Agenda Item 7

Treasury Management - Interim Review 2017/18

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Falkirk Council

Title:	**Treasury Management - Interim Review 2017/18**
Meeting:	**Falkirk Council**
Date:	**6 December 2017**
Submitted By:	**Director of Corporate & Housing Services**

1. Purpose of Report

1.1 The purpose of this report is to refer the Treasury Management Interim Review 2017/18 to Council for consideration.

2. Recommendation

Council is invited to consider the Treasury Management Interim Review for 2017/18.

3. Background

3.1 The Treasury Management Code of Practice reporting requirements make provision for a mid-year review of the Treasury Management function to be reported to the appropriate committee and to Council.

4. Consideration

4.1 The Interim Review was considered by the Executive on 28 November 2017. The Executive agreed to refer the report to Council for consideration.

4.2 The Treasury Management Strategy for 2017/18 was approved by Council on 29 March 2017. The interim review provides an update on the key elements of the Treasury Management function since then and revises forecasts.

5. Consultation

5.1 This report has not been subject to consultation.

6. Implications

Financial

6.1 There are no financial implications arising from the report.

Resources

6.2 There are no resource implications arising from the report.

Legal

6.3 There are no legal implications arising from the report.

Risk

6.4 There are no risk implications arising from the report.

Equalities

6.5 An equality and poverty impact assessment was not carried out.

Sustainability/Environmental Impact

6.6 No sustainability assessment has been completed as part of compiling the report.

7. Conclusions

7.1 The Interim Review of the Treasury Management Strategy was considered by the executive on 28 November 2017 and is now before Council for consideration.

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Director of Corporate & Housing Services

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Date: 28 November 2017

Appendix

1) Report to the Executive – 28 November 2017.

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:

None

Appendix 1
Agenda Item 14

Falkirk Council

Title:	**Treasury Management – Interim Review 2017/18**
Meeting:	**Executive**
Date:	**28 November 2017**
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 2017/18.
(2) Note the reduction in the long term borrowing requirement for 2017/18.
(3) 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 2017/18 was considered by the Executive on 21 March 2017 and thereafter approved by Council on 29 March 2017. This report provides an update on the progress of Treasury Management activities to 31 October 2017. There will be a final annual review report to the Executive in June 2018, following the financial year end.

4. Considerations

4.1 Economic and Interest Rate Outlook

4.1.1 Council approved the Treasury Management Strategy in March 2017. The Strategy stated that UK growth forecast for 2017 was 2.0%. However growth has been disappointingly weak with first quarter growth at 0.2% and quarter 2 at 0.3%. The main reason for this has been the sharp increase in inflation. This in turn has reduced the amount of disposable income, which has seen consumers cut back on expenditure resulting in weak growth in the services sector of the economy, which accounts for 80% of Gross Domestic Product (GDP). There have been encouraging signs in terms of the manufacturing sector as a result of increased demand for exports, however this sector only accounts for around 10% of GDP and will therefore have much less impact on the UK economy as a whole.

4.1.2 The U.S. economy grew at its fastest rate for two years, with growth of 3.1% in the second quarter to June 2017. Unemployment has fallen to 4.2%, its lowest level for many years. The Federal Reserve has already increased interest rates with three increases since December 2016 and a further increase is expected before the end of 2017. China's economy grew 6.8% between July and September, which has exceeded the 2017 annual growth target of 6.5%. Within the Eurozone, growth for the third quarter to September was 0.6%, which was above expectations. Consequently the European Central Bank (ECB) raised its 2017 growth forecast for the Eurozone to 2.2%, the fastest in 2 years.

4.1.3 In the Strategy Report, there was an expectation than the Bank Base Rate would remain at 0.25% with an increase not expected until June 2019. However, on 2 November, the Bank of England (BoE) announced an increase in the rate from 0.25% to 0.5%, the first interest rate rise in 10 years. Given the value of fixed rate loans that we have in our portfolio, this rate increase is unlikely to have a material impact on the Council. The Monetary Policy Committee (MPC) has again repeated previous guidance that future increases in interest rates will be at a gradual pace and to a limited extent.

