Agenda Item 6

Treasury Management Strategy

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FALKIRK COUNCIL

Subject: **Treasury Management Strategy**
Meeting: **Emergency Executive**
Date: **3 September 2020**
Author: **Director of Corporate & Housing Services**

1. Purpose of Report

1.1 The Code of Practice for Treasury Management sets out a framework for Treasury management reporting for a financial year. This framework requires a Treasury Management Strategy Report, an Interim Review Report and an Annual Review Report. Due to the Covid-19 pandemic, the reporting for Treasury has been interrupted. As a result, this report will cover both the Annual Review Report for 2019/20 and the Treasury Strategy Report for 2020/21.

1.2 The Code of Practice requires that, following consideration by the Executive, the report is referred to Council for approval.

2. Recommendations

2.1 **It is recommended that Emergency Executive:**

1) notes the Annual Review for 2019/20

2) adopts the Borrowing Strategy for 2020/21 as set out in section 4.2 of this report

3) adopts the Investment Strategy for 2020/21 and approves the list of "Permitted Investments" as set out in section 4.3 of this report

4) approves the Treasury Indicators as set out in section 4.4 of this report

5) approves the changes to the Loans Fund repayments as set out in section 4.7 of this report.

2.2 **Emergency Executive agree the report is referred to Council for consideration.**

3. Background

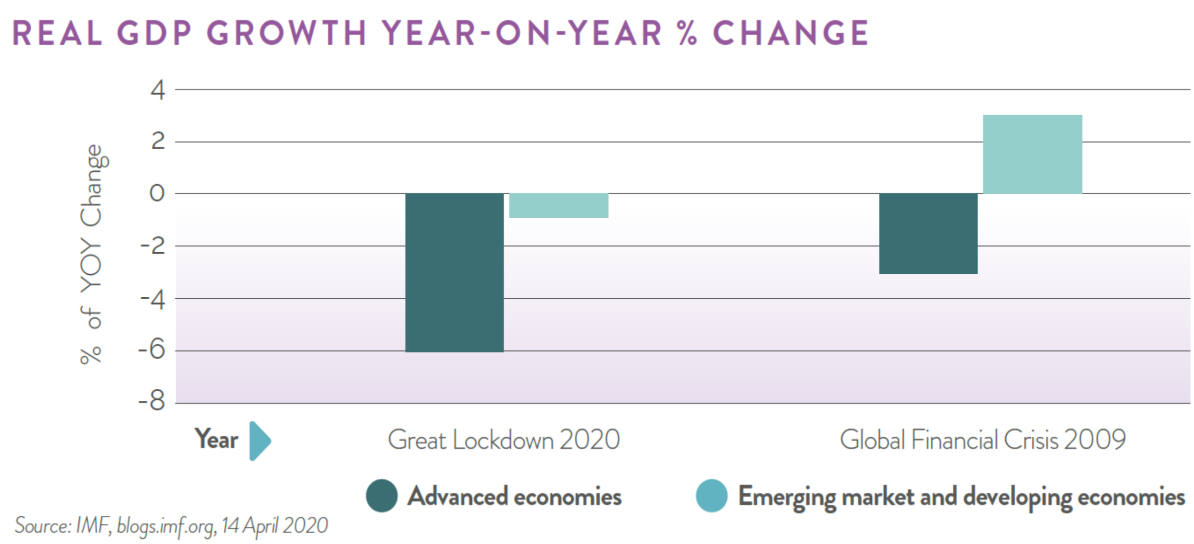
3.1 This report covers both the Annual Review Report for 2019/20 and the Treasury Management Strategy Report for 2020/21. As such, this report is the first of three Treasury Management reports to Members covering 2020/21. This report outlines the framework for Treasury Management activities in 2020/21. T hereafter an Interim Review report will be submitted to Members later in 2021.

The Interim Review report provides an update on the progress of Treasury Management activities during the course of the financial year. The final Annual Review report should be submitted to the Executive by 30 June 2021 and will advise Members of the final position in relation to Treasury Management activities during 2020/21.

4. Economic Review and Outlook

4.1 The spread of Covid-19 and the efforts taken globally to contain the virus, have had a massive impact. The UK has now entered a recession for the first time in 11 years, with the economy shrinking by 20.4% compared to the first three months of the year. The economic decline was at its greatest in April 2020, at the height of the lockdown and subsequent months have seen growth.

