CYNGOR SIR *POWYS* COUNTY COUNCIL.

FULL COUNCIL

5th March 2014

REPORT AUTHOR:	**County Councillor Dai Davies** **Portfolio Holder for Finance**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY STATEMENT & ANNUAL INVESTMENT STRATEGY**
REPORT FOR:	**Decision**

Summary

1. Introduction

1.1 This Treasury Management Strategy Statement and Annual Investment Strategy report is a requirement of the CIPFA Code of Practice on Treasury Management and a requirement under the Local Government Act 2003. It has regard to the 2010 Guidance on Local Government Investments issued by the Welsh Assembly Government which requires the Treasury Management Strategy Statement and Annual Investment to be approved by Full Council.

1.2 The report details the expected activities of the Treasury function in the forthcoming financial year 2014/15, in respect of borrowing and investments.

1.3 The report requires an appropriate strategy for borrowing and investing for the financial year 2014/15.

1.4 The Strategy will be monitored throughout the year and will be revised for approval by Full Council if there are any significant changes necessary due to such things as the following:-

- updates in legislation/guidance
- changes in the economy/financial outlook which may effect the Authority's Strategy
- changes in the financial position of the Authority.

2. Revised CIPFA Code of Practice on Treasury Management 2011

2.1 In 2009 CIPFA revised the Code of Practice on Treasury Management, the Cross Sectoral Guidance Notes and the template for the Treasury Management Policy Statement (see Appendix A). In December 2011 CIPFA issued a further revised edition of the Code of Practice. It is a requirement of the Code that this Authority should formally adopt the key principles of the Code and this was done by Cabinet on 14th February 2012 (see Appendix B).

2.2 The Code emphasises a number of key areas including the following:-

i. All authorities must formally adopt the revised Code
ii. The strategy report will affirm that the effective management and control of risk are prime objectives of the Authority's treasury management activities
iii. The Authority's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out
iv. Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation
v. Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support
vi. Authorities need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits
vii. Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities
viii. The main annual treasury management reports must be approved by Cabinet/Full Council
ix. There needs to be, at a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved
x. Each Authority must delegate the role of scrutiny of treasury management strategy and policies to a specific named body
xi. Treasury management performance and policy setting should be subject to scrutiny prior to implementation
xii. Members should be provided with access to relevant training
xiii. Those charged with governance are also personally responsible for ensuring they have the necessary skills and training
xiv. Responsibility for treasury management activities must be clearly defined within the organisation
xv. Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Authority.

2.3 The Authority will adopt the following reporting arrangements in accordance with the revised Code of Practice:-

Report/Document	**Committee**	**Frequency**
Treasury Management Policy Statement and Practices	Audit Committee followed by Cabinet	When changes require
Treasury Management Strategy and Annual Investment Strategy	Full Council	Annually before the start of financial year
Treasury Management Quarterly Reports	Audit Committee followed by Cabinet	Quarterly
Treasury Management Annual Review	Audit Committee followed by Cabinet	Annually by 30th Sept after the end of financial year

3. Economic Background and Forecasts

3.1 The economic background is attached at Appendix C. The information contained therein is considered in the formulation of this Treasury Management Strategy Statement and Investment Strategy.

3.2 The most recent forecast of interest rates for 2014/15 by the Authority's advisor is:

	Mar14	Jun14	Sep14	Dec14	Mar15	Jun15	Sep15	Dec15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%
5yr PWLB	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
10yr PWLB	3.70%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%
25yr PWLB	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.90%
50yr PWLB	4.40%	4.50%	4.50%	4.60%	4.80%	4.80%	4.90%	5.00%

Further interest rate views can be seen at Appendix C.

4. Borrowing Strategy

4.1 The Authority is currently maintaining an under borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cashflow has been used as a temporary measure. This is a prudent and cost effective approach in the current economic climate of low interest rates and is a good use of the Council's cash.The Authority's estimated closing Capital Financing Requirement (CFR) for 2013/14 is £215.8M. If no borrowing takes place within the remainder of the current financial year, the outstanding debt at 31st March 2014 will be £150.8M showing that the Authority is currently borrowed well below its CFR. Analysis of the balance sheet shows the Authority to be in an internally borrowed position. The current Capital budget for 2014/15 is £51M.

