CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
16th July 2015

CABINET
28th July 2015

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

SUBJECT: **Treasury Management Qtr 1 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 30th June 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:

	Sep 15	Dec 15	Mar 16	Jun 16	Sep 16	Dec 16	Mar 17	Jun 17
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.25%	1.25%	1.50%
5yr PWLB	2.30%	2.50%	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%
10yr PWLB	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%
25yr PWLB	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%	4.50%
50yr PWLB	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%	4.40%	4.50%

3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 5th March 2015 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 30th June 2015 is as shown below:-

Invested with:	**Principal £000's**	**Interest Rate**	**Start Date**	**Maturity Date**
Santander	6,310	0.40%	N/A	Deposit A/c
BOS	4,745	0.40%	N/A	Deposit A/c
HSBC	210	0.25%	N/A	Deposit A/c
Total	**11,265**	**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 variety of currencies in March 2012. An element of the distribution was in Icelandic Kroner (ISK) which was placed in an escrow account in Iceland. 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.

Cabinet will be aware that there have been recent options in respect of the monies in escrow but this authority has decided to retain the money in escrow until such time as there is further information forthcoming from the Icelandic government.

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 June 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 31.03.15 Actual	2015/16 Original Estimate	2016/17 Original Estimate	2017/18 Original Estimate
	£M	£M	£M	£M
Capital Financing Requirement	224,482	227,799	319,727	329,533

6.3 The Authority had outstanding long-term external debt of £150.8M at 31st March 2015. In relation to the CFR figure for 31st March 2015, this equated to the Authority being under borrowed by £73.7M. 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.

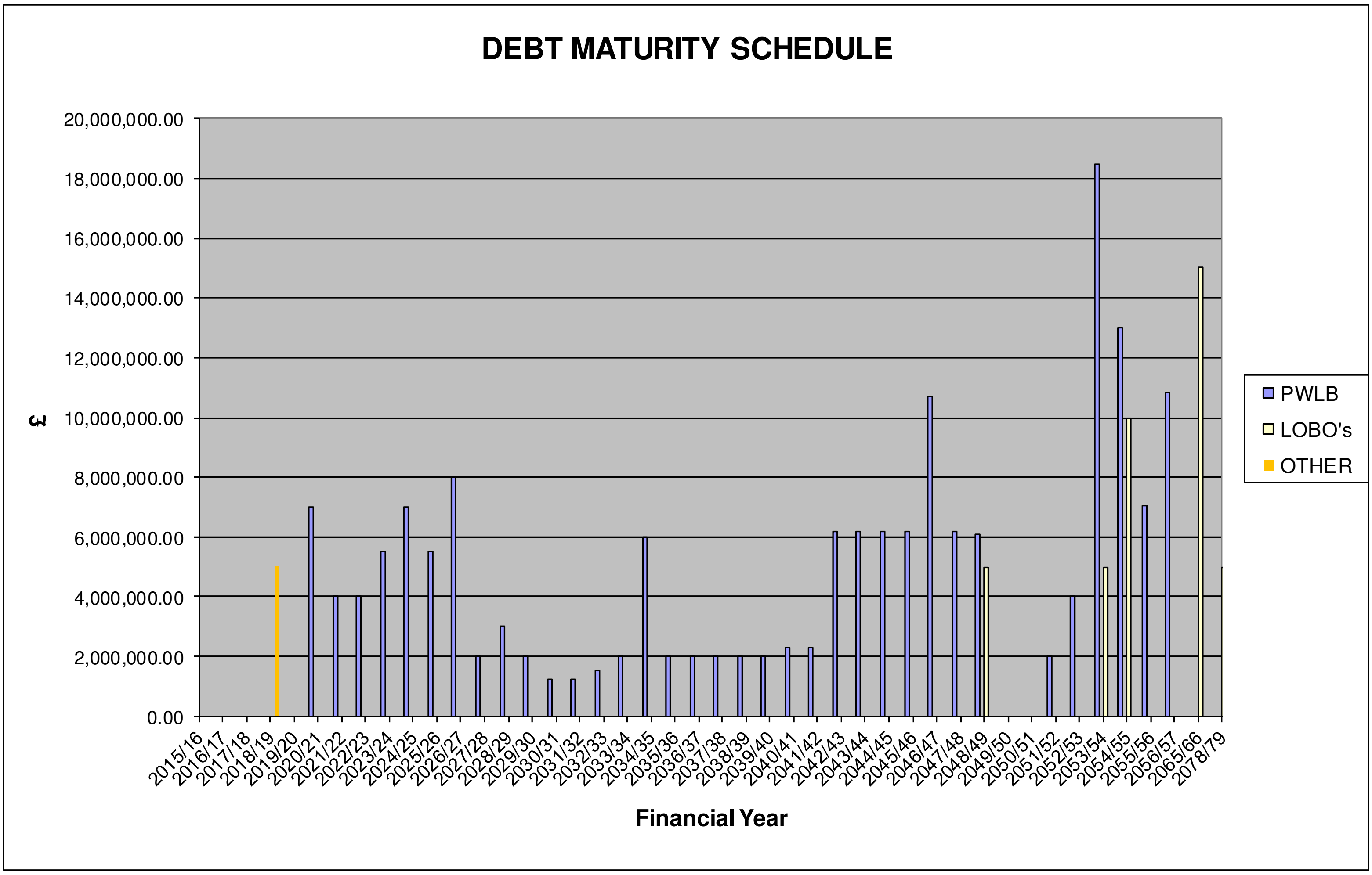
6.4 Capital Budget/Spend per efinancials:

Capital:	**Approved Budget**	**Working budget**	**Actual Capital Spend (not including commitments)**	**%age spend**
	128,931,594			
June		136,989,764	75,576,339	55.17%

The figures above include the figures for the self-financing of the HRA.
The financing of the approved capital budget included £97.4M of Prudential borrowing in total. £72.4M was borrowed on 2nd April in respect of the self-financing of the HRA.
The exact structure of loans arranged for the HRA purpose reflected the requirements of the HRA business plan, the overall requirements of the Council and certain limitations (e.g. the minimum average duration of any borrowing) put in place by the Welsh Government. The loans were, therefore, arranged at a set of bespoke, higher PWLB interest rates that applied only to Welsh HRA self-financing authorities and may make these loans less flexible, from a restructuring point of view, than would normally be the case.

6.5 *Debt Maturity Profile as at 30.06.15:*

(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 30.06.15	Target borrowing rate now	Target borrowing rate previous
5 year	2.54%	2.20%	2.15%
10 year	3.17%	2.80%	2.87%
25 year	3.73%	3.50%	3.49%
50 year	3.60%	3.50%	3.39%

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.

7. Prudential Indicators

7.1 All TM Prudential Indicators were complied with in the quarter ending 30th June 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:

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

7.6 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

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:*

<u>Specified Investments:</u>

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

<u>Non-Specified Investments:</u>

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.			

Appendix B

Economic Background

UK

Poor Qtr 1 GDP growth has yet to be revised higher but later revisions could prove slightly stronger. On a positive note, the economy still seems to have outperformed the US. Net trade certainly held back growth, cutting 0.9% off the overall position, but this was largely a reversal of the strong performance in Q4. Business investment growth, however, improved and consumer spending grew 0.5% qtr/qtr, though this was probably slower than the pace in real income growth. Surveys are supportive of the view that Qtr 2 will see a pick-up in economic growth despite the services sector PM Index easing a little in May. The sector remains strong and will be backed up by rises in both manufacturing and construction. The May overall PM Index indicates Q2 growth accelerating to around 0.6%.

Household spending has likely improved from the 0.5% real growth seen in Q1 as retail sales expanded by 1.2% month/month in April and the CBI reported sales balance for May saw a significant surge. Consumer confidence dipped slightly with the rise in petrol prices a possible reason, but it still continues to run at high levels and is indicative of further household spending growth acceleration. The housing market is also gathering momentum with mortgage approvals sharply higher in April. With low mortgage rates and recent stamp duty reforms there are reasons for confidence that the market has further gains ahead.

Rebalancing towards exports remains problematic as overseas demand remains weak, with the strength of sterling an issue. Net trade knocked 0.9% off Q1 GDP with the overall March trade deficit leaving the deficit for Q1 larger than in Q4. Weaker exports to the EU contributed to this despite the Eurozone showing recent economic growth. However, there was also an increase in imports. The potential for exports to improve seems limited in the near-term. Furthermore, recent gains in sterling strength will only serve to dent the competitiveness of UK goods.

The labour market indicators are supportive of the strength of household spending being sustainable. Employment increased by 202,000 in Qtr 1. Although there has been a slowing in falls in the unemployment rate, increases in jobs were still sufficient to pull the rate of unemployment down to 5.5% and surveys and rises in vacancies are pointing to further falls in the rate. As the labour market slack diminishes, wages are being boosted and March gains of 2.7% year/year (excluding bonuses) was the strongest in more than six years. It was markedly higher than inflation but real pay levels will take a considerable time to recover pre-crisis levels and sustained growth depends on a recovery of productivity levels.

Consumer price inflation slipped into deflation in April, prices falling 0.1% month/month. Analysts do not expect deflation to worsen or indeed be prolonged as petrol prices gained more than 2% month/month in May alone. As a result, the downside pressure that has previously contributed to CPI should weaken fairly quickly. On top of this food price inflation is expected to increase. Weakness in inflation has been goods based as services inflation has remained robust.

The Bank of England MPC continues to vote unanimously to hold policy at current levels, but two members indicated that the choice was marginal. However, the lack of price pressures, allied to weaker than expected Qtr 1 growth and a subsequent weaker start to Qtr 2 than hoped, has seen market rate expectations of a rate hike put no earlier than Qtr 2 next year.