

The background of the slide features a large, light blue watermark of the City of Vancouver's coat of arms. The crest includes a crown with four maple leaves, a shield divided into four quadrants (top-left: a building, top-right: a stag's head, bottom-left: a sailing ship, bottom-right: a grizzly bear), and a banner at the bottom with the motto 'CITY OF VANCOUVER' in Gaelic script.

Agenda Item 11

Treasury Management – Interim Review 2019/20

Falkirk Council

Title: Treasury Management – Interim Review 2019/20

Meeting: Executive

Date: 10 December 2019

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 2019/20.**
- (2) Note the reduction in the long term borrowing requirement for 2019/20.**
- (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 2019/20 was considered by the Executive on 16 April 2019 and thereafter approved by Council on 8 May 2019. This report provides an update on the progress of Treasury Management activities at the half year point. There will be a final annual review report to the Executive in June 2020, following the financial year end.

4. Considerations

4.1 Economic and Interest Rate Outlook

- 4.1.1 The first half of 2019/20 has seen economic growth in the UK fall as a result of the uncertainty surrounding Brexit. In terms of inflation, this has been hovering about 2% during 2019, albeit that there was a reduction to 1.7% in August. Going forward it is forecast to remain at the Bank of England's target level of 2% over the next couple of years. With regard to unemployment, despite the reduction in economic growth, the level remains low at 3.8%.
- 4.1.2 The U.S. economy has fallen back after a strong start in 2019. The Federal Reserve has reduced interest rates on three occasions during 2019, with the latest cut from 2% to 1.75% in October. Within the Eurozone, growth has been

slowing during 2019 and inflation has fallen well below the upper limit of its target range of 0% to 2%.

4.1.3 In the Strategy Report, there was an expectation than the Bank Base Rate would increase from 0.75% to 1% by the middle of 2019. However, this has not materialised and indeed the bank base rate is expected to remain at 0.75% until December 2020 with the expectation that it will reach 1% by March 2022.

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

AVERAGE ANNUAL %							
Year	Bank Rate	MONEY RATES		PUBLIC WORKS LOAN BOARD RATES (PWLb)			
		3 Months	1 Year	5 Year	10 Year	25 Year	50 Year
2019/20	0.75	0.68	0.87	1.70	1.96	2.54	2.41
2020/21	0.75	0.78	1.08	2.45	2.73	3.40	3.30
2021/22	1.00	1.03	1.38	2.75	3.05	3.70	3.60

4.2 Borrowing Strategy

4.2.1 Capital Investment plans and Treasury Management are intrinsically linked (see Capital Programmes Update 2019/20, a separate agenda item). The 2019/20 Treasury Strategy Report detailed the estimated long term borrowing requirement for 2019/20. It is calculated in January 2019 and takes into account the estimated borrowing for capital programme purposes (including the likely slippage for 2018/19), service repayment of debt, borrowing for TIF and the replacement of any short term or long term loans that are due to mature in 2019/20. As such it will inevitably change as the year progresses.

4.2.2 The Capital Programmes Update 2019/20 reported to the October Executive, advised that the Council's estimated longer term borrowing requirement was forecast to be £60.2m, which is £9m less than the £69.2m approved as part of the 2019/20 Treasury Strategy. The forecast has been further reduced to £53.4m. Details of the budgeted long term borrowing requirement and updated forecast borrowing requirement are shown in the following table:

	2019/20 Original Estimate £'m	2019/20 Revised Estimate £'m	2019/20 Movement £'m
Capital Programmes (net of receipts incl; TIF)	50.2	33.4	(16.8)
Service Payments	(13.5)	(12.5)	1.0
Long Term Loans Maturing In Year	2.5	2.5	-
Short Term Loans maturing In Year	30.0	30.0	-
Total Longer Term Borrowing Requirement	69.2	53.4	(15.8)

- 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:-

	2019/20 £'m	2019/20 £'m
Original Estimate - Capital Programme (net of receipts & including TIF)		50.2
Less:		
Re-profiled TIF projects	(8.2)	
General Fund Capital Receipts Replaced by Borrowing	2.6	
General Fund Projects rescheduled beyond 19/20	(6.4)	
Variance in estimated 18/19 Slippage for General Fund	2.6	
Increase in 19/20 Budgeted Slippage for General Fund	(2.2)	
Slippage in 19/20 Housing Capital Programme	(7.7)	
Re-profile of 19/20 New Build Housing Grant	2.5	
Total Movement		(16.8)
2019/20 Revised Estimate - Capital Programme (net of receipts & including TIF)		33.4