4.2 In view of the authority's position and the above interest rate forecast the Authority's strategy for borrowing, when required, will give consideration to new borrowing as follows:-

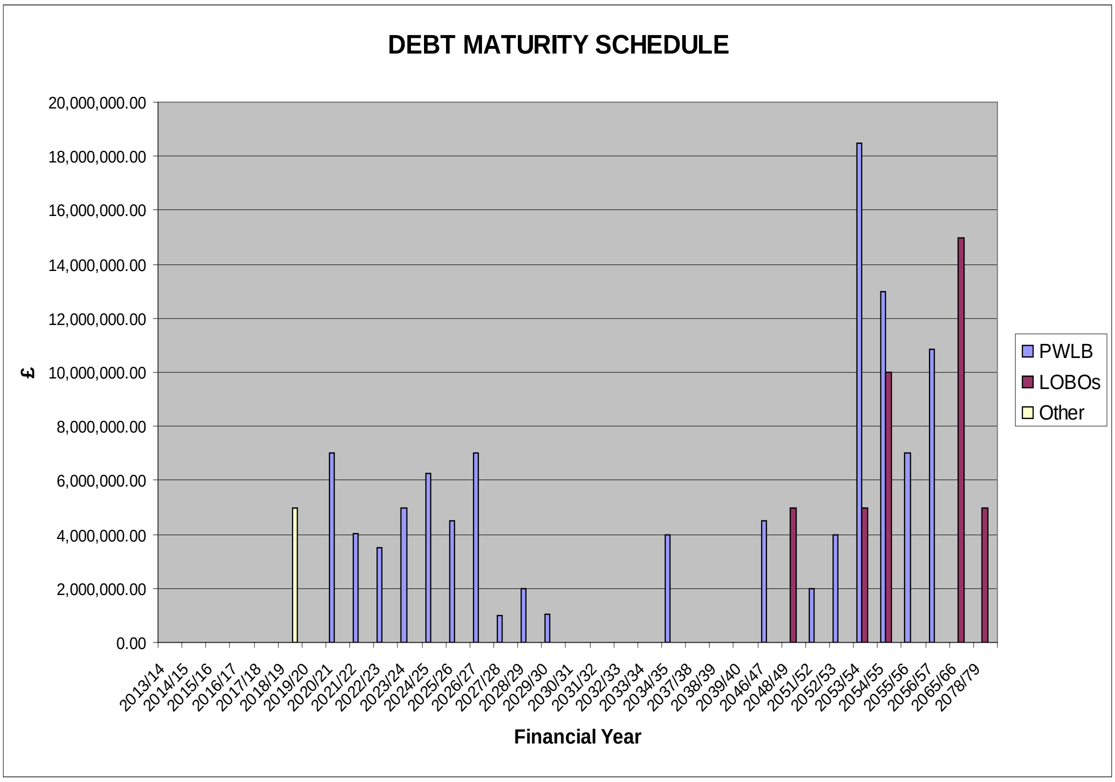
- PWLB variable rate loans for up to 10 years
- Short dated borrowing from non PWLB sources.

4.3 PWLB Certainty Rate:

In 2012-13, the Government introduced a 20 basis points (bps) discount on loans from the Public Works Loan Board (PWLB) under the prudential borrowing regime for those principal local authorities providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans. The Government said it would also work with the local authority sector to consider the potential for an independent body to facilitate the provision of PWLB lending at a reduced rate to authorities demonstrating best quality and value for money. This uthority registered its interest in this preferred rate option.

4.4 Estimated Debt Maturity Profile as at 01.04.14:

(please click on the graph below and increase the percentage in the toolbar above for an enhanced view)



5. <u>Debt Rescheduling</u>

5.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which was compounded on 20th October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than before both of these events.

5.2 However, as short term borrowing rates will be considerably cheaper than longer term rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. The cost of any debt repayment i.e. premiums incurred will also be taken into consideration.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings,
- helping to fulfil the strategy outlined in paragraph 4 above, and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

5.3 All rescheduling will be reported to Cabinet as soon as is practicable.

6. <u>Policy on borrowing in advance of need</u>

6.1 The Authority will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed (this is referenced in paragraph 7.14). Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds.

6.2 In determining whether borrowing will be undertaken in advance of need the Authority will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue liabilities created and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

7. <u>Investments</u>

7.1 *Investment Policy:*

7.1.1 The Authority has regard to the 2011 edition of the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”) and the Welsh Assembly Government Guidance on Local Government Investments.

7.1.2 The Authority’s investment priorities are: -

(a) the security of capital and
(b) the liquidity of its investments.