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

AVERAGE ANNUAL %							
		MONEY RATES		**PUBLIC WORKS LOAN BOARD RATES (PWLB)**			
Year	**Bank Rate**	**3 Months**	**1 Yr**	**5 Yr**	**10 Yr**	**25 Yr**	**50 Yr**
2017/18	0.31	0.29	0.65	1.42	2.04	2.72	2.45
2018/19	0.56	0.64	1.11	1.68	2.33	3.00	2.75
2019/20	0.75	0.80	1.40	1.90	2.58	3.20	3.00

4.2 Borrowing Strategy

4.2.1 Capital Investment plans and Treasury Management are intrinsically linked. The 2017/18 Treasury Strategy Report to Council in March 2017 detailed the estimated long term borrowing requirement for 2017/18. It is calculated in January 2017 and takes into account the estimated borrowing for capital programme purposes (including the likely slippage for 2016/17), service repayment of debt, borrowing for TIF and the replacement of any short term loans that are due to mature in 2017/18. As such it will inevitably change as the year progresses.

4.2.2 The Capital Programmes Update 2017/18 reported to the September Executive, advised that the Council's estimated longer term borrowing requirement was forecast to be £41.4m, which is £18m less than the £59.4m approved as part of the 2017/18 Treasury Strategy. The forecast has been further reduced to £38.4m. Details of the budgeted long term borrowing requirement and updated forecast borrowing requirement are shown in the following table:

	2017/18 Original Estimate £m	2017/18 Revised Estimate £m	2017/18 Variance £'m
Capital Programmes (net of receipts including TIF)	42.0	28.0	(14.0)
Service Payments	(13.6)	(13.6)	-
Short Term Loans maturing in year	31.0	24.0	(7.0)
Total Longer Term Borrowing Requirement	59.4	38.4	(21.0)

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:-

	2017/18 £'m	2017/18 £'m
Budgeted Capital Programme (net of receipts & including TIF)		42.0
Less:		
Re-profiled TIF projects	(4.6)	
Re-scheduled General Fund Projects	(6.9)	
Re- profile of General Fund Receipts	1.8	
Re-profile of New Build Housing Grant	0.6	
Additional Housing Income – Council House Sales	(2.4)	
Additional Housing Revenue Contribution	(3.9)	
Variance in estimated Slippage/Acceleration for General Fund & Housing Programmes for 2016/17 & 2017/18	1.4	**(14.0)**
Forecast Capital Programme (net of receipts & including TIF)		**28.0**

4.2.4 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. At the time the 2017/18 Strategy was prepared it was estimated that £31.0m of short term borrowing would be undertaken in 2016/17 and would therefore mature in 2017/18. However short term borrowing of only £24m was required which accounts for the £7m variance in the table at paragraph 4.2.2. These short term 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.

4.2.5 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, an element of borrowing may be undertaken in addition to that required to fund the 2017/18 capital programmes (see paragraph 4.2.3). Actual borrowing might therefore exceed the forecast of £38.4m, to address our under-borrowed position. Any such borrowing will be included in the annual review of Treasury activities reported to the Executive in June 2018.

4.2.6 The Strategy Report highlighted the potential for Market Loans, up to a value of £13m; 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 as previously advised they have waived their right to change the applicable interest rate of these loans. Given the current level of interest rates, the risk of early repayment of any of the remaining loans is assessed as low.

4.2.7 The PWLB has extended the "PWLB Certainty Rate" by a further year. This facility enables eligible local authorities to access discounted PWLB borrowing at 0.02% below standard PWLB rates. Falkirk Council's application for this facility has been submitted and we await confirmation of acceptance. Members will be advised in due course.

4.2.8 Given the latest outlook for the future direction of interest rates, as outlined in paragraph 4.1.4, it remains the case that funding of the longer term borrowing requirement will continue to be linked to short term rates.

4.2.9 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's credit and counterparty policies together with the specific counterparties that the Council engages with in terms of investments, are detailed in Appendix 1.

4.3.3 The Council held £36.3m of investments at the end of October 2017. Details are as follows:

Institution	**Investment (£'m)**	**Maturity**
UK Banks	8.27	Instant Access
UK Banks	10.00	November 2017 – January 2018
Money Market Funds	0.03	Instant Access
Local Authority	13.00	November 2017 – January 2018
UK Building Society	5.00	November 2017
Total Investments	**36.30**	

4.3.4 As detailed in paragraph 4.2.4, £24m of short term loans mature during 2017/18, £19m of which are due to mature in December 2017 – March 2018. 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 (31/10/17)	**2017/18 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 (31/10/17) %	**Lower** %	**Upper** %
Under 12 months	8	0	20
12 months – 2 years	0	0	20
2 years – 5 years	4	0	30
5 years – 10 years	28	0	30
10 years – 20 years	13	0	40
20 years – 30 years	23	0	40
30 years – 40 years	20	0	40
40 years – 50 years	4	0	40

(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 Banking Contract

4.5.1 As previously advised the Council's Banking contract was to be retendered during 2017/18 with an effective start date of 1 April 2018. A full OJEU tender process was undertaken with a closing date for submissions of 2 October 2017. There were 2 bids submitted, one from the current provider, Clydesdale

Bank and one from Royal Bank of Scotland. The tender evaluation process is underway and Members will be advised who the successful bank is in due course.

