CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
22nd April 2015

CABINET
12th May 2015

REPORT AUTHOR: **County Councillor Wynne Jones**
Portfolio Holder for Finance

SUBJECT: **Treasury Management Half Year Report**

REPORT FOR: **Information**

---

1. Summary

1.1 CIPFA's Treasury Management Bulletin issued in March 2009 suggested:

"In order to enshrine best practice it is suggested that authorities report formally on treasury management activities at least twice a year and preferably quarterly."

The CIPFA Code of Practice on Treasury Management emphasises a number of key areas including the following:-

xi. Treasury management performance and policy setting should be subject to scrutiny prior to implementation.

1.2 In line with the above this report is providing information on the activities for the quarter ending 31st March 2015.

2. Economic Background and Forecasts

2.1 The economic background is attached at Appendix B.

2.2 The most recent forecast of interest rates by the Authority's advisor is as follows:

	Jun 15	**Sep 15**	**Dec 15**	**Mar 16**	**Jun 16**	**Sep 16**	**Dec 16**	**Mar 17**
Bank rate	0.50%	0.50%	0.75%	0.75%	0.75%	1.00%	1.25%	1.25%
5yr PWLB	2.20%	2.30%	2.50%	2.60%	2.70%	2.80%	3.00%	3.10%
10yr PWLB	2.80%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%
25yr PWLB	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%
50yr PWLB	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%

3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 5th March 2014 is at Appendix A.

3.2 The Authority's investment priorities within the Strategy are: -

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

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

4. Current Investments

4.1 The current investment market is difficult in respect of earning the level of interest rates commonly seen in previous years as rates are very low and in line with the 0.5% Bank Rate.

4.2 The Authority's investment position as at 31st March 2015 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
Santander	12,795	0.40%	N/A	Deposit A/c
HSBC	310	0.25%	N/A	Deposit A/c
Total	**13,105**	**0.40%**		
Lloyds TSB - LAMS	1,000	3.20%	13.08.12	14.08.17

4.3 There have been no relevant credit rating changes in the last few months in respect of the banks that the Authority utilises for deposits.

4.4 Local Authority Mortgage Scheme:

In August 2012, following a Cabinet report, the Authority entered the Local Authority Mortgage Scheme with an allocation to Lloyds TSB of £1M. Under the scheme this was deemed as Capital Expenditure. However, the Wales Audit Office (WAO) opinion differed from this in that they suggested it should be treated as an investment. Unfortunately, despite meetings and extensive correspondence by Capita Treasury with the Welsh Government, Welsh Local Government Association and the Wales Audit Office, agreement on the accounting treatment for Welsh authorities has not been reached despite the provision of 3 separate legal opinions supporting the Capital Expenditure position. As such, Capita have said that they are not sure there is much more they can do in Wales. This Authority has concurred with WAO's requirement to treat this as an investment and, as such, the amount is included in the table above and is being accounted for as an investment. Council approved this investment following a retrospective report on 16th May 2013.

4.5 **Glitnir:**
The winding up board of Glitnir made a distribution to creditors in a basket of currencies in March 2012. An element of the distribution was in Icelandic Kroner

which was placed in an escrow account in Iceland and is earning interest of 3.65% as at 31/03/15. This element of the distribution has been retained in Iceland due to currency controls currently operating in Iceland and, as a result, is subject to exchange rate risk over which the Authority has no control. The distribution has been made in full settlement, representing 100% of the claim.

4.6 Redemption Penalties:
There are no current fixed investments to redeem.

4.7 Investment returns in future years:
Our advisors' current suggested earning rates for investments for budgeting purposes are as follows:-

	Suggested Rate now	Suggested Rate previous
2015/16	0.60%	0.60%
2016/17	1.10%	1.25%
2017/18	1.75%	1.75%

These are based on investments for three months duration in each year.

5. Credit Rating Changes

5.1 There have been no credit rating changes relevant to this Authority's position during the last quarter.

5.2 The credit rating list for end of March is attached as a separate file to this report.

6. Borrowing / Re-scheduling

6.1 Effective management of the Authority's debt is essential to ensure that the impact of interest payable is minimised against our revenue accounts whilst maintaining prudent borrowing policies.

6.2 The Authority's Capital Position:

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the current year's unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through external borrowing or utilising temporary cash resources within the Council.

Net external borrowing (borrowings less investments) should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current year and next two financial years. This allows some flexibility for limited early borrowing for future years.