7.1.3 The Authority will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Authority has been low in order to give priority to security of its investments.

7.1.4 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Authority will not engage in such activity.

7.1.5 The minimum amount that is to be held during the financial year in investments other than long-term is Nil.

7.2 *Derivatives:*

7.2.1 The 2011 Code of Practice introduced various references to the use of hedging tools such as derivatives. It is not this Authority's intention to make use of such tools.

7.3 Definition of Investments – Specified and Non-Specified:

7.3.1 The Local Government Act 2003 refers to specified and non-specified investments. The Welsh Assembly Government's Guidance on Local Government Investments, effective from 1st April 2010, defines the following:-

Specified Investments:

An investment is a specified one if all of the following apply:-

(a) it is denominated in sterling and any payments or repayments in respect of it are payable only in sterling
(b) the investment is not a long-term one i.e. one which is due to be repaid within 12 months of the date on which the investment was made or one which may require to be repaid within that period
(c) the making of the investment is not defined as capital expenditure by virtue of regulation 20(1)(d) of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [SI 3239 as amended]
(d) the investment is made with a body or in an investment scheme of ***** high credit quality or with one of the following public sector bodies:
   i. the UK Government
   ii. a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland
   iii. a parish or community council.

***** High credit quality is defined in Paragraph 7.5 below.

Non-specified Investments:

(i) An investment is non-specified if it does not meet the above definition.

There are various innovative products on offer which fit this criteria, many of which do so because their initial and maturity value can differ. The spirit of the 2004 National Assembly for Wales guidance was to ensure that authorities had the skills to assess any such products prior to possible commitment. Our advisors have confirmed that officers within Powys have the ability and knowledge to assess the value of such products. Any such assessment will involve determining a high credit quality in line with Paragraph 7.5 below.

As per Prudential Indicator 16.3.3 below the Authority has a maximum limit for investments held for a period of over 364 days.
As per Paragraph 7.7 below the Authority has a maximum limit to be held in Money Market Funds of £50M.

7.4 Creditworthiness policy:

7.4.1 This Authority uses the creditworthiness service provided by Capita Asset Services although the Authority has taken a prudent view and adopted a position that is more risk averse than Capita's suggested list in respect of counterparties and durations.

7.4.2 Capita uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors - forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays : -

- credit watches and credit outlooks from credit rating agencies
- CDS spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries.

7.4.3 This approach is in line with the CIPFA Code of Practice which states that "credit ratings should only be used as a starting point when considering credit risk". Authorities should also use financial press, market data, information on government support for banks and the credit ratings of that government support.

7.4.4 Capita's modelling approach combines credit ratings, credit watches, credit outlooks and Credit Default Swap spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes can be used by the Authority to determine the duration for investments and are therefore referred to as durational bands.

7.4.5 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Capita's weekly credit list of worldwide potential counterparties. The Authority will therefore be able to use counterparties within the following durational bands*:* -

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

7.4.6 A copy of the current full credit rating list is being sent to members alongside this report for information regarding which banks fall into each duration.

7.4.7 The 2011 revised Code of Practice advises that authorities have regard for all the ratings issued by all three main agencies and to make their decisions based on all ratings. The advisors' creditworthiness service corresponds with this as it uses the ratings from all three agencies but, by using a scoring system, does not give undue preponderance to just one agency's ratings.

7.5 "High" credit quality:

7.5.1 It is proposed that the Authority continue with the following in respect of defining a "high" credit quality. If a rating is not available from any of the rating agencies then the available ratings will be used. Members will note that this proposal excludes investments with some banks off the advisors' suggested list:-

Long Term Ratings (in respect of long-term investments):

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
AAA	Aaa	AAA
AA+	Aa1	AA+
AA	Aa2	AA
AA-	Aa3	AA-

Short Term Ratings (in respect of short-term investments):

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
F1+	N/A	A-1+
F1	P-1	A-1

7.5.2 All credit ratings will be monitored daily. The Authority is alerted to changes to ratings of all three agencies through its use of the advisors' creditworthiness service.

7.5.3 Any institution which drops below any of the above ratings will be removed from the Authority's counterparty list for investments. Any investments held with the counterparty will also be reviewed in order to establish whether the premature maturity of the investment should be sought.

7.5.4 In addition to the use of Credit Ratings the Authority will also be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's investment list. Any investments held with the counterparty will also be reviewed in order to establish whether the premature maturity of the investment should be sought.

