Agenda Item 12

Treasury Management – Interim Review 2016/17

Falkirk Council

Title: **Treasury Management – Interim Review 2016/17**

Meeting: **Executive**

Date: **29 November 2016**

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 2016/17.

(2) 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 2016/17 was considered by the Executive on 15 March 2016 and thereafter approved by Council in May 2016. This report provides an update on the progress of Treasury Management activities to 31 October 2016. There will be a final annual review report to the Executive in June 2017, following the financial year end.

4. Considerations

4.1 Economic and Interest Rate Outlook

4.1.1 Council approved the Treasury Management Strategy in May 2016. The Strategy highlighted that growth was forecast to remain at between 2.2% and 2.4% over the next three years. However Brexit delivered an immediate fall in confidence indicators, pointing to an impending sharp slowdown in the economy. Unexpectedly though, GDP for the third quarter of the year grew by 0.5% and although less than in the previous quarter (0.7%), it was above the forecast of 0.3%. This was largely attributable to the country's service sector which counteracted the decline in manufacturing and construction. Inflation rose from 0.6% in August to 1% in September, which is the highest rate for nearly two years. The value of the pound against the euro has fallen following Brexit, with a current level of 1.10 euros compared to pre-Brexit of 1.30 euros.

4.1.2 The U.S. economy grew at its fastest rate for two years, with growth of 2.9% in the third quarter against a predicted growth of 2.5%. This stronger than expected growth has raised expectations that the Federal Reserve will raise interest rates before the end of December. However following the U.S. Presidential Election result, the position is by no means certain. China's economy seems to be stabilising with growth of 6.7% in the third quarter which is consistent with the previous two quarters. Within the Eurozone, growth for the third quarter was 0.3% compared to 0.5% in the second. The European Central Bank (ECB) has held interest rates in October and maintained its quantitative easing scheme which is due to run until March 2017.

4.1.3 In the Strategy Report, there was an expectation than the Bank Base Rate would remain at 0.5% with an increase not expected until March 2017. However Brexit completely turned this on its head and indeed the rate was cut to 0.25% on 4 August to address the expected slowdown in growth. It was also indicated at this time that the Bank Base Rate would be near zero by the end of 2017 with the expectation of a further cut to 0.10% in November. However, the Bank of England has maintained the rate at 0.25% for the time being possibly due to the better than expected third quarter growth figures.

4.1.4 The latest interest rate forecast as supplied by Capita Asset Services, the Council's treasury advisers, is as follows:

Annual Average %	**Bank Rate**	**MONEY RATES**		**PUBLIC WORKS LOAN BOARD RATES (PWLB)**			
		3 Months	**1 Yr**	**5 Yr**	**10 Yr**	**25 Yr**	**50 Yr**
2016/17	0.5	0.4	0.8	1.4	2.0	2.7	2.5
2017/18	0.1	0.2	0.6	1.0	1.5	2.3	2.1
2018/19	0.2	0.3	0.8	1.2	1.7	2.5	2.3

4.2 Borrowing Strategy

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

	2016/17 Original Estimate £m	**2016/17 Revised Estimate £m**
Capital Programmes (net of receipts including TIF)	46.5	24.4
Service Payments	(13.5)	(13.2)
Short Term Loans maturing in year	29.0	29.0
Address Under-borrowing (see paragraph 4.2.4)	-	21.8
Total Longer Term Borrowing Requirement	62.0	62.0

4.2.2 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 we needed to borrow. The table above includes £29.0m of short term debt that matures during the course of 2016/17. 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. We will shortly be engaging with our treasury advisers to determine the best mix of borrowing periods and the best time to borrow based on available interest rates.

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:-

	2016/17 £'m	**2016/17 £'m**
Budgeted Capital Programme (net of receipts & including TIF)		46.5
Add:		
Revenue Budgets Transferred to Capital	0.7	
Less:		
Re-profiled TIF projects	(4.1)	
Re-scheduled/Slipped General Fund Projects	(7.8)	
Additional General Capital Grant	(3.7)	
Slippage in Housing Capital Programme	(3.0)	
Additional Housing Income	(3.2)	
Additional Housing Revenue Contribution	(1.0)	(22.1)
Forecast Capital Programme (net of receipts & including TIF)		**24.4**

4.2.4 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, the budgeted borrowing requirement of up to £62.0m detailed in paragraph 4.2.1, may still be undertaken regardless of the reduction in the borrowing required to fund the 2016/17 capital programmes (see paragraph 4.2.3). To this end the revised borrowing forecast includes c.£22m of borrowing to address our under-borrowed position.

4.2.5 The Strategy Report 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. This has not occurred. Two of the four Market Loans (£13m) are held with Barclays Bank and they have advised in June this year, that they were waiving their right to change the applicable interest rate of the two loans. This effectively means that these loans become fixed interest rate loans at their current rate with no risk that the rates will change. The potential for repayment of the remaining two Market Loans remains low given the current structure of long term interest rates.