4.2 The most recent April 2020 forecasts by the IMF (in the chart below) indicate that the damage to global growth will be worse than the downturn of 2008/09.



4.3 As the Covid-19 pandemic has unfolded, the scale of monetary and fiscal stimulus and support announced by central banks and governments worldwide has been unprecedented; fiscal stimulus measures alone have been estimated at c6% of global GDP. The UK economy has been affected harder than a number of other European economies and that of the US. The reasons for this are in the main that the UK economy is in general more reliant on areas that have been hardest hit by the Covid-19 pandemic, for example services, hospitality and consumer spending.

4.4 At the start of August 2020 the Bank of England Monetary Policy Committee highlighted a number of positive signs in the economy:

- The fall in GDP in the first of 2020 of 28% was revised upwards to 23%.
- The peak in the unemployment rate was revised downwards from 9% in quarter 2 to 7.5% by quarter 4.

4.5 In short, the economy is recovering better than anticipated albeit this is likely to be a prolonged recovery, not a rapid one. However, uncertainty persists. The dangers of a 'second wave' of the Covid-19 pandemic have been highlighted, but it is recognised this may be more likely to result in local, rather than national measures. In addition Brexit uncertainties remain ahead of the year end deadline and this in turn could negatively impact on the recovery process.

4.6 The Bank of England (BoE) reduced the base rate to 0.25% on 11 March 2020 and reduced it further to 0.10% on 19 March 2020. These reductions were a result of the covid-19 pandemic, and rates were set with the aim to help cash flow for households and small businesses. Recently the Bank of England Monetary Policy Committee has said that it is still considering the use of a negative interest rate, and will continue to review whether this would be appropriate. However, a move to negative interest rates is unlikely to happen in the next six months.

4.7 The Council's Treasury Advisors, Link Asset Services, have recently updated their forecasts for the bank rate, money rates and PWLB rates. No change is forecast to the bank base rate over the next three year period. The PWLB rate in the table below is the certainty rate (standard rate minus 0.2%). Low PWLB rates are likely to continue to support recovery following the shutdowns arising from the Covid-19 pandemic. The PWLB has recently concluded a consultation exercise on future lending terms. It is anticipated that the certainty rate will be reduced further during 2020/21.

		MONEY RATES		**PWLB RATES**			
	Bank Rate	**3 Mths**	**1Yr**	**5Yr**	**10Yr**	**25Yr**	**50Yr**
2020/21	0.10	0.00	0.20	1.90	2.10	2.50	2.30
2021/22	0.10	0.00	0.20	2.00	2.10	2.50	2.40
2022/23	0.10	-	-	2.10	2.10	2.70	2.50

4.8 Inflation is one of the key factors that the BoE consider when setting the base rate. For example if inflation is likely to be below the target of 2%, the bank may cut interest rates to lower the cost of borrowing and encourage spending. In January 2020 the inflation rate was sitting at 1.8% but reduced dramatically to 0.8% in April 2020. However, caution should be used when considering inflation rates as the basket of services used to calculate inflation may not reflect the shopping habits adopted during the pandemic to date. The Monetary Policy Committee project that inflation is likely to continue to be low for the coming year and will reach the target of 2% in 2023.

5. 2019/20 Annual Review

5.1 The annual review looks at the outcome against estimates for:

- The borrowing strategy
- The investment strategy
- Prudential Indicators

5.2 A summary of the outcomes in these key areas is set out below, with more detail provided in Appendix 1 of this report.

Borrowing Strategy 2019/20

Borrowing Requirement 2019/20	
	£'m
Borrowing Requirement per February 2020 Executive Report	55.6
Actual Borrowing Requirement	54.7
Variance	**(0.9)**

5.3 The borrowing requirement for the capital programme was £1.1m less than estimated which was offset by a reduction in repayment of debt by £0.2m. The reduction in borrowing for the capital programme is mainly due to slippage on the general capital programme of £2.6m, offset by increases in borrowing requirements for housing and TIF. Further detail on these movements is included in Appendix 1.

5.4 Whilst £54.7m was the actual borrowing requirement, £50m of borrowing was undertaken (£40m of short term loans and £10m of long term loans). This is the result of timing differences in cashflow, meaning sufficient cash balances were in place to offset the borrowing requirement. Previous Strategy reports have noted the Council's under-borrowed position. The level of borrowing undertaken is within the limits approved in the Strategy and remains within the prudential indicator limits approved by Members.

