Agenda Item 13

Treasury Management – Interim Review 2021/22

Falkirk Council

Title:	**Treasury Management – Interim Review 2021/22**
Meeting:	**Executive**
Date:	**19 October 2021**
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.

1.2 The Treasury Management function covers two broad areas:

- Managing the day to day cashflow of the Council by investing surplus monies in secure counterparties and/or borrowing to deal with the timing of cashflows, and

- Funding the Council's Capital Programme, ensuring borrowing needs are met through either long term or short term loans or by using cash surpluses.

1.3 This report sets out a summary of the factors affecting both these areas, as well as a position statement on the Council's Treasury Management activities at the half year point.

2. Recommendations

2.1 The Executive is asked to:

(1) Note the progress of the Council's Treasury Management Strategy for 2021/22.

(2) Note the reduction in the long term borrowing requirement for 2021/22.

(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 2021/22 was considered by the Executive on 13 April 2021.

3.2 The purpose of the interim review is to provide:

- An economic update of the first half of 2021/22
- A review of the Council's borrowing activity
- A review of the Council's investment activity
- An update on the Council's capital expenditure and prudential indicators
- A review of compliance with Treasury and Prudential limits.

3.3 There will be a final annual review report to the Executive in June 2022, following the financial year end.

4. Considerations

4.1 Economic and Interest Rate Outlook

4.1.1 The Bank of England Monetary Policy Committee (MPC) met in September 2021 and voted unanimously to leave the Bank Rate unchanged at 0.10%. There was a shift at this meeting however in that there was a clear indication that interest rate increases are now on the horizon, although no indication was given as to when the Bank Rate may be increased. Link Asset Services have therefore brought forward their projection on interest rate rises from the second quarter of 2023 to the second quarter of 2022.

4.1.2 Inflation is expected to grow to over 4% during 2021. This would ordinarily be a trigger for raising the interest rate. High energy prices, combined with high consumer spending of savings built up during lockdown, has led to a surge in inflation. However, the current debate is whether the inflationary increases are temporary or will have an ongoing impact. It is possible that labour shortages will push up wage growth and therefore inflation may stay higher for longer.

4.1.3 MPC forecasts show inflation at c2% in two to three years time. The MPC policy is to see inflation at a sustainable 2% level. Link Asset Services, the Council's Treasury Advisors, forecast the first increase in the Bank Rate in quarter one of 2023/24.

4.1.4 There has been a lot of volatility in gilt yields (essentially Government bonds) in 2021. This is important because PWLB fixed interest borrowing rates are based on gilt yields and these yields can be affected by both national and global markets. The current forecast from Link Asset Services shows a steady rise of PWLB interest rates over the next three years, albeit long term rates may continue to be volatile.

4.1.5 The latest interest rate forecast as supplied by Link Asset Services, 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
2021/22	0.10	0.10	0.20	1.20	1.60	2.00	1.80
2022/23	0.25	0.10	0.25	1.30	1.80	2.30	2.10
2023/24	0.50	0.30	0.55	1.45	1.95	2.40	2.20

4.2 Borrowing Strategy

4.2.1 The borrowing function within Treasury considers:

- The timing of cashflows
- The capital expenditure forecasts
- How capital expenditure will be financed
- The impact of this on the need to borrow and on prudential indicators
- Ensuring this remains within the limits in place for borrowing activity

4.2.2 The 2021/22 Treasury Strategy detailed the estimated long term borrowing requirement for 2021/22. This figure takes into account estimated borrowing for Capital Programme purposes, plus TIF borrowing and replacement of any short term or long term loans. This figure is reduced by the service repayment of debt. As such it will inevitably change as the year progresses.

4.2.3 The Capital Programme report, also on this agenda provides a forecast for capital expenditure. The forecast position, as projected by Services, is summarised below:

	Total Capital Spend Forecast £m	To be met from Borrowing £m
General Fund	69.374	30.067
Housing Revenue Account (HRA)	45.096	39.725
Total	**114.470**	**69.792**

4.2.4 The Capital Programme update report however notes that there are concerns that the level of spend projected for 2021/22 is optimistic and well beyond the level of spend achieved in previous years. As a result, the projected borrowing required for the Capital Programme has been reduced to £53.8m. This will continue to be closely monitored and updated as required.