7.5.5 Sole reliance will not be placed on the use of this external service. In addition the Authority will also use market data and information, information on government support for banks and the credit ratings of that government support.

7.6 Country limits:

7.6.1 It is proposed that the Authority will use approved counterparties from the UK and approved counterparties from other countries with the following sovereign credit ratings:-

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
AAA	Aaa	AAA

The list of countries (excluding the UK) that qualify using this credit criteria as at the date of this report are shown in Appendix D. This list will be added to or deducted from by officers should ratings change.

7.6.2 Our advisor's view is that all Authorities should avoid a concentration of investments in too few counterparties or countries but that a suitable spreading approach in itself is likely to be sufficient given the safeguards already built into its creditworthiness service.

As such the following limits are proposed:-

Country	Maximum Investment per Country	Credit Rating/Other Assessment of Risk
AAA countries (listed at Appendix D)	£20M (held in call accounts)	As per rating list
UK	No Maximum Investment	As per rating list

7.7 Group/Institutions - Counterparty Criteria/Limits:

The current limits per the 2013/14 Strategy are as follows:-

Specified Investments (2013/14):

Institution	Maximum Investment per Group/Institution £M	Maximum Length	Credit Rating/Other Assessment of Risk
UK Banks	20 (a maximum £10M to be held in fixed term investments)	Up to 364 days	As per Capita's matrices and the Authority's definition of a high credit rating
Foreign Banks	5	Up to 364 days	As per Capita's matrices and the Authority's definition of a high credit rating
Other Local Authorities	25	Up to 364 days	N/A

Non-Specified Investments (2013/14):

Institution	**Maximum Investment per Group/Institution £M**	**Maximum Length**	**Credit Rating/Other Assessment of Risk**
UK Banks	10 (£2M limit with any one institution)	Up to 2 years	As per Capita's matrices and the Authority's definition of a high credit rating
Lloyds Bank (as a mortgage lender in the LAMS scheme)	5	Up to 5 years	N/A
Foreign Banks	2	Up to 2 years	As per Sector's matrices and the Authority's definition of a high credit rating
Money Market Funds (max. of 5)	10	N/A	All are AAA rated plus the parents/owners must meet the Authority's short term investment criteria
Other Local Authorities	10	Up to 2 years	N/A
European Investment Bank Bonds	3	2-3 years	N/A
Note: Limits for Specified and Non-Specified are combined limits. The maximum limit will also apply to a banking group as a whole.			

7.7.1 The Authority has been fortunate to have had continued access to above average rates in respect of its RBS and Lloyds/BOS deposit accounts. However, as advised by officers, these rates reduced towards the end of 2013. As such, returns in 2014/15 are likely to be more in line with Bank Rate or below.

It is proposed that the limits above remain the same for 2014/15.

. **The Local Authority Mortgage Scheme (LAMS)**

8.1 The Authority is currently participating in the cash backed mortgage scheme which requires the Authority to place a five year deposit matched to the life of the indemnity. This is outlined in the investment criteria above.

9. Investment Strategy

9.1 In-house funds*:*
The majority of the Authority's in-house managed funds are cash flow derived. However, this has and will continue to decrease as per the information in 4.1 above.

9.2 The suggested budgeted investment returns from the Authority's advisors are:

2014/15	0.50%
2015/16	0.50%

9.3 The Authority currently has no investments that are longer-term. It is unlikely that the Authority will lock into further longer term deals while investment rates are down at historically low levels and due to the reduction in cash balances.

9.4 For its cash flow generated balances, the Authority will seek to utilise its business reserve accounts, fixed term deposits (if appropriate) and money market funds.

10. <u>Policy on the use of external service providers</u>

10.1 The Authority currently uses Capita Asset Services as its external treasury management advisors. This contract was awarded following a competitive process. The current contract is until 31st March 2015.

10.2 The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed on external service providers.

10.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review. This review will incorporate assessing the following:-

- level of technical expertise/advice
- appropriateness of advice given
- value of information provided i.e. market commentaries, forecasts, etc.
- value of training given
- attendance at meetings

11. <u>Scheme of delegation</u>

11.1 (i) Full Council

- approval of annual strategy

(ii) Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

(iii) Cabinet

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of amendments to the Authority's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers.