CFR Position:

	As at 31.03.14 Actual	2014/15 Original Estimate	2015/16 Original Estimate	2016/17 Original Estimate
	£M	£M	£M	£M
Capital Financing Requirement	220,383	236,446	241,480	249,017

6.3 The Authority had outstanding external debt of £150.8M at 31st March 2014. In relation to the CFR figure for 31st March 2014, this equated to the Authority being under borrowed by £69.6M. This is a prudent and cost effective approach in the current economic climate. However, internal borrowing is only a temporary situation and, based on capital estimates, it will be necessary for the Authority to borrow at stages over the next few years. As such, the Authority needs to be mindful that it may be prudent to borrow whilst interest rates are at their low levels and carry the cost of this borrowing as opposed to borrowing at a future date at increased rates.

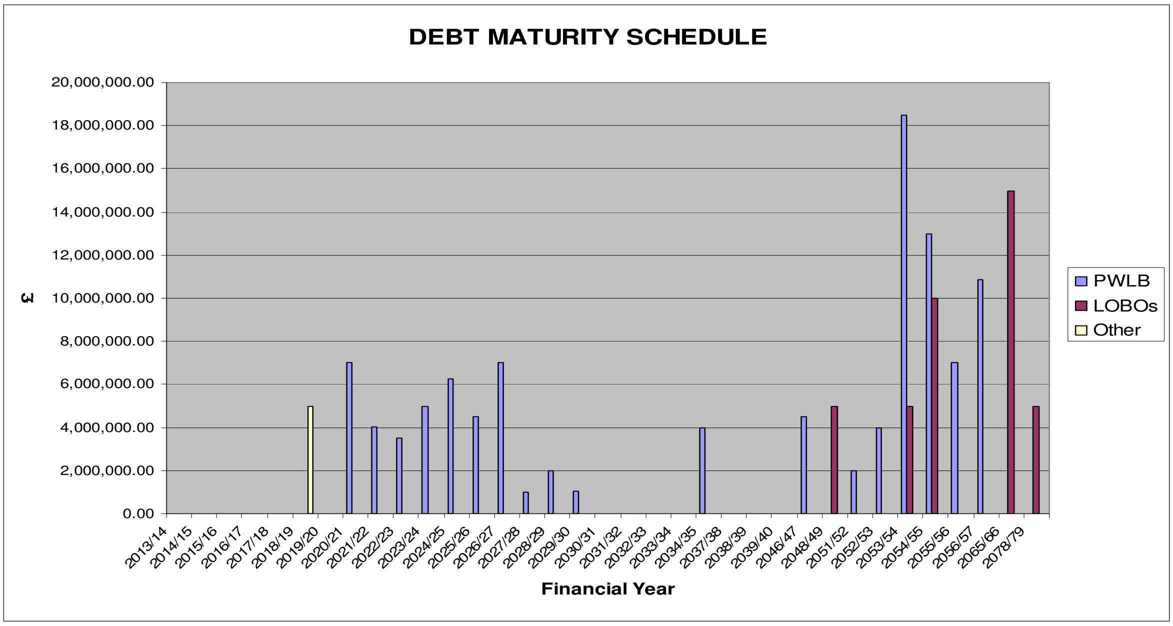
6.4 Capital Budget/Spend per efinancials:

Capital:	**Approved Budget**	**Working budget**	**Capital Spend**	**%age spend**
	47,642,983			
June		53,174,278	2,775,606	5.20%
Sept		57,083,520	12,992,540	22.76%
Dec		57,341,365	19,760,096	34.46%
March (latest figures at time of report)		38,697,223	30,976,625	80.00%

The financing of the approved capital budget included £13.4M of Prudential borrowing but no actual long-term borrowing took place.

6.5 *Debt Maturity Profile as at 31.03.15:*

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



6.6 Target rates:

Our advisors' target rates and current PWLB rates are set out below:

Period	Borrowing rate at 31.03.15	Target borrowing rate now	Target borrowing rate previous
5 year	2.15%	2.10%	2.20%
10 year	2.69%	2.70%	2.80%
25 year	3.32%	3.30%	3.40%
50 year	3.28%	3.30%	3.40%

6.7 Rescheduling:

The Public Works Loans Board released a circular regarding rates on 20th October 2010. As a result of this, rates immediately increased by 0.87-0.88 basis points across the board. The overall impact of this circular was that it is far more difficult for authorities to reschedule debt

6.8 Members are aware that officers continue to look for interest savings on a daily basis by monitoring rates that may mean the Authority can re-schedule some of its debt or prematurely repay debt if applicable. However, PWLB interest rates have not been conducive towards rescheduling.

6.9 PWLB Certainty Rate:

In the March 2012 budget report the Government announced that it would introduce in 2012-13, 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. This discount continued to be available in 2014/15 and the Authority registered its interest in this preferred rate option.

7. Prudential Indicators

7.1 All TM Prudential Indicators were complied with in the quarter ending 31st March 2015.

Proposal

It is proposed that the Treasury Management quarterly report is received.