4.6 Prudential Code

4.6.1 CIPFA has issued consultation documents on proposed changes for both the Treasury Management Code and the Prudential Code. The closing date for submissions was 30 September 2017. Members will be provided with an update on the results of the consultations in future Strategy Reports.

4.7 Treasury Management Advisers

4.7.1 The Council has entered into a new 2 year contract with Capita Asset Services as its treasury management advisers. The contract is effective from 1 April 2017 to 31 March 2019. 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

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

4.7.3 As advised in the Treasury Strategy 2017/18, Capita plc planned to sell Capita Asset Services. In June 2017, Capita Assets plc exchanged contracts with Link Group for the sale of Capita Asset Services. The new brand name is Link Asset Services. We have been assured that there will be no disruption to the service Falkirk Council receives or the teams providing support to the Council.

4.8 Markets in Financial Instruments Directive II (MiFID II)

4.8.1 As advised in the Treasury Strategy 2017/18, the Markets in Financial Instruments Directive II (MiFID II) comes into effect in January 2018. This is being implemented by the Financial Conduct Authority (FCA) and relates to local authority treasury management activities with banks and other financial institutions. Specifically it classifies local authorities as retail clients, which could restrict their treasury management activities. However, in order to ensure that there are no restrictions, the Council has the option to “opt up” to professional client status.

4.8.2 We have been liaising with our Treasury Advisers and are in the process of completing documentation which will enable us to “opt up”. This will ensure that we are able to continue to interact with brokers, firms and financial institutions in much the same way as is currently the case.

4.9 Member Training

4.9.1 The Investment Regulations provide for increased scrutiny by Members of treasury management issues. Training sessions have been arranged in the past and going forward, further training sessions will be scheduled to ensure that Members are fully aware of their scrutiny role for treasury management activities.

4.10 Benchmarking

4.10.1 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 2017. 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.

5. Consultation

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

6. Implications

Financial

6.1 Assumptions made on both borrowing and investment is an integral part of the Revenue Budget setting process. As such the Revenue Budget and Capital Programmes for both General Fund and Housing reflect the financial consequences of the proposed Borrowing and Investment Strategies within this report.

Resources

6.2 A substantial amount of staff time will be required in relation to the Banking contract if the provider changes. A significant staff input would be required throughout the Council to ensure a smooth and timely transition between providers.

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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. inflation, UK growth and fallout from Brexit, and work closely with our treasury advisers to ensure that any borrowing is undertaken at the most advantageous rate possible.

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Director of Corporate & Housing Services

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Date: 28 November 2017

Appendices

Appendix 1 – Credit and Counterparty Policies.
Appendix 2 – Investment Levels at 30 September 2017.

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 2017/18 submitted to Council on 29 March 2017.

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 9 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	9 months
Barclays Bank	£8m	9 months
Clydesdale Bank	£8m	Call
HSBC	£8m	9 months
Standard Chartered	£8m	9 months
Sumitomo Mitsui Banking Corporation, Europe	£8m	9 month
Lloyds Banking Group *		
Lloyds TSB	£8m	9 months
Bank of Scotland	£8m	9 months
* A maximum combined monetary limit of	£8m	
Royal Bank of Scotland *		
Royal Bank of Scotland	£8m	9 Months
Nat West	£8m	9 Months
* A maximum combined monetary limit of	£8m	
Goldman Sachs International Bank	£8m	9 Months
BUILDING SOCIETIES		
Nationwide	£8m	9 months
Leeds	£8m	9 months
Coventry	£8m	9 months
Yorkshire	£8m	9 months
Skipton	£8m	9 months
UK LOCAL AUTHORITIES	£5m per LA	9 months
UK GOVERNMENT	Unlimited	6 Months
MONEY MARKET FUNDS	£5m per fund	Call

Summary of Scottish Local Authority Total Investments Outstanding as at 30 September 2017 **APPENDIX 2**