12. Role of the section 151 officer (Chief Financial Officer)

12.1 The S151 officer will have responsibility for:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

13. Treasury Management Training

13.1 The Authority recognises that relevant individuals will need appropriate levels of training in treasury management due to its increasing complexity. There are two categories of relevant individuals: -

- treasury management staff employed by the Authority
- members charged with governance of the treasury management function.

13.2 All treasury management staff should receive appropriate training relevant to the requirements of their duties at the appropriate time. All treasury management staff are required to be members of an appropriate professional body and, in line with the continuing professional development requirements of these professional bodies, the Authority operates a Professional Development Review system which identifies the training requirements of individual members of staff engaged on treasury related activities. Additionally, training is also provided in the job and it is the s the level of training appropriate to their duties.

13.3 Details of Approved Training Courses

Treasury management staff and members will go on courses provided by our treasury management advisors, CIPFA, etc.

13.4 Records of Training received by Treasury Staff

As required by their relevant professional bodies, treasury management staff will maintain records of training they receive.

13.5 Approved Qualifications for Treasury Staff

It is the Authority's policy that the Treasury Manager and the Senior Accountancy Assistants are qualified to at least AAT level.

13.6 Members

The CIPFA Code of Practice states that members charged with governance (all members as the annual strategy requires approval by Full Council) have a personal responsibility to ensure that they have the appropriate skills and training for their role. To aid this, the Authority holds two briefing sessions per year for members and members should ensure that they attend at least one of these each year.

14. Pension Fund Cash

The Authority will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1st Jan 2010. From 1st April 2010 the Pension fund has its own bank accounts although, due to use of the Authority's financial systems, a small amount of pension fund cash remains pooled with the Authority's cash balances for investment purposes. Any investments made by the pension fund directly with this local authority will comply with the requirements of SI 2009 No 393.

15. Treasury Management Budget

A requirement of the Authority's Treasury Management Policy Statement is that a summary treasury management budget is included in the Strategy report. This is attached at Appendix E.

16. CIPFA Prudential Code - Prudential and Treasury Indicators

16.1 The following indicators, required by the CIPFA Prudential Code, are included as part of the annual budget report :-

- authorised limit for external debt
- operational boundary for external debt

- actual external debt

16.2 Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy and, as such, the indicators required to be included as part of this strategy are as follows:-

16.3.1 *Interest Rate Exposure:*

The setting of upper and lower limits for interest rate exposures has the effect of creating ranges within which the Authority will limit its exposure to both fixed and variable interest rate movements.

The current limits are as follows:-

Fixed rates	140%
Variable rates	60%

As dictated by the Code of Practice this indicator for fixed and variable limits is calculated by looking at the net position between debt and investments. The following table shows the Authority's position as at 14th February 2014 and clearly shows what the Indicator is trying to achieve in that the investments we hold in variable rate contracts easily outweigh those in fixed rates:

	Debt	Investments	Net Debt
	£,000	£,000	£,000
Total at Fixed Rates	115,804	4	115,800
Total at Variable Rates	35,000	25,295	9,705
Total	150,804	25,299	125,505
	%	%	%
Fixed Debt less investments (net position)	76.79%	0.02%	92.27%
Variable Debt less investments (net position)	23.21%	99.98%	7.73%

It is proposed that the limits above remain the same for 2014/15.

16.3.2 Maturity Structure of Borrowing:

Local authorities are exposed to the risk of having to refinance debt at a time in the future when interest rates may be volatile or uncertain. This indicator is designed to assist authorities in avoiding large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time. It is recommended that the Authority sets upper and lower limits in each period as a percentage of its total borrowings.

The current limits are as follows:-

	Upper Limit	Lower Limit
Under 12 months	40%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	40%

The 2013 edition of the Prudential Code requires further analysis if a large proportion of debt is maturing in the >10 years category. As such:

It is proposed that the limits for 2014/15 are as follows:-

	Upper Limit	Lower Limit
Under 12 months	40%	0%
12 months to 2 years	40%	0%
2 years to 5 years	40%	0%
5 years to 10 years	40%	0%
10 years to 20 years	40%	0%
20 years to 30 years	40%	0%
30 years to 40 years	40%	0%
40 years to 50 years	40%	0%

6.3.3 Principal sums invested for periods longer than 364 days:

This indicator is used to demonstrate that the Authority has taken into account all the resources available for investment. This is to minimise the possibility that longer-term investments will need to be realised early which might have disadvantageous results. This indicator is also used to demonstrate that the Authority is not borrowing more than it needs to, or in advance of its needs, purely to profit through investment from the extra borrowing.