- 4.2.4 The Service repayment of debt is £1m less than originally estimated. Additional debt repayments from Capital Receipts were made in 2018/19 which has reduced future Loan Charges, hence the £1m reduction in the anticipated 2019/20 debt repayment.
- 4.2.5 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 the Council needed to borrow. The table at paragraph 4.2.2 includes long term borrowing of £2.5m and short term borrowing of £30m that is due to mature during 2019/20. These loans may be replaced on a short term or long term basis depending on prevailing interest rates at the time borrowing is undertaken. In addition, depending on cash flow balances, the replacement of these loans might not necessarily be undertaken at the date of maturity. Indeed, to date £16m of these loans have matured, but only £10m of long term PWLB borrowing has been arranged so far. Officers will continue to engage with the Council's treasury advisers, Link Asset Services, to determine the best mix of borrowing periods and the best time to borrow, based on available interest rates.
- 4.2.6 The Council has four Market Loans valued at £26m in totality. The Strategy Report highlighted the potential for two of these 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. These Market Loans are held with Dexia Credit (£8m) and Just Retirement Ltd; (£5m). The remaining two Market Loans (£13m) are held with Barclays Bank and as previously advised Barclays 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. This reduced rate is applicable to all borrowing that is undertaken. Falkirk Council’s application for this facility has been approved.
- 4.2.8 In addition to the “PWLB Certainty Rate”, the Council submitted an application to access further discounted borrowing for TIF, under the “PWLB Local Infrastructure Rate”. The initiative is aimed at encouraging new infrastructure and enables eligible local authorities to access PWLB borrowing at 0.04% below standard PWLB rates. A borrowing limit of £2.678m has been allocated to Falkirk Council.
- 4.2.9 PWLB interest rates hit a record low over August and September 2019. Consequently local authorities, including Falkirk Council, took advantage and increased their PWLB borrowing (see paragraph 4.2.4). However, as there is a statutory limit on the amount of outstanding PWLB loans at any point in time, HM Treasury increased all PWLB rates by 1% in early October, to reduce the amount of loan applications. Although this rate increase appears substantial, it has in fact simply increased these extremely low interest rates up to the level which the Council had previously assumed. However, the Council’s Treasury advisers, will continue to review alternatives to PWLB borrowing and should less expensive options become available, this will be explored with the Council.
- 4.2.10 Given the latest outlook for the future direction of interest rates, as outlined in paragraph 4.1.4, it’s possible that funding of the longer term borrowing requirement will continue to be linked to short term rates. However this will be discussed in detail with the Council’s treasury advisers.

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 c£48m of investments at the end of October 2019. Details are as follows:

Institution	Investment (£'m)	Maturity
UK Banks	1.84	Instant Access
UK Bank	8.00	32 day Notice Account
UK Banks	13.00	November 2019
Money Market Funds	16.15	Instant Access
Local Authorities	9.00	November/December 2019
Total Investments	47.99	

4.3.4 As detailed in paragraph 4.2.4, £32.5m of loans mature during 2019/20 (£2.5m long term and £30m short term), £16.5m of which are due to mature between December 2019 and March 2020. The significant level of investments shown in the table above will dissipate as these 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. The budgeted Treasury indicators and the position at 31 October, are noted below:

	Position	2019/20	2019/20
1) MATURITY STRUCTURE	31/10/19	LOWER	UPPER
	%	%	%
Fixed Interest Rate Borrowing 2019/20:			
Under 12 months	13	0	25
12 months – 2 years	1	0	25
2 years – 5 years	9	0	25
5 years – 10 years	22	0	35
10 years – 20 years	12	0	35
20 years – 30 years	11	0	35
30 years – 40 years	16	0	35
40 years – 50 years	16	0	35
Variable Interest Rate Borrowing 2019/20:			
Under 12 months	0	0	5
12 months – 2 years	0	0	5
2 years – 5 years	0	0	5
5 years – 10 years	0	0	5
10 years – 20 years	0	0	5
20 years – 30 years	0	0	5
30 years – 40 years	0	0	5
40 years – 50 years	0	0	5
2) MAXIMUM PRINCIPAL SUMS INVESTED > 365 DAYS			
The Council does not place investment for periods longer than 365 days.			

