AGENDA ITEM 11

FALKIRK COUNCIL

Subject:	**TREASURY MANAGEMENT STRATEGY 2015/16**
Meeting:	**EXECUTIVE**
Date:	**17 March 2015**
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 Executive for consideration prior to being recommended to Council for approval. This strategy outlines the framework for the expected treasury activities for 2015/16.

2. ECONOMIC AND INTEREST RATE OUTLOOK

2.1 Within the Eurozone, growth for the closing quarter of 2014 was better than expected, with an increase of 0.3% on the previous quarter and up 0.9% on the previous year. The main reason for the increase was the growth experienced by Germany which returned an overall growth figure of 1.6% for 2014.

2.2 The sovereign debt crisis in the Eurozone has re-emerged with the current Greek bailout expiring on 28 February 2015. Greece had initially put forward a proposal for a six month extension of its Eurozone loan programme instead of renewing its existing bailout. This proposal was rejected by Germany. At the time of writing, agreement in principal has been reached whereby provided that the Greeks can present a list of reforms ratified by the Greek government, then the bailout will be extended for a further four months. In addition to the Greek crisis, high debt to GDP ratios still continue to be an issue for other countries such as Italy, Portugal, Ireland and Cyprus, meaning that any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis.

2.3 The USA has returned growth figures of 2.4% for 2014 which provides optimism for strong growth going forward. Policymakers are therefore wary of raising interest rates and unnecessarily stifling economic growth. The timing of am increase in rates will continue to be monitored. In terms of China, although the target growth rate of 7.5% for 2014 was almost achieved, recent government statements have emphasised that going forward, growth will slow marginally.

2.4 Strong UK GDP growth in 2013 (2.7%) was followed by another year of improvement in 2014 when growth returned at 2.6% with experts now predicting an estimated growth of 2.9% for 2015. In overall terms the recovery is in response to the sharp fall in oil prices in the last quarter of 2014 and the unexpected return to a significant rise in average wage rates due to the continuing fall in unemployment, currently at 5.7% but expected to decrease further to 5.5% in 2015. Inflation has also dipped to 0.3%, the lowest rate recorded which is due to a reduction in fuel and food costs again as a consequence of the sharp fall in oil prices. It was noted in the Treasury Management Interim Review 2014/15, that it was expected that the Bank Base Rate would remain low at c0.5% until as far out as June 2015, however an increase in the rate is now not expected until March 2016.

2.5 Albeit the economy appears to be recovering, for this recovery to be more balanced and sustainable, it needs to move away from its dependence on consumer expenditure and the housing market to exporting, particularly manufactured goods. In addition there needs to be an improvement in labour productivity to support the continued recovery after the positive effect of the fall in oil prices dissipates. It should be noted that an adverse reaction by financial markets to the result of the UK General Election in May 2015 and any change in EU, economic and debt management policies of the new government could also impact on the economic recovery.

2.6 In the longer term, it is expected that gilt yields and therefore PWLB rates will rise, as shown in the table below, details of which have been provided by Capita Asset Services, the Council's Treasury advisers.

Annual Average %	Bank Rate	MONEY RATES		PWLB RATES			
		3 Months	1Yr	5Yr	10Yr	25Yr	50Yr
2014/15	0.5	0.4	0.9	2.5	3.2	3.9	3.9
2015/16	0.5	0.5	1.0	2.3	2.9	3.5	3.5
2016/17	0.9	1.0	1.5	2.8	3.4	4.1	4.1
2017/18	1.5	1.6	2.2	3.2	3.8	4.5	4.5

3. DEBT OUTSTANDING AT 01/04/15

3.1 The Council's estimated debt position at 01/04/15 is:

	£'m	% of Total Debt
LONGER TERM FUNDING		
- Maturing loans in 2015/16	-	-
- Loans with Maturity > 1 year	203.0	88.8%
	203.0	
SHORT TERM FUNDING	25.6	11.2%
TOTAL ESTIMATED DEBT	228.6	100.0%