4.2.5 Details of the budgeted long term borrowing requirement and updated forecast borrowing requirement are shown below:

	2021/22 August Projection £'m	2021/22 Revised Estimate £'m	2021/22 Movement £'m
Capital Programmes (net of receipts)	63.3	53.8	(9.5)
Service Payments	(21.7)	(21.7)	-
Long Term Loans Maturing In Year	2.0	2.0	-
Short Term Loans Maturing In Year	41.0	36.0	(5.0)
Total Longer Term Borrowing Requirement	**84.6**	**70.1**	**(14.5)**

4.2.6 The reduction in borrowing for the capital programme is primarily due to a projected slippage in the General Fund and Housing Capital Programmes. The reduction in replacement of short term borrowing is because some of the borrowing will not now be repaid until early 2022/23.

4.2.7 Part of the treasury function is to determine the best options for borrowing for the Capital Programme. To date, in 2021/22, the Council has had a surplus of cash, mainly as a result of Government funding. As a result, no borrowing has been undertaken to date, albeit forward borrowing of £10m, on a short term basis, has been arranged for November 2021.

4.2.8 The Council is expected to move to a borrowing position in December 2021. As always, consideration will be given to the range of borrowing options available to the Council. The decision to borrow on a long or short term basis will be based on prevailing and projected interest rates available and the balance of borrowing periods across the loans portfolio. No long term borrowing has been undertaken since August 2019. However, with the expected rise in PWLB rates, it is likely that some long term borrowing will be carried out towards the end of the calendar year. This will help to manage interest rate risk.

4.2.9 The Strategy Report noted that the Council has four Market Loans valued at £26m in totality. There is 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.

4.2.10 The current climate of low interest rates means that there are no benefits in carrying out debt rescheduling and therefore no debt rescheduling has been undertaken in 2021/22. It is considered unlikely that any debt rescheduling will be undertaken in the short term.

4.3 Investment Strategy

4.3.1 Members are reminded that the primary objectives of the Council's investment strategy remain:

- Security of capital
- Liquidity
- Yield

4.3.2 The most important of these is security – i.e. ensuring any funds we invest are returned.

4.3.3 As noted in the money rates in the table at paragraph 4.1.5, expected yields on investments are very low as interest rates are barely above zero, reflecting the low Bank of England base rate. As a result, investment yields are expected to remain low for the foreseeable future. The chances of negative interest rates have reduced as the economy has reopened and the Council's money market funds are still offering marginally positive returns.

4.3.4 The Council held £80.88m of investments as at 17 September 2021. Details are as follows:

Institution	Investment £'m	Maturity
UK Banks	23.98	Instant Access
UK Bank	5.00	35 day Notice Account
Money Market Funds	35.90	Instant Access
Building Societies	16.00	1 – 3 month deposits
Local Authorities	-	
Total Investments	**80.88**	

4.3.5 The high level of cash balances, as shown in the table above, led to previous recommendations to increase investment limits, under the advice of the Council's Treasury Management Advisors, and to open the Handelsbanken accounts. These changes were put in place and have made it easier to manage such large cash balances. There have been no breaches of the limits set in 2021/22.

4.3.6 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. These are currently sufficient to allow officers to manage the Council's investments and no changes are proposed.

4.4 Treasury Management Prudential Indicators

4.4.1 Financing of the Capital Programme is one of the primary functions of Treasury Management 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 as at 30 September 2021, are noted below:

	Position	2021/22	2021/22
1) MATURITY STRUCTURE	**30/09/21**	**LOWER**	**UPPER**
	%	%	%
Fixed Interest Rate Borrowing 2021/22:			
Under 12 months	12	0	35
12 months – 2 years	6	0	20
2 years – 5 years	8	0	20
5 years – 10 years	23	0	30
10 years – 20 years	9	0	30
20 years – 30 years	11	0	30
30 years – 40 years	21	0	30
40 years – 50 years	10	0	40
Variable Interest Rate Borrowing 2021/22:			
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 has a two year contract with Link Asset Services effective from 1 April 2021 to 31 March 2023. 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. A training session on Treasury Management was held on 17 August 2021 and was well attended. Further training sessions will be arranged as necessary to ensure that Members are fully aware of their scrutiny role for Treasury Management activities. In the meantime, officers will continue to provide support and advice as required.

