSBC	£8m	3 Month
Lloyds Banking Group *		
Lloyds TSB	£8m	3Month
Bank of Scotland	£8m	3 Month
* A maximum combined monetary limit of £8m		
Royal Bank of Scotland	£8m	3 Month
BUILDING SOCIETIES		
Nationwide	£5m	3 Months
UK LOCAL AUTHORITIES	£5m per LA	1 Year
UK GOVERNMENT	Unlimited	6 months
MONEY MARKET FUNDS	£5m per fund	Call

APPENDIX 3

THIRD PARTY LOANS

The Investment Regulations require all loans to third parties to be classified as investments.

The (questionable) rationale behind this is to identify monies utilised in this way, which would otherwise be available for general investment and give rise to investment income.

To comply with the Regulations, the following is presented:-

Category and Context		Outstanding	
		No of loans	Value £
(a)	**Car Loans to Employees** Loans advanced to assist employees finance a vehicle needed for their work. Current interest rate is 4.45% per NJC Circular	69	160,806
(b)	**Home Loans** There are a small number of residual loans which were advanced to people purchasing under the right to buy scheme. The interest rate is set by the Scottish Government and is currently 3.13%.	9	41,025
(c)	**Care Home Deferred Payments** When a person enters a care home, legislation requires the Council to offer the facility to pay care home fees to avoid a forced house sale. A standard security allows the monies to be recovered in due course. The Council is not allowed to charge interest.	35	348,488
(d)	**Bike to Work Scheme** During the course of 2010/11, the Council launched a "Bike to Work" Scheme to encourage employees to become greener. The scheme provides tax and national insurance savings to employees who obtain bicycles and safety equipment used mainly for cycling to and from work. The scheme provides a loan which is paid over a one year period.	84	30,118
(e)	**Owner/Occupiers – High Rise Flats** Communal repairs for High Rise blocks of flats e.g. lift refurbishment. Owner/occupiers have deferred their share of costs until such time as flat is sold and thereafter Council will be reimbursed. An Admin Fee for the service is also recharged to owner/occupiers.	17	172,240
(f)	**Private Roads – Support to Residents** During the course of 2012/13, the Council may provide up front funding to residents to enable them to upgrade private roads. Loans to residents will be secured over their properties and the interest rate fixed at a level to reflect the cost of making funding available.	N/A	N/A