5.5 The 2019/20 Strategy highlighted the continuing uncertainty over the timing of interest rate changes in both the short and longer term. However, it noted that the next few years were likely to see a continuation of a significantly more favourable rate for short term loans. As ever though the complete range of borrowing period options is considered at the point of borrowing. Borrowing undertaken during 2019/20 was on both a short term and long term basis because of the relative interest rates prevailing at the time.

Investment Strategy 2019/20

5.6 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 those counterparty risks.

5.7 Consistent with the requirement of the investment regulations and as part of the Strategy Report, Council approved a list of "Permitted Investments" setting out the types of investments to be used and monetary/time limits applied to each type of investment. There was no change to the counterparty selection criteria nor to the list of eligible counterparties as advised in the annual Strategy Report to Members.

5.8 The Council held £35.6m of investments as at 31 March 2020 of which, £23.5m was available on instant access from money market funds, £2.1m was available on instance access from two UK Banks and £10m of deposits was placed with other Local Authorities. This temporary level of investments will be drawn down over the coming months to meet future Council commitments such as maturing short term debt, salary costs, supplier invoices etc.

Treasury Management Prudential Indicators

5.9 Financing of the Capital Programme is a key driver of Treasury Management activities. A series of treasury management prudential indicators are included within the Strategy. The purpose of the 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.

5.10 The three treasury indicators for 2019/20 are included in Appendix 1 and show comparison with the Council's actual exposure as at 31 March 2020. This confirms that the Council's treasury operations were operating well within the set parameters during financial year 2019/20.

6. 2020/21 Treasury Management Strategy

6.1 As with the annual review, the Strategy covers three main areas:

- The borrowing strategy
- The investment strategy
- Prudential Indicators

Borrowing Strategy 2020/21

6.2 The Council's debt position at 01/04/20 was:

	£'m	% of Total Debt
LONG TERM FUNDING		
- Maturing loans in 2020/21	4.0	1.4%
- Loans with Maturity > 1 year	234.2	84.2%
	238.2	
SHORT TERM FUNDING	40.0	14.4%
TOTAL ESTIMATED DEBT	**278.2**	**100.0%**

6.3 Previous reports to Members have noted that at each borrowing point, consideration is given to all the options available and the complete range of borrowing periods is reviewed. Section 4 of this report includes indicative interest rates for both the bank base rate and PWLB long term borrowing.

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 paragraphs 4.6 and 4.7, are considered to be the most probable outcome. The rates available at a given time will impact on cost to the General Fund and HRA. However, the indications are that there will continue to be a significant interest rate differential in favour of short term borrowing.

6.4 When the capital programmes were approved in January and February 2020, the total borrowing requirement was estimated at £120.5m, with £96.8m required for the capital programme. The balance of £23.7m represented replacement of existing borrowing offset by the annual repayment of debt. As a result of the Covid-19 pandemic, the borrowing requirement has reduced significantly. The budgeted borrowing requirement is now c£83m as shown in the table below:

	£'m
Capital Programmes (net of capital receipts)	59.4
Service Payments	(20.1)
Replacement of Long Term Borrowing (see table above)	4.0
Replacement of Short Term Borrowing (see table above)	40.0
TOTAL BUDGETED BORROWING REQUIREMENT	**83.3**

6.5 The £59.4m borrowing requirement for capital programmes is made up of £3.4m borrowing for TIF projects, £28.2m for the Housing capital programme and £27.8m for the General Fund capital programme. These figures reflect the capital programme updates provided to Members on 6 August 2020 but will no doubt change during the year and in particular as Members consider the Corporate Plan and Business Plan in September 2020.

6.6 Previous strategy reports to Members have outlined the Council's under borrowed position and the reduction of this on a gradual and managed basis. Consequently the budgeted borrowing requirement of c£84m in the table above may still be required regardless of any slippage in the 2020/21 capital programmes. However, it is more likely that the requirement will reduce.

6.7 The replacement of short term borrowing shown in the table above refers to £40m of short term debt that matures in 2020/21. These loans may be replaced on a short term or long term basis depending on cash flow requirements and relative prevailing interest rates.

6.8 The total value of Market Loans is £26m. It should be noted that there is potential for £13m of these Market Loans to be repaid during the year should any of the lenders invoke a rate change clause as per their individual contracts. 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 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.