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

4.2.7 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.

4.2.8 Debt rescheduling activities remain on hold given the current structure of long-term interest rates which makes such transactions unattractive. This position is likely to persist until such time as the premature repayment rates for PWLB loans rise from their current levels.

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 held £36.5m of investments at the end of October 2016. Details are as follows:

Institution	**Investment (£'m)**	**Maturity**
UK Banks	8.6	Instant Access
Money Market Funds	0.3	Instant Access
Local Authority	18.0	Nov '16 – Jan '17
UK Building Society	9.6	Instant Access
Total Investments	**36.5**	

4.3.3 As detailed in paragraph 4.2.2, £29m of short term loans mature during 2016/17, £15m of which are due to mature in November – January. The significant level of investments shown in the table above will dissipate as these short term 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.

These are:

(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.

	Position (31/10/16)	**2016/17 Limit**
Limits on fixed interest rates based on net debt	99%	100%
Limits on variable interest rates based on net debt	1%	40%

(2) **Maturity Structure on Fixed Interest Rate Borrowing**

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

	Position (31/10/16) %	**Lower %**	**Upper %**
Under 12 months	13.4	0	25
12 months – 2 years	0.0	0	25
2 years – 5 years	1.3	0	50
5 years – 10 years	11.3	0	75
10 years – 20 years	25.3	0	75
20 years – 30 years	18.0	0	75
30 years – 40 years	11.3	0	75
40 years – 50 years	19.4	0	75

(3) **Maximum Principal Sum Invested > 364 Days**

As indicated in the Strategy Report, the Council does not place investments for periods longer than 364 days.

4.5 Loans Fund Review

4.5.1 The Strategy report advised that the Scottish Government had issued a consultation document to all Councils as part of their review of local authority borrowing. Following completion of the consultation period, the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 came into force on 1 April 2016.

4.5.2 These new Regulations specify the circumstances in which an authority may borrow, the purpose of the borrowing and the requirement for Authorities to set authorised limits for external debt. They also state that an Authority must maintain a Loans Fund and that the repayment of Loans Fund advances should be prudent, ensuring that the repayment period and amount are reasonably in line with the period and pattern of the benefits provided by the capital investment, for which the Loans Fund advance was made. A Local Authority will have the option to decide what repayment option to use but should be consistent in its application. There are a number of repayment options including the annuity method (currently in use by the Council) and equal instalments of principal (EIA) method. There is a five year transition period and as such it is only new advances from 1 April 2021 that will be subject to the new Regulations. Historic borrowing will continue to be accounted for on an annuity basis if considered appropriate.

4.6 Member Training

4.6.1 The Investment Regulations provide for increased scrutiny by Members of treasury management issues. Consequently training for Members of the Executive, Audit and Scrutiny Committee was delivered in March 2016. Going forward, further training sessions will be scheduled to ensure that Members are fully aware of their scrutiny role, particularly following the Local Elections in May 2017 and the potential for new Councillors to be elected.

4.7 Benchmarking

4.7.1 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 30 September 2016. 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.

4.7.2 The CIPFA Scottish Director of Finance Performance Indicators for 2015/16 have been released. In terms of benchmarking, Falkirk Council has the 5th lowest loans fund interest rate across all Scottish Local Authorities.

5. Consultation

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

6. Implications

Financial

6.1 There are no financial implications arising from the report recommendations.

Resources

6.2 There are no resource 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 Capita, 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.

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 our borrowing requirement we must remain vigilant to the factors affecting the movement in rates e.g. fallout from Brexit, UK growth, Eurozone and US issues, and work closely with our treasury advisers to ensure that any borrowing is undertaken at the most advantageous rate possible.

____
Director of Corporate & Housing Services

Author – Carole McGhee, Capital Manager 01324 506340,
carole.mcghee.@falkirk.gov.uk
Date: 17 November 2016

Appendices

Appendix 1 – Credit and Counterparty Policies.
Appendix 2 – Investment Levels at 30 September 2016.

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 2016/17 submitted to Council on 11 May 2016.

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 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

- Part nationalised UK banking Groups – 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 6 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 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.