4. LONGER TERM BORROWING REQUIREMENT 2015/16

4.1 The expected longer term borrowing requirement for 2015/16 is £49.0m, as set out below:

	£'m
Capital Programme (net of capital receipts)	37.1
Service Payments	(13.7)
Replacement of Short-Term Borrowing	25.6
TOTAL LONGER TERM BORROWING REQUIREMENT	49.0

The estimated borrowing requirement above only takes into account the requirements of the current approved capital programmes. As stated in the Revenue and Capital Budget reports approved by Members on 11 February 2015, there is the potential to use CFCR and capital receipts to help fund voluntary severance and if this were to happen, borrowing levels may need to increase beyond the £49m detailed. This will be monitored carefully to ensure all borrowing remains within prudent, sustainable and affordable levels.

4.2 The borrowing requirement in paragraph 4.1 includes £5.1m borrowing for TIF projects. The total project costs equate to £6.2m with £1.1m being funded by non-domestic rate income and the balance by borrowing. However, given the revenue budget pressures, we may utilise the non-domestic rate income to fund voluntary severance costs and replace this funding resource for TIF with prudential borrowing.

4.3 The replacement of short term borrowing shown in the table above refers to £25.6m of short term debt that matures in 2015/16. These loans may be replaced on a short term or long term basis depending on cash flow requirements and prevailing interest rates.

4.4 It should be noted that 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.

4.5 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. The PWLB has extended the "PWLB Certainty Rate" by a further year. This facility enables local authorities to access discounted PWLB borrowing. Falkirk Council's application for this facility has been approved.

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 paragraph 2.6, are considered to be the most probable outcome.

5.2 The longer term borrowing requirement is c£49m. The next few years indicate a significant interest rate differential in favour of short term rates, however, the complete range of borrowing periods will be reviewed as we need to borrow.

6. INVESTMENT STRATEGY

6.1 The 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. 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.

6.2 The Strategy Report provides details of the counterparties that the Council engages with in terms of its investments. In order to assess counterparty risk prior to investing, the Council makes use of credit rating information for specific institutions as published by the three credit rating agencies, Fitch, Moody's and Standard and Poors. Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The lending criteria for 2015/16 has been reviewed to ensure it is robust enough to enable the Council to manage its investments effectively.

6.3 The 2014/15 interim Strategy report advised Members that there would be a change in the ratings methodology adopted by rating agencies. This change has not yet taken place and Members will be updated in due course.

6.4 It is estimated that the Council will have on average £5m of surplus funds available for investment from time to time during 2015/16. The source of surplus funds is expected to arise largely from availability of internal balances held.

6.5 The Local Government Investments (Scotland) Regulations 2010 requires Council approval of all the types of investments, known as "Permitted Investments", to be used and set limits, where appropriate, for the amount and period 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:

<table>
<tr><td></td><td></td><td>2015/16
Upper</td><td colspan="2">2016/17
Upper</td><td>2017/18
Upper</td></tr>
<tr><td>1)</td><td>INTEREST RATE EXPOSURE</td><td></td><td colspan="2"></td><td></td></tr>
<tr><td></td><td>Limits on fixed interest rates based on net debt
Limits on variable interest rates based on net debt</td><td>100%
40%</td><td colspan="2">100%
40%</td><td>100%
40%</td></tr>
<tr><td>2)</td><td colspan="5">MATURITY STRUCTURE ON FIXED INTEREST RATE BORROWING 2015/16</td></tr>
<tr><td></td><td></td><td colspan="2">LOWER</td><td colspan="2">UPPER</td></tr>
<tr><td></td><td></td><td colspan="2">%</td><td colspan="2">%</td></tr>
<tr><td></td><td>Under 12 months</td><td colspan="2">0</td><td colspan="2">25</td></tr>
<tr><td></td><td>12 months – 2 years</td><td colspan="2">0</td><td colspan="2">25</td></tr>
<tr><td></td><td>2 years – 5 years</td><td colspan="2">0</td><td colspan="2">50</td></tr>
<tr><td></td><td>5 years – 10 years</td><td colspan="2">0</td><td colspan="2">75</td></tr>
<tr><td></td><td>10 years – 20 years</td><td colspan="2">0</td><td colspan="2">75</td></tr>
<tr><td></td><td>20 years – 30 years</td><td colspan="2">0</td><td colspan="2">75</td></tr>
<tr><td></td><td>30 years – 40 years</td><td colspan="2">0</td><td colspan="2">75</td></tr>
<tr><td></td><td>40 years – 50 years</td><td colspan="2">0</td><td colspan="2">75</td></tr>
<tr><td>3)</td><td colspan="5">MAXIMUM PRINCIPAL SUMS INVESTED > 364 DAYS
The Council does not envisage having sums available for investment for periods longer than 364 days.</td></tr>
</table>