6.9 The Council's main source for longer term funding is the PWLB from which it can access all of its borrowing requirement. The PWLB has extended the "PWLB Certainty Rate" by a further year. This facility enables local authorities to access discounted PWLB borrowing at 0.20% below standard PWLB rates.

In order to qualify for the "PWLB Certainty Rate", Falkirk Council have to provide details of their planned borrowing and associated capital spending across all three Capital Programmes i.e. General Fund, Housing and TIF. The application for this facility is due by 30 September 2020.

6.10 The Council's application for the "PWLB Local Infrastructure Rate" has also been approved. The initiative is aimed at encouraging new infrastructure and enables eligible local authorities to access PWLB borrowing at 0.40% below standard PWLB rates. In order to qualify for the "PWLB Local Infrastructure Rate", Falkirk Council had to provide a business plan in relation to its planned investment in infrastructure. Consequently a borrowing limit of £2.678m was allocated to Falkirk Council for eligible projects.

6.11 Following the Spring Budget 2020, HM Treasury announced a new discounted PWLB borrowing rate to support social housing. The interest applicable to such borrowing is 1% less than the PWLB Certainty rate. This new rate applies to all borrowing undertaken in relation to the HRA and is effective from 12 March 2020.

Investment Strategy 2020/21

6.12 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.

6.13 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.

6.14 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 2)
  - Loans to a local authority company (none currently held by the Council)
  - Non-local authority shareholdings (refer to Appendix 2)
  - Loans to third parties, including soft loans (refer Appendix 4)

6.15 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 are also a number of property asset, such as Kilns House, the Steeple and Arnotdale, which attract a rental yield.

6.16 Details, as appropriate, of the risks, mitigating controls and limits associated with each of the Permitted Investments are attached at Appendix 2. Members should be aware that the Covid-19 pandemic has resulted in the Council having regular large cash balances. This is partly due to Government funding and partly due to reduced spend across the Council and as a result, most Local Authorities are experiencing the same high level of cash balances. This means that, at a given time there can be a large number of councils looking to place money and in some cases, an appropriate counterparty, such as another local authority cannot be sourced. In some cases, this may mean that deposits with a counterparty, Royal Bank of Scotland for example, breach the approved limits, although in the majority of cases, this will be for one night only. The Treasury section is working with Treasury Advisors to find solutions to this by either increasing the number of counterparties the Council has or increasing limits with existing counterparties. The Treasury section is in the process of setting up new accounts with counterparties on the existing list. If any more revisions are required, further recommendations will come back to Members.

6.17 The Report provides details of the counterparties that the Council engages with in terms of its investments (see Appendix 2). 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 criterion for 2020/21 has been reviewed to ensure it is robust enough to enable the Council to manage its investments effectively.

6.18 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 3.

6.19 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.

Treasury Indicators

6.20 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.

6.21 Members are asked to approve the undernoted Treasury indicators:

		2020/21	2020/21 (2019/20)
1)	**MATURITY STRUCTURE**	**LOWER**	**UPPER**
	Fixed Interest Rate Borrowing 2020/21:	%	%
	Under 12 months	0	35 (25)
	12 months – 2 years	0	20 (25)
	2 years – 5 years	0	20 (25)
	5 years – 10 years	0	30 (35)
	10 years – 20 years	0	30 (35)
	20 years – 30 years	0	30 (35)
	30 years – 40 years	0	30 (35)
	40 years – 50 years	0	40 (35)
	Variable Interest Rate Borrowing 2020/21:		
	Under 12 months	0	5 (5)
	12 months – 2 years	0	5 (5)
	2 years – 5 years	0	5 (5)
	5 years – 10 years	0	5 (5)
	10 years – 20 years	0	5 (5)
	20 years – 30 years	0	5 (5)
	30 years – 40 years	0	5 (5)
	40 years – 50 years	0	5 (5)
2)	**MAXIMUM PRINCIPAL SUMS INVESTED > 365 DAYS** The Council does not envisage having sums available for investment for periods longer than 365 days.		

6.22 The shift in the upper thresholds between 2019/20 and 2020/21 reflects the continuing favourable rates available and projected, particularly for short term borrowing.

