

FALKIRK COUNCIL

Subject: TREASURY MANAGEMENT – INTERIM REVIEW 2010/11
Meeting: FALKIRK COUNCIL
Date: 8 December 2010
Author: DIRECTOR OF FINANCE

1. INTRODUCTION

- 1.1 As part of the new regulatory framework for Treasury Management, reporting requirements make provision for a mid-year review of the Treasury Management function to be considered by full Council.

2. ECONOMIC AND INTEREST RATE OUTLOOK

- 2.1 At the time the Treasury Management Strategy for 2010/11 was approved by Council in April, it was noted that accommodative monetary policies adopted by central banks had allowed the global economy to emerge from recession. However, there was concern that any early reversal of loose monetary policies and government support packages might trigger a setback to growth prospects.
- 2.2 In the Strategy Report, there was an expectation that Bank Rate would remain at 0.5%, at least until the end of the financial year, in spite of above target inflation and early evidence of economic recovery. It may well be the case, however, that the record low rate will extend well into 2011 given the danger of a double-dip recession, the ongoing debt crisis in the eurozone and as a counter to the severe budget cuts anticipated over the coming months and years. As such, it is thought unlikely that Bank Rate will rise much above 1.5% by March 2012.
- 2.3 The Strategy Report indicated that the prospects for long-term interest rates were a lot less favourable and that rates would be on a rising trend towards 5% as the year progresses. An announcement by the Chancellor, as part of his October Spending Review, has resulted in an instruction to the Public Works Loan Board (PWLB)(Circular No. 147) to:
- Increase the average interest rate on all new loans to an average of 1% above Government's cost of borrowing with immediate effect.
 - Publish at the end of each month a list of individual loans it has made to local authorities including the type, amount, term and rate applying to each loan.

As a consequence, it is forecast that long-term interest rates are unlikely to rise much above 3.5% for shorter-dated periods of up to 5 years but for extended periods in excess of 20 years interest rates have risen, and expected to remain, above 5%.

3. BORROWING STRATEGY

- 3.1 The Council's longer term borrowing requirement is set out below:

	2010/11 Original Estimate £m	2010/11 Revised Estimate £m
Capital Programme (net of receipts)	22.5	24.0
Service Payments	(16.8)	(16.9)
Longer Term Loans maturing in year	<u>0.5</u>	<u>0.5</u>
Total Longer Term Borrowing Requirement	<u>6.2</u>	<u>7.6</u>

The increased borrowing requirement reflects in particular an adjustment to the level of carried forward expenditure.

- 3.2 In the Strategy Report, it was noted that the Council's longer term borrowing requirement for the year would be relatively minor. With this in mind, it was planned to concentrate funding linked to short term rates and/or longer term fixed rates for periods of up to 5 years thereby taking advantage of the significant interest rate differential available from these periods. The report also highlighted the potential for four Market Loans, up to a value of £26m, to be repaid during the year should any of the lenders invoke a rate change clause as per their contracts.
- 3.3 Given the latest outlook for the future direction of interest rates, as outlined in Section 2, it remains the case that funding of the longer term borrowing requirement will continue to be linked to short term rates and/or fixed rate periods of up to 5 years. The potential for repayment of any of the Market Loans identified in para 3.2 still remains low given the current structure of long-term interest rates.
- 3.4 There has been no longer term borrowing in the year to date. Also, debt rescheduling activities remain on hold given the current structure of long-term interest rates. This position is likely to persist until such time as the premature repayment rates for PWLB loans rise from their current levels.
- 3.5 The Strategy Report also highlighted significant cashflow implications on 31 March and 1 April when aggregate payments of £24m are due under the terms of the Council's NPDO projects to provide four new high schools. Any decision on the most appropriate form of borrowing will be deferred towards the end of the financial year having regard to the prevailing interest rates and cashflow at that time.

4. INVESTMENT STRATEGY

- 4.1 The primary objectives of the Council's investment strategy remains 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.

- 4.2 The Council held £9.1m of investments, available on instant access, in two UK Banks at 31 October 2010 of which circa £5m relates to Pension Fund surplus monies. It is worth noting that, consistent with new pensions legislation, arrangements are being made to open a bank account for the Pension Fund to which all relevant transactions will be directed. The deadline date for implementation is 31 March 2011 and this will have the effect of reducing the amount of Council funds available for investment.
- 4.3 There has been no change to the counterparty selection criteria nor the list of eligible counterparties as advised in the Strategy Report to Council in April.

5. TREASURY MANAGEMENT PRUDENTIAL INDICATORS

- 5.1 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.
- 5.2 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.

(i) **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.

	<u>Limit</u>	<u>2010/11</u> <u>Position</u> <u>(01/10/10)</u>
Fixed interest rates	100%	98%
Variable interest rates	40%	2%

(ii) **Maturity Structure on Borrowing**

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

	<u>Position</u> <u>(01/10/10)</u>	<u>Lower</u>	<u>Upper</u>
	%	%	%
Under 12 months	5	0	25
12 months – 2 years	0	0	25
2 years – 5 years	14	0	25
5 years – 10 years	2	0	75
10 years – 20 years	15	0	75
20 years – 30 years	12	0	75
30 years – 40 years	21	0	75
40 years – 50 years	31	0	75

(iii) **Principal Sum Invested > 364 Days**

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

6. TREASURY MANAGEMENT ADVISERS

- 6.1 The Strategy Report confirmed the appointment and services provided by Butlers as the Council's adviser on Treasury Management.
- 6.2 A letter dated 4 October has been received from Butlers advising that, following a strategic review by its parent company ICAP plc, a decision has been made to transfer the business to Sector Treasury Services with effect from 25 October. The letter advises that the intention is for the majority of Butlers staff to move to Sector thereby ensuring no disruption to the services provided to this Council.
- 6.3 Along with Butlers, Sector Treasury Services have been the key players in the provision of treasury consultancy to the local authority market. Officers will monitor closely the transition of the business to Sector Treasury Services.

7. MEMBER TRAINING

- 7.1 The new Investment Regulations provide for increased scrutiny by Members of treasury management issues. Council has remitted to the Director of Finance to arrange training for Members relevant to their needs and responsibilities. To this end, it is anticipated that training will be made available towards the end of the financial year.

8. CONCLUSION

- 8.1 The potential for further quantitative easing and the level of inflation in the UK will be two of the key drivers which determine the future direction of long-term interest rates. As such, the timing of any interest rate rises and monitoring the significant gap which currently exists between short and longer term rates remain the key focus for the Treasury Section at this time.

9. RECOMMENDATION

- 9.1 That Council note the progress of the Council's Treasury Management Strategy for 2010/11.

Director of Finance

Date: 15 October 2010

Contact Officer: Alastair Redpath

LIST OF BACKGROUND PAPERS

1. Treasury Management Strategy 2010/11 submitted to Council on 28 April 2010.
2. Treasury Management Advisers – Letter from Butlers dated 4 October 2010.
3. Public Works Loan Board – Circular No. 147 dated 20 October 2010.

Any person wishing to inspect the background papers listed above should telephone Falkirk 01324 506338 and ask for Alastair Redpath.