The current limit is set at £10M.

It is proposed that this limit remains at £10M for 2014/15 although it is unlikely to be utilised.

<u>Proposal</u>

It is proposed that Council approves the Treasury Management Strategy Statement and Annual Investment Strategy.

<u>Statutory Officers</u>

The Strategic Director – Resources (s151 officer) has made the following comment:

“The Treasury Management Strategy Statement and Annual Investment Strategy forms a key part of the Council`s overall approach to borrowing and investments. The report ensures the authority complies with relevant legislation and the Code of Practice on Treasury Management."

The Solicitor to the Council (Monitoring Officer) has made the following comment:

"I have nothing to add to the report."

<u>Future Status of the Report</u>

Not applicable

Recommendation:		**Reason for Recommendation:**	
That Council approves the Treasury Management Strategy Statement and Annual Investment Strategy		**Statutory Requirement**	
Relevant Policy:		Treasury Management Policy	
Within Policy:	**Y**	**Within Budget:**	**Y**
Person(s) To Implement Decision:		**Ann Owen – Treasury Manager**	
Date By When Decision To Be Implemented:			**1st April 2014**

Contact Officer Name:	Tel:	Fax:	Email:
Ann Owen	01597 826327	01597 826290	ann.owen@powys.gov.uk

Background Papers used to prepare Report:

CIPFA Code of Practice on Treasury Management and Cross Sectoral Guidance Notes
Treasury Management Policy Statement
Advisors' Information
WAG Guidance on Local Government Investments 2010

Appendix A:

<u>Treasury Management Policy Statement</u>

1. This organisation defines its treasury management activities as: “The management of the authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.

2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage these risks.

3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.”

Appendix B:

1. This Authority adopts the key principles of CIPFA's *Treasury Management in the Public Services : Code of Practice (2011 Edition),* as described in Section 4 of that Code as follows:-

   Key Principle 1:
   Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

   Key Principle 2:
   Their policies and practices should make clear that the effective management and control of risks are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.

   Key Principle 3:
   They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that, within the context of effective risk management, their treasury management policies and practices should reflect this.

   In framing these recommendations, CIPFA acknowledges the difficulties of striving for effective risk management and control, whilst at the same time pursuing value for money. This code does not seek to be prescriptive about how this issue should be handled, particularly since it covers such a wide variety of organisations. However, where appropriate, the sector specific guidance notes give suitable advice. CIPFA recognises that no two organisations in the public services are likely to tackle this issue in precisely the same manner but success in this area of treasury management is likely to be viewed, especially in value for money terms, as an indicator of a strongly performing treasury management function.

   Even though it dates back to 1991, CIPFA considers that the report by the Treasury and Civil Service Committee of the House of Commons on the BCCI closure is still pertinent, wherein it was stated that:

   In balancing risk against return, local authorities should be more concerned to avoid risks than to maximise returns.

   Indeed this view was supported by the Communities and Local Government Select Committee report into local authority investments in 2009.
   It is CIPFA's view that throughout the public services the priority is to protect capital rather than to maximise return. The avoidance of all risk is neither appropriate nor possible. However, a balance must be struck with a keen responsibility for public money.

2. Accordingly, the Authority will create and maintain, as the cornerstones for effective treasury management:

- a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities

- suitable treasury management practices (TMPs) setting out the manner in which the Authority will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Authority. Such amendments will not result in the Authority materially deviating from the Code's key principles.

3. The Authority will also have regard for the Guidance on Local Government Investments issued by the Welsh Assembly Government and effective from 1st April 2010.

4. Full Council will receive the annual strategy report as recommended in the Welsh Assembly Guidance on Local Government Investments and the Authority's Cabinet will receive reports on its treasury management policies, practices and activities, including, as a minimum, a mid year review and an annual report after its close, in the form prescribed in its TMPs.

5. The Authority delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Chief Financial Officer, who will act in accordance with the Authority's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

6. The Authority nominates Audit Committee to be responsible for ensuring effective scrutiny of treasury management policies, practices and performance.

Appendix C:

ECONOMIC BACKGROUND

THE UK ECONOMY

Economic growth:
Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded in 2013 to surpass all expectations as all three main sectors i.e. services, manufacturing and construction contributed to this strong upturn. The Bank of England has, therefore, upgraded growth forecasts for 2014 from 1.7% to 2.8% with 2015 unchanged at 2.3%.
Forward surveys are currently very positive in indicating that growth prospects are also strong in 2014 for the three main sectors as well as for the UK economy as a whole. This is very encouraging as there needs to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure although income tax cuts have mitigated this to some extent. This means, therefore, that labour productivity must improve significantly for this situation to be corrected by the warranting of increases in pay rates.