Prudential Code

6.23 Members were previously advised that CIPFA revised both the Prudential Code and Treasury Management Code in December 2017. One of the key requirements of the revised Prudential Code requires Councils to prepare a Capital Strategy. The Capital Strategy 2020/21 – 2024/25 was therefore approved by Members at Council on 26 February 2020. The Capital Strategy sets out the medium and long term context in which Falkirk Council's capital expenditure and investment decisions are made and demonstrates the linkage with the Council's Corporate Asset Management Strategy, Strategic Property Review, the Council's Corporate Plan and the Council's Treasury Management Strategy. It is integrated with the Revenue Budget and aligns with the Medium Term Financial Plan and also links to the Council of the Future agenda and Service Business Plans.

Treasury Management Advisers

6.24 The Council has appointed Link 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

6.25 The Council's currently has a two year contract with Link Asset Services effective from 1 April 2019 to 31 March 2021.

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

Loans Fund

6.27 The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 require disclosures within the Annual Strategy, in relation to Loans Fund Accounting. Details of the disclosures required are as follows:

- Explanation of the Loans Fund
- The policy for determining the repayment for Loans Fund Advances.
- An analysis of the movement in Loans Fund Advances
- A profile of future Loans Fund Repayments
- Separate disclosure for Housing Revenue Account (HRA)
- An explanation for any changes to Loans Fund Repayment profile.

6.28 Every local authority in Scotland as required by The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016, has to operate a loans fund. This is unique to Scotland and is not required in the rest of the UK. The loans fund acts as an internal bank for the Council. The loans fund also provides the long term financing that the Council needs in respect of capital expenditure.

6.29 Under the 2016 regulations, the Council is required to set out its method for the statutory repayment of loans fund advances prior to the start of the financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years. The Council's method is as follows:

- All historic loans fund advances made up to 31 March 2020, will continue to be repaid on the existing repayment basis i.e. annuity method. The repayment term is commensurate with the benefit of the asset to which the advance relates. All loans fund advances made during 2020/21 will also be repaid using the annuity method with a repayment term which is commensurate with the benefits of asset to which the advance relates.

6.30 As required by the 2016 regulations, an analysis of the current loans fund advances together with a profile of future loans fund repayments is detailed in Appendix 5. This information has been separately shown for General Fund, HRA and TIF. Specific details have been provided for 2019/20 and thereafter shown in bands of years. Note that the advances for years 1 – 5 includes 2019/20 slippage/rescheduled projects as well as those included in the approved 2020/21 – 2024/25 Capital Programmes.

6.31 The 2019/20 Treasury Management Strategy advised Members that there was much discussion between COSLA, Scottish Government and Audit Scotland, on the 2016 Regulations in terms of debt incurred pre 1 April 2016. The discussion focused on whether debt incurred pre 1 April 2016 could be re-profiled. It has since been confirmed that the 2016 Regulations does in fact allow Council's to revise the repayment period and/or the repayment amount of historic debt for debt prior to 1 April 2016.

6.32 Consequently a briefing paper on the subject of Loans Fund Accounting was prepared and passed to the Council's external auditors, EY, for their review and comment. This paper advised of the Council's intention to revise the repayment period of outstanding loans fund advances for Education assets, most of which was advanced pre 1 April 2016. This revision aligned the repayment term with the remaining useful life of these assets as confirmed by an independent valuation report. The revised repayment term was effective from 1 April 2019 and as a result the repayment profile of this debt altered from 2019/20 onwards.

6.33 In addition, the paper looked at the interest rate used to calculate the loans fund repayment. The rate currently used is a consolidated loans fund interest rate that is applied consistently to the General Fund debt and Housing Revenue Account (HRA) debt. It does not reflect that in recent years and indeed over the next five years, the level of borrowing has been/will be heavily skewed towards the HRA because of the significant investment programmes that have been approved. It is therefore the intention to review the interest rate applied and consider whether different interest rates should be applied to the General Fund and HRA, to more accurately reflect the actual cost of borrowing undertaken.

6.34 It is expected that the planned changes to Loans Fund Accounting, as detail in the paragraphs above, will make a contribution to closing the Revenue Budget Gap.

Member/Officer Training

6.35 The Investment Regulations provide for increased scrutiny by Members of treasury management issues. It was expected that training sessions for Members would be scheduled during 2020. However, the Covid-19 pandemic has impacted on this. Training sessions will be scheduled as and when required, to ensure that Members are fully aware of their scrutiny role.