By Council	Total Sum Investment
Misc 1	£366,730,618.06
Misc 27	£231,523,652.24
Misc 3	£147,450,000.00
Misc 7	£113,220,000.00
Misc 5	£98,000,000.00
Misc 2	£96,899,208.41
Misc 8	£90,100,000.00
Misc 4	£82,231,400.00
Misc 11	£77,808,000.00
Misc 28	£74,943,784.43
Misc 6	£58,817,000.10
Misc 14	£56,307,731.00
Misc 10	£52,175,000.00
Misc 12	£50,680,000.00
Misc 9	£44,776,422.03
Misc 22	£43,850,000.00
Misc 13	£42,632,816.58
Misc 18	£37,502,840.99
Misc 17	£36,735,840.00
Misc 15	£32,322,328.38
Misc 21	£26,194,518.89
Misc 16	£23,074,733.69
Misc 25	£16,290,000.00
Misc 20	£11,950,000.00
Misc 31	£11,600,000.00
Misc 23	£10,657,897.28
Misc 19	£10,069,693.00
Misc 32	£5,000,000.00
Misc 29	£4,711,122.45
Misc 30	£4,351,053.04
Misc 24	£2,815,000.00
Misc 26	£0.00
FALKIRK	£37,502,840.99

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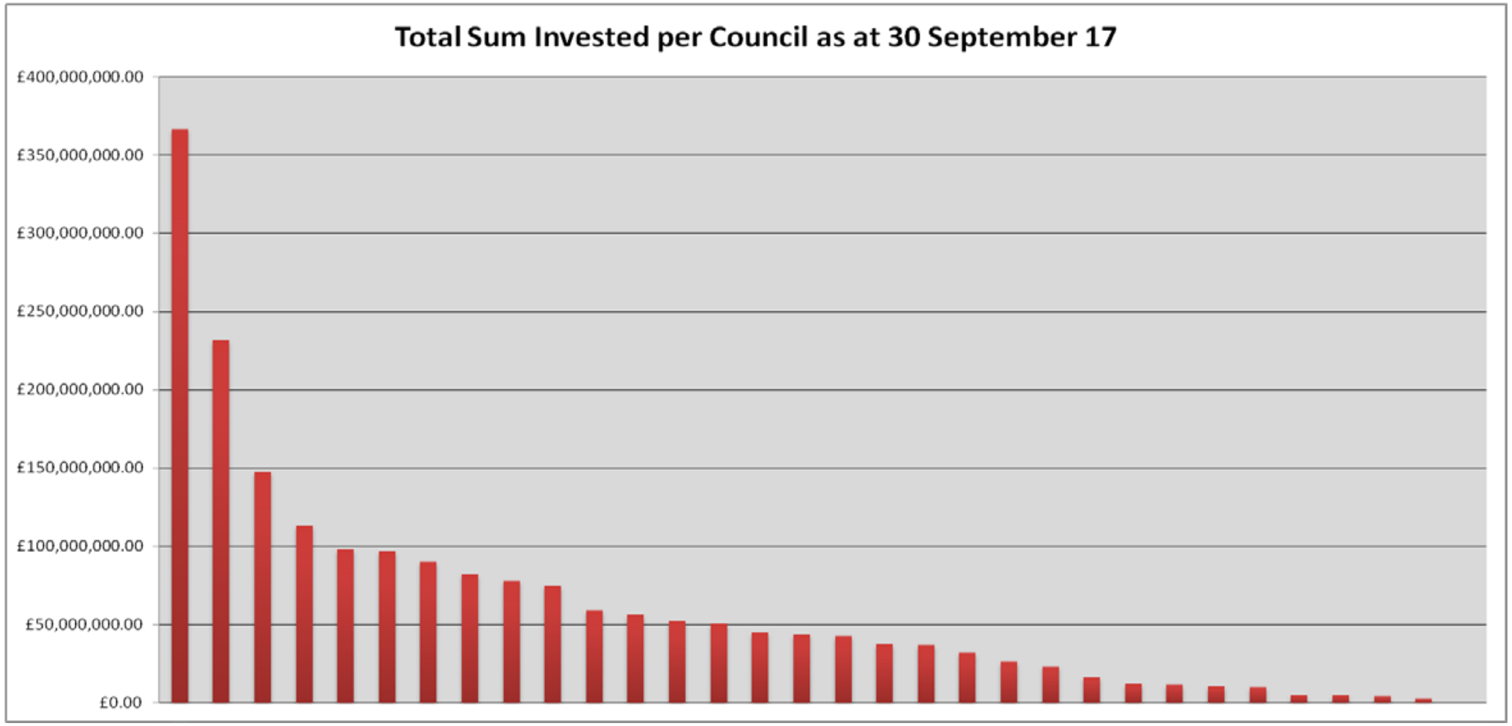

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