4.5 Treasury Management Advisers

4.5.1 The Council's has entered into a new two year contract with Link Asset Services effective from 1 April 2019 to 31 March 2021. 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

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

4.6 Member Training

4.6.1 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 as and when required, to ensure that Members are fully aware of their scrutiny role for treasury management activities.

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 2019 (October 2019 not available - figures provided from external source). 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 and consistent with our position in 2018/19.

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 are 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 There are no resources 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 Link, 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. The Council's prudent approach to lending as noted at paragraph 4.3.1 protects the Council's risk.

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

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Date: 27 November 2019

Appendices

Appendix 1 – Credit and Counterparty Policies.

Appendix 2 – Investment Levels at 30 September 2019.

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 2019/20 submitted to Council on 8 May 2019

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 or equivalent 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

- The Council's own banker (Royal Bank of Scotland) will continue to be used for investment purposes even if the bank falls below the above criteria, because it is part nationalised. Balances will also be held on a Call basis too. Investments will be restricted to the ring fenced bank – Royal Bank of Scotland Plc.
- Investments in Nat West, which is also part nationalised with the Royal Bank of Scotland, can be included if they continue to be part nationalised or if they meet the ratings above. Investments will be restricted to the ring fenced bank – National Westminster Bank Plc.

- The maximum period for investments will be 1 year 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.

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.

<u>UK BANKS</u>		
<u>INSTITUTIONS</u>	<u>LIMIT</u>	<u>MAX PERIOD</u>
Royal Bank of Scotland *		
Royal Bank of Scotland	£8m	1 year
Nat West	£8m	1 year
* A maximum combined monetary limit of	£8m	
Santander UK	£8m	1 year
Barclays Bank	£8m	1 year
HSBC	£8m	1 year
Standard Chartered	£8m	1 year
Sumitomo Mitsui Banking Corporation	£8m	1 year
Europe		
Lloyds Banking Group *		
Lloyds Bank	£8m	1 year
Bank of Scotland	£8m	1 year
* A maximum combined monetary limit of	£8m	
Goldman Sachs International Bank	£8m	1 year
<u>BUILDING SOCIETIES</u>		
Nationwide	£5m	1 year
Coventry	£5m	1 year
Leeds	£5m	6 months
Yorkshire	£5m	6 months
Skipton	£5m	6 months
<u>UK LOCAL AUTHORITIES</u>	£8m per LA	1 year
<u>UK GOVERNMENT</u>	Unlimited	6 months
<u>MONEY MARKET FUNDS</u>	£8m per fund	Call

By Council	Total Sum Investment
Misc 1	£392,883,889.89
Misc 27	£277,524,238.67
Misc 2	£266,372,898.68
Misc 9	£184,856,809.95
Misc 3	£161,970,000.00
Misc 5	£130,970,000.00
Misc 7	£123,850,000.00
Misc 11	£99,345,748.36
Misc 28	£92,996,519.25
Misc 8	£78,500,000.00
Misc 14	£74,407,502.10
Misc 16	£72,810,234.65
Misc 12	£66,625,000.00
Misc 6	£63,571,574.18
Misc 10	£59,783,660.00
Misc 18	£48,969,179.73 FC
Misc 17	£48,173,979.00
Misc 13	£32,938,024.28
Misc 23	£32,536,617.46
Misc 22	£31,450,000.00
Misc 15	£28,707,469.88
Misc 21	£26,547,665.26
Misc 20	£24,300,000.00
Misc 4	£22,960,900.00
Misc 19	£20,844,369.45
Misc 25	£18,131,000.00
Misc 30	£17,435,955.87
Misc 32	£10,500,000.00
Misc 29	£7,712,961.56
Misc 31	£7,000,000.00
Misc 24	£4,110,000.00
Misc 26	£0.00
	£2,528,786,198.22