6.36 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.

7. Consultation

7.1 There is no requirement to carry out a consultation on this report.

8. Implications

Financial

8.1 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

8.2 There are no resource implications arising from the report recommendations.

Legal

8.3 There are no legal implications arising from the report recommendations.

Risk

8.4 Although interest rate assumptions are considered after discussion with Link, the Council's treasury advisers, there is always the risk that they could change, which could impact on the level of interest payable by the Council. The Council's prudent approach to lending attempts to mitigate the Council's risk.

8.5 In terms of investments, the Council engages with a number of counterparties who meet the minimum rating criteria with at least one of the three credit rating agencies. There is a risk that some counterparties will fall below this minimum criteria which would limit the number of available counterparties to the Council.

8.6 The high level of cash balances that the Council currently has, mainly as a result of the Covid-19 pandemic has meant that counterparty limits can be breached on occasion. The Treasury team are working hard to stop this occurring and engage regularly with brokers and Treasury Advisors to find suitable placements for the funds. However, any breach of counterparty limits carries risk.

Equalities

8.7 An equality and poverty impact assessment is not required.

Sustainability/Environmental Impact

8.8 A sustainable assessment is not required.

9. Conclusion

9.1 The Covid-19 pandemic has fundamentally shifted the global economic outlook and the UK has gone into recession for the first time in 11 years. It is anticipated that there is low risk of interest rates rising substantially over the next 2 to 3 years. However, there remains uncertainty with issues such as the impact of a "second wave" of the pandemic and the ongoing Brexit negotiations capable of delivering a further significant impact on the UK economy. A mid-year review of the treasury management function will be submitted to Members by as required by the Regulations.

Director of Corporate & Housing Services

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Appendices
Appendix 1 – 2019/20 Annual Strategy Review
Appendix 2 - Falkirk Council Permitted Investments, Associated Controls and Limits
Appendix 3 – Credit & Counterparty Policies
Appendix 4 – Third Party Loans
Appendix 5 – Loans Fund Advances & Repayments

List of Background Papers
Link Asset Services Interest Rate Forecast

APPENDIX 1

2019/20 ANNUAL TREASURY REVIEW

Borrowing Strategy 2019/20 – Outcome

1. The Council's borrowing requirement for 2019/20 was estimated as part of the three year Capital Programmes for both General Fund & HRA. Assumptions on 2019/20 borrowing were made in January 2019, taking in to account the anticipated approved capital programmes (not approved until March 2019), the estimated slippage for 2018/19 and any projects which may be rescheduled to 2019/20. Given that the capital projects are part of a three year plan, there will be movement in spend across the years. Consequently because of the timing of spend, borrowing will also move across the years to match the spend.

2. The 2019/20 Interim Strategy report to the December Executive advised Members that the revised borrowing requirement was c£53.4m. This figure was revised further to £55.6m in the Capital Programmes Update 2019/20 reported to the Executive on 18 February 2020. The actual borrowing requirement against this revised forecast is as detailed below:

	2019/20 Revised Estimate £'m	**2019/20 Actual £'m**	**2019/20 Variance £'m**
Capital Programme (net of receipts and including TIF)	35.6	34.5	(1.1)
Service Payments	(12.5)	(12.3)	0.2
Replacement of Long Term Loans Maturing	2.5	2.5	-
Replacement of Short Term Loans Maturing	30.0	30.0	-
Total Borrowing Requirement	**55.6**	**54.7**	**(0.9)**

3. The borrowing requirement for Capital Programme purposes, is £1.1m less than reported to the February Executive. This reduction is analysed below:

		2019/20 Actual £'m
February Executive - Forecast borrowing required for Capital Programme (net of receipts & including TIF)		35.6
Adjustments:		
Slippage General Fund Capital Programme	(2.6)	
Slippage in Housing Capital Programme	(0.1)	
Reduction in Housing Revenue Contribution	1.3	
Miscellaneous Additional Housing	(0.5)	
Borrowing for TIF Capital Programme	0.8	
		(1.1)

Actual Borrowing Requirement for Capital Programme (net of receipts & including TIF)	**34.5**

4. Slippage on the General Capital Programme has increased by a further c£2.6m. In the last month of the financial year, projects began to see the impact of Covid-19 through contract delays in negotiations with contractors. The pending review of the new HQ/Arts Centre and the Strategic Property Review (SPR) also resulted in reduced borrowing in the year.