8. TREASURY MANAGEMENT ADVISERS

8.1 The Council has appointed Capita Asset Services 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

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

8.3 The current contract expires on 31 March 2015 and Finance are engaging with the Central Purchasing Unit with a view to entering into a new contract with Capita Asset Services.

9. MEMBER AND OFFICER TRAINING

9.1 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.

9.2 Consistent with the requirements of the Investment Regulations and the increased Member consideration of treasury management issues the Chief Finance Officer has to ensure that those tasked with such responsibilities have access to training relevant to their needs and responsibilities. A training session took place on 28 April 2014 and further training will be delivered as required.

10. CONCLUSION

10.1 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 future inflationary expectations and the pace of the economic recovery. A mid-year review of the treasury management function will be submitted to Members in November as required by the Regulations.

11. RECOMMENDATIONS

11.1 Executive agree the report is referred to Council for consideration.

11.2 Executive recommends that Council:

i) adopts the Borrowing Strategy for 2015/16 as set out in this report
ii) adopts the Investment Strategy for 2015/16 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

Chief Finance Officer

Date: 19 February 2015

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 have 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. 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. 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 31/03/14 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 Capita Asset Services, 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 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 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 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

- Part nationalised UK banking Groups – Lloyds Bank/Bank of Scotland and Royal Bank of Scotland/Nat West. 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	100 days
Barclays Bank	£8m	100 days
Clydesdale Bank	£8m	Call
HSBC	£8m	100 days
Lloyds Banking Group *		
Lloyds TSB	£8m	100 days
Bank of Scotland	£8m	100 days
* A maximum combined monetary limit of	£8m	
Royal Bank of Scotland *		
Royal Bank of Scotland	£8m	100 days
Nat West	£8m	100 days
* A maximum combined monetary limit of	£8m	
Goldman Sachs International Bank	£8m	100 days
BUILDING SOCIETIES		
Nationwide	£5m	100 days
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. The scheme closed to new applicants from 1 June 2012 and as such the number of loans and value will continue to decrease until all loans have been repaid.	12	19,117
(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%.	6	8,404
(c)	**Care Home Deferred/Front Funding 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. In the case of Deferred Payments, a standard security allows the monies to be recovered in due course. The Council is not allowed to charge interest.	49	714,616
(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.	103	30,886
(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	131,295

Category and Context	Outstanding	
	No of loans	Value £
(f) **Private Roads – Support to Residents** During the course of 2015/16, 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
(g) **National Housing Trust Initiative** The Council was granted Scottish Government consent to borrow under the National Housing Trust Initiatives. The consent was used to finance a loan to Carrongrove NHT 2011 LLP for the purchase of housing units under this scheme. The loan will be repaid to the Council on the sale of the houses.	1	2,341,563
(h) **thinkWhere** thinkWhere provide the Council with a service for the management, development and interrogation of geographical information. The Council relies on their systems, software and data management capacity to analyse, interrogate and utilise information that underpins some of the Council's core Services. An investment totalling £0.5m has been approved by Council.	1	500,000