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 31 July 2021 (these figures are provided by an external source and this is the latest data available). The data includes information for 31 out of 32 Scottish Authorities and Falkirk Council is positioned 17 out of 31.

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 The Council has ready access to cash through borrowing in the money market and the PWLB. The risks associated with this are the interest rates that the Council will have to pay to access this money. There are a number of risks which could impact on PWLB rates moving forward, arising from both national and global issues. However, the forecast is that rates will remain relatively low for the short to medium term.

6.5 Although interest rate assumptions are considered after discussion with 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 Treasury Management aims to mitigate the Council's risk.

Equalities

6.6 An equality and poverty impact assessment is not required.

Sustainability/Environmental Impact

6.7 A sustainable assessment is not required.

7. Conclusion

7.1 As expected, there remains a significant amount of uncertainty in the economy and that impacts on prevailing interest rates. In terms of borrowing, the short term interest rates continue to remain low relative to the long term PWLB rates. For investments, it is highly unlikely that significant yields will be achieved and as always, security of funds remains the driving principal.

7.2 Given the borrowing requirement the Council must remain vigilant to the factors affecting the movement in rates and work closely with the treasury advisers to ensure that any borrowing is undertaken at the most advantageous rate possible.

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Appendices
Appendix 1 – Credit and Counterparty Policies
Appendix 2 – Investment Levels at 31 July 2021

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

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
  Money Market Funds

- 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 £10 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.

UK BANKS INSTITUTIONS	**LIMIT**	**MAX PERIOD**
Royal Bank of Scotland *		
Royal Bank of Scotland	£10m	1 year
Nat West	£10m	1 year
* A maximum combined monetary limit of	£10m	
Santander UK	£10m	1 year
Barclays Bank	£10m	1 year
HSBC	£10m	1 year
Standard Chartered	£10m	1 year
Sumitomo Mitsui Banking Corporation Europe	£10m	1 year
Lloyds Banking Group *		
Lloyds Bank	£10m	1 year
Bank of Scotland	£10m	1 year
* A maximum combined monetary limit of	£10m	
Goldman Sachs International Bank	£10m	1 year
Handelsbanken	£10m	1 year
BUILDING SOCIETIES		
Nationwide	£7m	1 year
Coventry	£7m	1 year
Leeds	£7m	6 months
Yorkshire	£7m	6 months
Skipton	£7m	6 months
UK LOCAL AUTHORITIES	£10m per LA	1 year
UK GOVERNMENT	Unlimited	6 months
MONEY MARKET FUNDS	£10m per fund	Call

Summary of Scottish Local Authority Total Investments Outstanding as at 31 July 2021

By Council	Total Sum Investment
Misc 1	£663,195,879.14
Misc 2	£241,395,000.00
Misc 3	£233,760,000.00
Misc 9	£186,508,092.43
Misc 4	£158,665,000.00
Misc 28	£133,993,087.01
Misc 11	£123,959,000.00
Misc 27	£109,744,772.34
Misc 8	£105,800,000.00
Misc 14	£79,801,728.50
Misc 5	£74,360,000.00
Misc 22	£71,000,000.00
Misc 12	£66,753,000.00
Misc 7	£66,250,000.00
Misc 10	£61,732,319.00
Misc 17	£60,477,705.00
Misc 18	£54,061,827.44
Misc 29	£47,345,745.98
Misc 13	£46,899,873.64
Misc 16	£40,283,375.32
Misc 21	£35,585,617.68
Misc 15	£31,422,130.29
Misc 6	£30,970,595.27
Misc 20	£30,950,000.00
Misc 31	£27,000,000.00
Misc 30	£23,352,320.64
Misc 25	£20,365,000.00
Misc 23	£12,351,516.13
Misc 24	£11,500,000.00
Misc 19	£6,100,917.00
Misc 32	£4,200,000.00
Misc 26	£0.00
	£2,859,784,502.81