5. Whilst there was a small amount of slippage in the Housing Capital Programme, borrowing for housing investment increased due to less than anticipated revenue contributions from the Housing Revenue Account of c£1.3m. Borrowing for housing investment therefore increased by £0.7m overall after taking account of small movements in other grants such as buy backs, new builds and CHP which offset the drop in revenue contributions.

6. The February report did not anticipate any borrowing in respect of TIF. However, borrowing of £0.8m was required because of the increased spend on the Westfield Roundabout project and Falkirk Council's share of the Low Carbon Vehicle Hub project which was nearly completed in the last quarter of the financial year.

7. The slippage in the capital programmes is rolled forward to the next year along with the associated borrowing. However, as a result of the Covid-19 pandemic, it is likely that a significant proportion of the planned capital investment will be rescheduled into future years and that borrowing will be lower than anticipated. The anticipated borrowing requirement for 2020/21 will be reported to Members in the 2020/21 Treasury Management Strategy in September.

8. Borrowing undertaken during 2019/20 is as detailed below:

	Short Term £'m	**Long Term £'m**	**Total £'m**
Borrowing at 01/04/19	**30.0**	**230.6**	**260.6**
Maturing in Year	(30.0)	(2.5)	(32.5)
Borrowing in Year	40.0	10.0	50.0
Borrowing at 31/03/20	**40.0**	**238.1**	**278.1**

9. As detailed in the table at paragraph 4.2.2, the actual borrowing requirement for 2019/20 was £54.7m, however £50m of borrowing was undertaken as shown in the table above.

10. The Strategy noted that the Council has £13m of Market Loans which could be repaid during the year should any of the lenders invoke a rate change, albeit the risk of this was assessed as low. As anticipated these rate changes were not made and the Market Loans remain on existing terms. The Market Loans are held with Dexia Credit (£8m) and Just Retirement Ltd; (£5m).

11. There was no debt rescheduling activity carried out during the year.

Borrowing Strategy 2019/20 – Outcome

12. The Council held £35.6m of investments as at 31 March 2020 of which, £23.5m was available on instant access from money market funds, £2.1m was available on instance access from two UK Banks and £10m of deposits was placed with other Local Authorities. This temporary level of investments will be drawn down over the coming months to meet future Council commitments such as maturing short term debt, salary costs, supplier invoices etc.

Treasury Management Prudential Indicators 2019/20 – Outcome

Interest Rate Exposure

13. 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.

	2019/20	
	UPPER LIMIT	**POSITION (31/03/20)**
Fixed Interest Rates	100%	100%
Variable Interest Rates	40%	0%

Maturity Structure on Fixed Interest Rate Borrowing 2019/20

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

	Lower %	**Upper %**	**Position (31/03/20) %**
Under 12 months	0	20	15.8
12 months – 2 years	0	20	0.7
2 years – 5 years	0	30	9.1
5 years – 10 years	0	30	24.9
10 years – 20 years	0	40	8.4
20 years – 30 years	0	40	9.4
30 years – 40 years	0	40	17.7
40 years – 50 years	0	40	14.0
			100.0%

Principal Sum Invested > 365 Days

15. The Council does not place investments for periods longer than 364 days.

APPENDIX 2

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 there is no risk to value. Deposits will be for a fixed term and liquidity may therefore 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. Non local authority deposits will follow the approved credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. .	£8m 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 there is no risk to value. Deposits can be between overnight and 6 months and liquidity may therefore present a problem as deposits can only be broken with the agreement of the counterparty and penalties can apply.	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) - CNAV **(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.	£8m per fund and on Call

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
(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 max and on Call subject to individual institution criteria
(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.	Banks - £8m and maximum 1 year subject to individual institution criteria for banks. Building Societies - £5m and maximum 1 year subject to individual institution criteria for building societies
(f) Investment Properties - The Council does not currently hold any investment properties, but this may change with the progression of the Falkirk Gateway Development	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 at the moment, but may be revised in the future

	Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
(g)	Loans to third parties, including soft loans and loans to Registered Social Landlords	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
(i)	Shareholdings in a local authority Company. The Council has an investment of £3.721m as at 31/03/19 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.	£5m
(j)	Non-local authority shareholdings: The Council has an investment of £0.5m in thinkWhere, an independent company in Geographical Information Systems. 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	These are non-service investments which may exhibit market risk; be only considered for longer term investments and will likely be liquid.	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.	£0.5m

The Monitoring of Investment Counterparties – The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Link 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 3

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.