UK BANKS

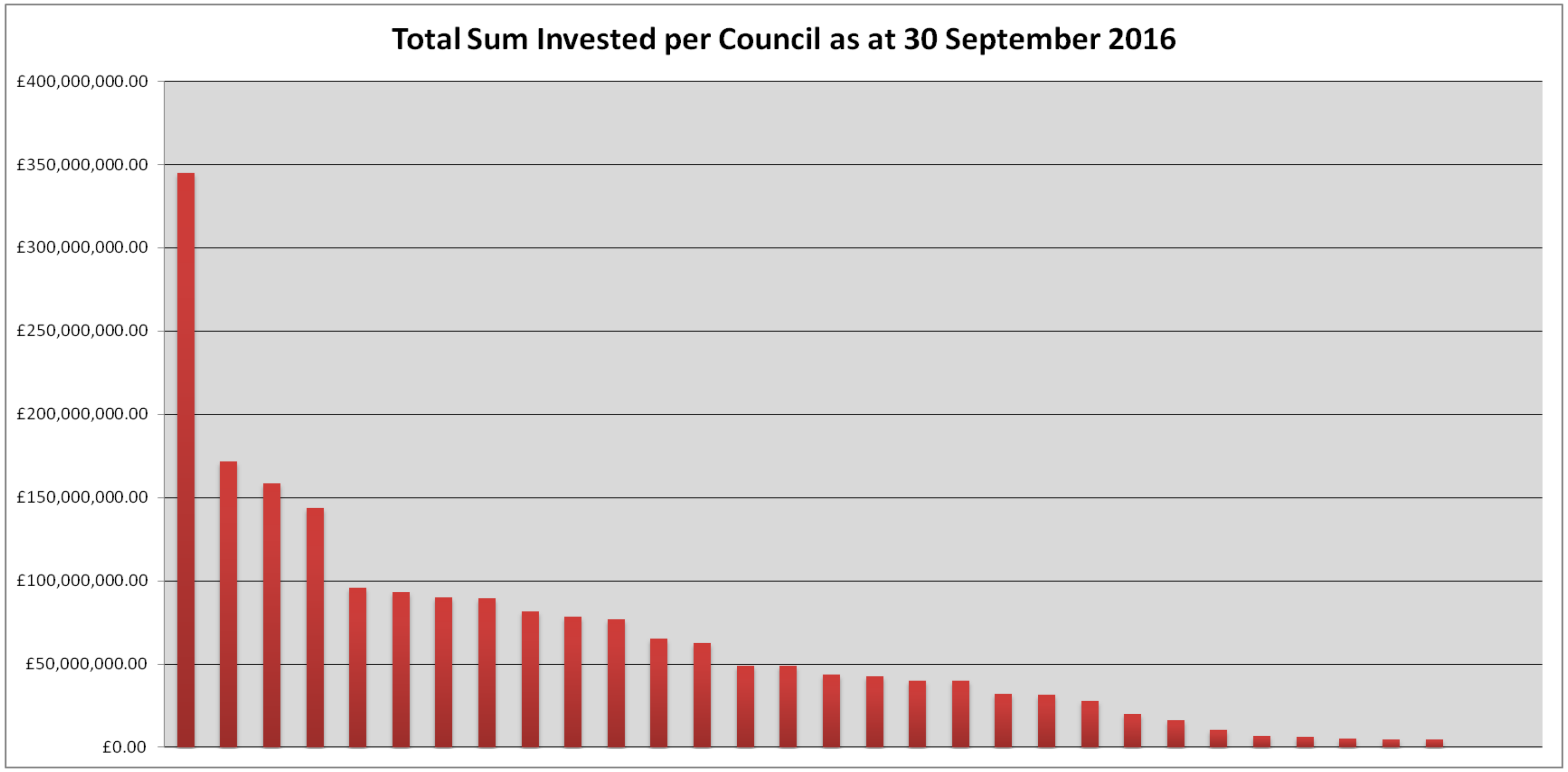
INSTITUTIONS	**LIMIT**	**MAX PERIOD**
Santander UK	£8m	6 Months
Barclays Bank	£8m	6 Months
Clydesdale Bank	£8m	Call
HSBC	£8m	6 Months
Lloyds Banking Group *		
Lloyds TSB	£8m	6 Months
Bank of Scotland	£8m	6 Months
* A maximum combined monetary limit of	£8m	
Royal Bank of Scotland *		
Royal Bank of Scotland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

Summary of Scottish Local Authorities Total Investments Outstanding as at 30 September 2016

APPENDIX 2

By Council	Total Sum Investment
Misc 1	£345,130,781.13
Misc 5	£171,896,512.02
Misc 3	£158,550,000.00
Misc 4	£143,843,000.00
Misc 7	£95,800,000.00
Misc 22	£93,400,000.00
Misc 6	£89,972,549.25
Misc 8	£89,546,000.00
Misc 28	£81,673,344.83
Misc 11	£78,371,748.00
Misc 2	£77,100,000.00
Misc 10	£65,350,000.00
Misc 9	£62,675,000.00
Misc 12	£49,105,000.00
Misc 14	£48,720,000.00
Misc 13	£43,725,926.37
Misc 16	£42,456,966.91
Misc 18	**£39,981,457.67**
Misc 15	£39,884,788.52
Misc 17	£32,158,557.00
Misc 27	£31,826,620.01
Misc 21	£27,834,287.34
Misc 31	£20,100,000.00
Misc 29	£16,266,107.00
Misc 19	£10,347,307.79
Misc 23	£6,965,127.69
Misc 20	£6,120,000.00
Misc 25	£5,500,000.00
Misc 32	£4,700,000.00
Misc 24	£4,540,000.00
Misc 30	£0.00
Misc 26	£0.00
FALKIRK	**£39,981,457.67**

FC



FC