Forward guidance:
The Bank of England issued forward guidance in August which stated that they will not start to consider raising interest rates until the jobless rate (not the claimant count measure) has fallen to 7% or below. This would require the creation of about 750,000 jobs and was forecast in August to take three years. This was revised in November to possibly quarter 4 of 2014 but the UK unemployment rate has since already fallen to 7%. However, the Bank's guidance is subject to three provisos mainly around inflation and breaching any of these would sever the link between interest rates and unemployment levels. This makes forecasting Bank rate much more complex given the lack of available reliable forecasts by economists over a three year plus horizon. The recession since 2007 was notable for how unemployment did not rise to the levels that would normally be expected in a major recession and the August Inflation Report noted that productivity had sunk to 2005 levels. There has, therefore, been a significant level of retention of labour which will mean that there is potential for a significant amount of GDP growth to be accommodated without a major reduction in unemployment. However, it has been particularly encouraging that the strong economic growth in 2013 has also been accompanied by a rapid increase in employment and forward hiring indicators are also currently very positive. It is therefore increasingly likely that early in 2014, the Monetary Policy Committee will need to amend its forward guidance by reducing its 7% threshold rate and/or by adding further wording similar to the US Federal Reserve's move in December (see below).

Credit conditions:
While Bank Rate has remained unchanged at 0.5% and quantitative easing has remained unchanged at £375bn, the Funding for Lending Scheme (FLS) was extended to encourage banks to expand lending to small and medium size enterprises. The second phase of Help to Buy aimed at supporting the purchase of second hand properties started in earnest in January 2014. These measures have been so successful in boosting the supply of credit for mortgages and so increasing house purchases, that the Bank of England announced at the end of November that the FLS for mortgages would end in February 2014.

Whilst there have been concerns that these schemes are creating a bubble in the housing market, house price increases outside of London and the south-east have been much weaker. However, bank lending to small and medium enterprises continues to remain weak and inhibited by banks still repairing their balance sheets and anticipating tightening of regulatory requirements.

Inflation:
Inflation has fallen from a peak of 3.1% in June 2013 to 1.9% in January 2014. It is expected to remain near to the 2% target level over the MPC's two year time horizon.

AAA rating:
The UK lost its AAA rating from Fitch and Moody's but that caused little market reaction.

THE GLOBAL ECONOMY

The Eurozone (EZ):

The sovereign debt crisis eased considerably during 2013 which has been a year of comparative calm after the Cyprus bailout in the spring. In December, Ireland escaped from its three year EZ bailout programme as it had dynamically addressed the need to substantially cut the growth in government debt, reduce internal price and wage levels and promote economic growth. The EZ finally escaped from seven quarters of recession in quarter 2 of 2013 but growth is likely to remain weak and so will dampen UK growth. The European Central Bank's pledge to buy unlimited amounts of bonds of countries which ask for a bail out has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2012 figures) of Greece 176%, Italy 131%, Portugal 124%, Ireland 123% and Cyprus 110%, remain a cause of concern, especially as many of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are continuing to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US. Greece remains particularly vulnerable and continues to struggle to meet EZ targets for fiscal correction. Whilst a Greek exit from the Euro is now improbable in the short term, as Greece has made considerable progress in reducing its annual government deficit and a return towards some economic growth, some commentators still view an eventual exit as being likely. There are also concerns that austerity measures in Cyprus could also end up in forcing an exit. The question remains as to how much damage an exit by one country would do and whether contagion would spread to other countries. However, the longer a Greek exit is delayed, the less are likely to be the repercussions beyond Greece on other countries and on EU banks.