INSTITUTIONS UK BANKS	**LIMIT**	**MAX PERIOD**
Royal Bank of Scotland or Nat West *	£8m	1 year
Santander UK	£8m	1 year
Barclays Bank	£8m	1 year
HSBC	£8m	1 year
Standard Chartered	£8m	1 year
Sumitomo Mitsui Banking Corporation Europe	£8m	1 year
Lloyds Bank or Bank of Scotland *	£8m	1 year
Goldman Sachs International Bank	£8m	1 year

A maximum combined monetary limit of £8m in Royal Bank of Scotland/Nat West and £8m in Lloyds Bank/ Bank of Scotland

BUILDING SOCIETIES		
Nationwide	£5m	1 year
Coventry	£5m	1 year
Leeds	£5m	6 months
Yorkshire	£5m	6 months
Skipton	£5m	6 months
UK LOCAL AUTHORITIES	£8m per LA	1 year
UK GOVERNMENT	Unlimited	6 months
MONEY MARKET FUNDS	£8m per fund	Call

APPENDIX 4

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) 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.	45	952,086
(b) 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.	68	23,165
(c) 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

APPENDIX 5

LOANS FUND ADVANCES & REPAYMENTS

TOTAL		Years	Years	Years	Years	Years	Years	Years	Years	Years
	2019/20	1-5	6-10	11-15	16-20	21-30	31-40	41-50	51-60	61-65
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Opening Balance	**292.77**	**307.49**	**661.09**	**543.35**	**415.11**	**307.23**	**147.52**	**72.28**	**35.87**	**7.09**
Advances	34.46	456.78	-	-	-	-	-	-	-	-
Repayments	(19.75)	(103.18)	(117.74)	(128.24)	(107.88)	(159.71)	(75.24)	(36.41)	(28.78)	(7.09)
Closing Balance	**307.48**	**661.09**	**543.35**	**415.11**	**307.23**	**147.52**	**72.28**	**35.87**	**7.09**	**-**

GENERAL FUND		Years	Years	Years	Years	Years	Years	Years	Years	Years
	2019/20	1-5	6-10	11-15	16-20	21-30	31-40	41-50	51-60	61-65
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Opening Balance	**140.74**	**135.78**	**244.16**	**196.64**	**149.99**	**109.17**	**46.72**	**18.80**	**6.20**	**-**
Advances	4.85	146.52	-	-	-	-	-	-	-	-
Repayments	(9.81)	(38.14)	(47.52)	(46.65)	(40.82)	(62.45)	(27.92)	(12.60)	(6.2)	-
Closing Balance	**135.78**	**244.16**	**196.64**	**149.99**	**109.17**	**46.72**	**18.80**	**6.20**	**-**	**-**

HRA		Years	Years	Years	Years	Years	Years	Years	Years	Years
	2019/20	1-5	6-10	11-15	16-20	21-30	31-40	41-50	51-60	61-65
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Opening Balance	**152.03**	**171.17**	**384.73**	**325.03**	**256.02**	**198.04**	**100.78**	**53.46**	**29.65**	**7.09**
Advances	29.07	274.23	-	-	-	-	-	-	-	-
Repayments	(9.93)	(60.67)	(59.70)	(69.01)	(57.98)	(97.26)	(47.32)	(23.81)	(22.56)	(7.09)
Closing Balance	**171.17**	**384.73**	**325.03**	**256.02**	**198.04**	**100.78**	**53.46**	**29.65**	**7.09**	**-**

TIF		Years	Years	Years	Years	Years	Years	Years	Years	Years
	2019/20	1-5	6-10	11-15	16-20	21-30	31-40	41-50	51-60	61-65
	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m	£'m
Opening Balance	**0.00**	**0.55**	**32.19**	**21.66**	**9.08**	**-**	**-**	**-**	**-**	**-**
Advances	0.55	36.01	-	-	-	-	-	-	-	-
Repayments	-	(4.37)	(10.53)	(12.58)	(9.08)	-	-	-	-	-
Closing Balance	**0.55**	**32.19**	**21.66**	**9.08**	**-**	**-**	**-**	**-**	**-**	**-**