Statutory Officers

The Strategic Director – Resources (s151 officer) notes the content of the report and supports the recommendation. It is important that Cabinet continues to be informed about this key activity.

The Solicitor to the Council (Monitoring Officer) has made the following comment: "I have nothing to add to the report".

Future Status of the Report
Not applicable

Recommendation:		**Reason for Recommendation:**	
That the Treasury Management Quarterly Report be received		**To ensure Cabinet remains informed about current Treasury Management performance**	
Relevant Policy (ies):		Treasury Management Policy	
Within Policy:	**Y**	**Within Budget:**	**N/A**
Person(s) To Implement Decision:		**N/A**	
Date By When Decision To Be Implemented:		**N/A**	

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
PWLB circulars

<u>Appendix A:</u>

Approved Treasury Management Strategy 2014/15:

Long Term Ratings:

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:

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

Further to the ratings above the Strategy includes using UK nationalized or part nationalized institutions based on the following explanation:

"Nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high creditworthiness. These institutions, however, are recipients of an F1+ short term rating as they have effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.

Country Limits:

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

Group/Institutions - Counterparty Criteria/Limits:

Specified Investments:

Institution	Maximum Investment per Group/ Institution £M	Maximum Length	Credit Rating/Other Assessment of Risk
UK Banks	20 (a maximum £10M of this 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:

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 Capita'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.			

Appendix B

Economic Background

March kicked off with Chancellor George Osborne releasing his sixth and final Budget ahead of the General Election and saw the FTSE 100 break the 7,000 mark for the first time in its history. On the other side of the pond the Federal Reserve made a meaningful change to the wording of its accompanying policy statement, raising the prospect of policy tightening at some stage this year. Meanwhile, the Bank of England provided no surprises, once again voting unanimously for no change in UK monetary policy.

Chancellor George Osborne's final Budget was pitched with an upbeat tone, with strong growth, falling national debt and rising employment. This was evident as a positive reaction to the speech saw the FTSE 100 break through 7,000. The Office for Budget Responsibility (OBR) revised up its forecast for UK growth in 2015 to 2.5%, noting that a fall in oil prices since the Autumn Statement will see GDP increase by around 0.4% across 2015 and 2016, compared to its previous forecast. In terms of the deficit, the Government has taken an optimistic stance and lowered its forecast for public sector net borrowing for each year up to 2018-19 from the Autumn Statement projections.

UK Manufacturing PMI growth reached a seven month high in February as domestic demand helped fuel activity. Despite the strong domestic growth, export orders remained weak as a result of an appreciating £ which has strengthened by nearly 7% against the Euro. Meanwhile, the Construction PMI rose to a four month high. In contrast, the Services PMI slipped back in February. Despite this slight fall, all three PMI releases are well above the 50 mark, which divides expansion from contraction.

UK inflation fell to its lowest rate since 1960 in February at 0.3%, mainly driven by a sharp fall in wholesale energy prices and continued supermarket price wars. On the back of this, deflation looks likely to be around the corner due to the effect of British Gas cutting their prices impacting the March data. However, if we do move in to deflationary territory, it is believed that it will be short lived as sustained economic growth eats away at slack in the economy.

The Bank of England kept interest rates on hold at a record low of 0.5% again in March. The imminent risk of deflation suggests that there is no pressure for a rate rise in the near term. However, once deflation passes, the outlook will become far less certain as suggested by market expectations of the first change fluctuating around late 2015 to mid-2016.

Growth in British workers' pay slowed in January due to fewer bonus payments even though the percentage of people in work hit an all-time high. Britain's unemployment rate was stable at 5.7% in January, its lowest level in seven years.

Britain's public finances finally showed significant improvements in February. Public sector net borrowing came in at £6.9bn, well below last year's figure of £10.4bn, making it the smallest February deficit figure in seven years. This fall in the deficit was mainly due to a 7.2% annual increase in tax receipts. Over January and February, the total self-assessed income tax increased by £1.9bn from last year. Overall borrowing still looks set to come in at around £89bn for the fiscal year as a whole, marginally lower than the OBR's forecast .

Retail sales in February grew by more than expected with a rise of 0.7% from January and a year on year increase of 5.7%. The particularly strong showing of furniture purchases is likely a result of last year's recovery in the housing market. However, retail sales have generally been helped by the return of real wage growth on the back of falling energy prices and record low inflation.

Final quarter 2014 growth in UK was revised up from 0.5% to 0.6%, driven by a positive revision to service sector output. In year-on-year terms, growth was revised up from 2.6% to 2.8%, making it the strongest annual growth rate since 2006. Figures released so far for this year would suggest that the strong performance seen in 2014 has been carried on in to 2015, with growth looking to remain robust throughout the coming year.