Sentiment in financial markets has improved considerably during 2013 as a result of firm Eurozone commitment to support struggling countries and to keep the Eurozone intact. However, the foundations to this current "solution" to the Eurozone debt crisis are still weak and events could easily conspire to put this into reverse. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries like Greece and Spain which have unemployment rates of over 26% and unemployment among younger people of over 50%. The Italian political situation is also fraught with difficulties in maintaining a viable coalition which will implement an EZ imposed austerity programme and undertake overdue reforms to government and the economy. There are also concerns over the lack of political will in France to address issues of poor international competitiveness,

USA:

The economy has managed to return to robust growth in Q2 2013 of 2.5% y/y and 4.1% y/y in Q3, in spite of the sharp fiscal cuts in federal expenditure and increases in taxation. The Federal Reserve therefore decided in December to reduce its $85bn per month asset purchases programme of quantitative easing by $10bn. It also amended its forward guidance on its pledge not to increase the central rate until unemployment falls to 6.5% by adding that there would be no increases in the central rate until 'well past the time that the unemployment rate declines below 6.5%, especially if projected inflation continues to run below the 2% longer run goal'. Consumer, investor and business confidence levels have all improved markedly in 2013. The housing market has turned a corner and house sales and increases in house prices have returned to healthy levels. Many house owners have, therefore, been helped to escape from negative equity and banks have also largely repaired their damaged balance sheets so that they can resume healthy levels of lending. All this portends well for a reasonable growth rate looking forward.

China:

There are concerns that Chinese growth could be on an overall marginal downward annual trend. There are also concerns that the new Chinese leadership have only started to address an unbalanced economy which is heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size and dubious creditworthiness of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

Japan:

The initial euphoria generated by the huge quantitative easing operation instituted by the Japanese government to buy Japanese debt, has tempered as the follow through of measures to reform the financial system and the introduction of other economic reforms, appears to have stalled. However, at long last, Japan has seen a return to reasonable growth and positive inflation during 2013 which bodes well for the hopes that Japan can escape from the stagnation and deflation and so help to support world growth. The fiscal challenges however are huge; the gross debt to GDP ratio is circa 245% in 2013 while the government is currently running an annual fiscal deficit of around 50% of total government expenditure. Within two years, the central bank will end up purchasing circa Y190 trillion (£1,200 billion) of government debt. In addition, the population is ageing due to a low birth rate and, on current trends, will fall from 128m to 100m by 2050.

CAPITA ASSET SERVICES FORWARD VIEW:

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds. There could well be volatility in gilt yields over the next year as financial markets anticipate further tapering of asset purchases by the US Federal Reserve. The timing and degree of tapering could have a significant effect on both Treasury and gilt yields. The longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the

UK, and of bond issuance in other major western countries. Increasing investor confidence in economic recovery is also likely to compound this effect as a continuation of recovery will further encourage investors to switch back from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly weighted. However, only time will tell just how long this period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis, or a break-up of the EZ, but rather that there will be a managed, albeit painful, resolution of the debt crisis where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be tepid for the next couple of years and some EZ countries experiencing low or negative growth, will, over that time period, see a significant increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the large countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

Further Interest Rate Forecasts 2014/15:

	Mar14	**Jun14**	**Sep14**	**Dec14**	**Mar15**	**Jun15**	**Sep15**	**Dec15**
Bank rate								
UBS	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%
5yr PWLB								
UBS	-	-	-	-	-	-	-	-
Capital Economics	2.60%	2.60%	2.60%	2.60%	2.70%	2.80%	3.00%	3.20%
10yr PWLB								
UBS	3.70%	3.80%	3.90%	4.05%	4.05%	4.30%	4.55%	4.55%
Capital Economics	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	3.80%	4.05%
25yr PWLB								
UBS	4.55%	4.55%	4.80%	4.80%	5.05%	5.05%	5.30%	5.30%
Capital Economics	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.35%	4.45%
50yr PWLB								
UBS	4.45%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%
Capital Economics	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.60%

Appendix D:

Approved Countries for Investment

AAA

- Australia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

Appendix E:

Summary Treasury Management Budget

	2014/15 £	2013/14 £
Employees	161,180	176,693
Transport	3,256,750	3,496,790
Supplies and Services	194,139	197,590
Interest Paid	7,057,993	7,579,588
Debt Management Expenses	6,000	6,000
Gross Expenditure	**10,676,062**	**11,455,661**
Interest Received	0	0
Gross Income	**0**	**0**
Net Expenditure	**10,676,062**	**11,455,661**

Notes:

- Transport is the Authority's leasing costs – leasing is classified as a Treasury Management activity.

- Supplies and Services includes the following main items:-

Bank and card charges	177k
Treasury /Leasing Advice	15k

- The Interest Paid figure for 2014/15 does not include Prudential Borrowing costs.

- Interest Received has no budget as cash balances have significantly reduced. Any interest received in respect of cash surpluses may need to be used to offset borrowing costs for negative cash balances.