AGENDA ITEM 10

FALKIRK COUNCIL

Subject:	**TREASURY MANAGEMENT ANNUAL REVIEW 2012/13**
Meeting:	**FALKIRK COUNCIL**
Date:	**26 June 2013**
Author:	**CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 The Council is required by regulations issued under the Local Government Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2012/13. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 During 2012/13 the reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 14/03/2012)
- a mid-year treasury update report (Council 05/12/2012)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

1.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is therefore important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policy and strategy previously approved by members.

2. ECONOMIC AND INTEREST RATE REVIEW

2.1 The Treasury Management Strategy 2012/13, approved by Council in March 2012, noted that the outlook for the global economy remained uncertain with the UK economy struggling to recover. The original expectation was that the bank rate would start gently rising from quarter 4 of 2014. However, economic growth in the UK was disappointing during the year due to the UK austerity programme, weak consumer confidence and spending, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market – the European Union (EU). The bank rate is now not expected to rise until March 2015.

2.2 There had been previous warnings from two credit rating agencies that the UK could lose its AAA credit rating. Moody's followed up this warning by downgrading the rating to AA+ in February 2013 and Fitch then placed their rating on negative watch after the budget statement in March. Key to retaining the AAA rating from Fitch and S&P will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within a reasonable timeframe. At this time, the UK Coalition Government has maintained a tight fiscal policy stance.

2.3 Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £50bn in July to a total of £375bn. The bank rate ended the year unchanged at 0.5%. CPI inflation fell from 3% at the start of the year to end at 2.8% in March, with a forecast fall back to below 2% pushed back to quarter 1 of 2016.

2.4 The EU sovereign debt crisis was an ongoing issue during the year with first Greece and then Cyprus experiencing crises which were met with bailouts after difficult and fraught negotiations. This resulted in fluctuations in safe haven flows into and out of UK gilts and therefore oscillating gilt yields. This in turn meant a volatile year for PWLB rates.

2.5 The investment environment remains challenging with low investment returns and continuing heightened levels of counterparty risk.

3. BORROWING STRATEGY 2012/13 – OUTCOME

3.1 The Council's longer term borrowing requirement for the year is set out below:

	2012/13 Original Estimate £m	**2012/13 November Estimate £m**	**2012/13 Actual £m**
Capital Programme (net of receipts)	40.5	41.8	25.9
Service Payments	(18.1)	(18.4)	(18.7)
Longer Term Loans maturing in year	20.6	20.6	20.6
Total Longer Term Borrowing Requirement	43.0	44.0	27.8

3.2 The reduction in borrowing was factored into the budget approved by Members in February 2013. This reduction relates to slippage in both the General and Housing Capital Programmes and utilisation of reserves. The expenditure and related borrowing will now fall into the current financial year.

3.3 The Strategy noted that whilst short term rates were likely to be more favourable, all borrowing periods would be considered. The longer term loans noted above matured in December 2012 when PWLB rates were low. Consequently, £20m of loans were therefore replaced with PWLB borrowing (10 and 11 year maturities).

3.4 As noted in previous Strategy updates, the long term borrowing requirement over the last three years has been mainly funded from internal balances and we have therefore been in an under-borrowed position. In 2012/13, internal balances were no longer sufficient to sustain this position. As a result, borrowing of £22m was required. This borrowing has been concluded on a short term basis for periods of up to 3 months. It is anticipated that PWLB rates will fall again and at that point, longer term borrowing may be carried out. This borrowing remains within the prudential indicator limits approved by Members.

3.5 The Strategy noted that the Council has £26m of Market Loans which could be repaid during the year should any of the lenders invoke a rate change. However, these rate changes were not made and the Market Loans remain on existing terms.

3.6 There was no debt rescheduling activity during the year.

4. INVESTMENT STRATEGY

4.1 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 those counterparty risks.

4.2 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. The Council has during the year breached the limit of £8m with the Clydesdale Bank. This is due to difficulties in the selection of investment counterparties noted in section 2.5 of this report.

4.3 There was no change to the counterparty selection criteria nor the list of eligible counterparties as advised in the Strategy Report to Council in March 2012. However, in the light of the position outlined at 4.2, action is now being taken to utilise AAA rated Money Market Funds as allowed under the approved counterparty list.

4.4 The Council held £10.7m of investments, available on instant access in three UK Banks at 31 March 2013.

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 indictors. 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.

5.2 The three treasury indicators are set out at Appendix 1 and show comparison with the Council's actual exposure as at 31 March 2013. This confirms that the Council's treasury operations were operating well within the set parameters during financial year 2012/13.

6. CONCLUSION

6.1 Treasury objectives consistent with the Strategy have been met in terms of both borrowing and investment. The legacy of the financial crisis means that market conditions remain challenging.

7. RECOMMENDATION

7.1 Council notes the contents of the Annual Review 2012/13.

Chief Finance Officer

Date: 11 June 2013

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<u>LIST OF BACKGROUND PAPERS</u>

NIL

APPENDIX 1

TREASURY MANAGEMENT PRUDENTIAL INDICATORS

1. INTEREST RATE EXPOSURE

These limits set the maximum for fixed and variable interest rates based on the debt position net of investments and seeks to control the level of debt exposed to short term movements in interest rates.

	2012/13	
	UPPER LIMIT	**POSITION (31/03/13)**
Fixed Interest Rates	100%	99%
Variable Interest Rates	40%	1%

2. MATURITY STRUCTURE ON FIXED INTEREST RATE BORROWING 2012/13

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

	Lower %	**Upper** %	**Position (31/03/13)** %
Under 12 months	0	25	0
12 months – 2 years	0	25	19
2 years – 5 years	0	50	0
5 years – 10 years	0	75	6
10 years – 20 years	0	75	21
20 years – 30 years	0	75	10
30 years – 40 years	0	75	21
40 years – 50 years	0	75	23
			100%

3. PRINCPAL SUM INVESTED > 364 DAYS

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