CYNGOR SIR *POWYS* COUNTY COUNCIL

AUDIT COMMITTEE
16th July 2015

CABINET
28th July 2015

REPORT BY:	**Cllr. Wynne Jones** **Portfolio Holder for Finance**
SUBJECT:	**Treasury Management Review 2014/15**
REPORT FOR:	**Approval**

1. Introduction:

1.1 The Council's Treasury Management Policy, as per the CIPFA Code of Practice, requires an annual report on Treasury Management activity to be approved by Cabinet by 30th September each year.

1.2 Treasury Management in this context is defined as:
"The management of the authority's 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. The Council's Overall Borrowing Need:

2.1 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 represent's 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.

2.2 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.

3. Strategy for 2014/15:

3.1 At the start of 2014/15 the Authority had an estimated Capital Financing Requirement of £223.3m, projected to rise by £29.9m during the course of the next four years to £253.2m. The Authority's external borrowing at 1st April 2014 stood at £150.8m. Analysis of the balance sheet at 31st March 2014 showed that the Authority was internally borrowed by £67.1M compared to £68.5M at 31st March 2013.

3.2 The expectation for interest rates within the strategy for 2014/15 anticipated low but rising Bank Rate (starting in Qtr 1 of 2015) and gradual rises in medium and longer term fixed borrowing rates during 2014/15. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued economic uncertainty promoted a cautious approach whereby investments would continue to be denominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

3.3 The Capital Programme for 2014/15 incorporated £13.4m of prudential borrowing at start of year so there was the possibility the Authority may need to externally borrow during the year. The agreed strategy for this at the start of the year, based on interest rate forecasts and discussions with Capita (the Authority's advisors), was to set a benchmark of 2.60% for 5 year borrowing, 3.70% for 10 year borrowing, 4.40% for 25 year borrowing and 4.40% for 50 year borrowing. This was revised several times during the year before ending at 2.10% for 5 year borrowing, 2.70% for 10 year borrowing, 3.30% for 25 year borrowing and 3.30% for 50 year borrowing.

3.4 In light of the continuing stress on the world banking system, enhanced priority was given to the security and liquidity of investments.

The strategy for investments therefore was:

a) to ensure the security of the Authority's funds
b) to ensure the Authority had sufficient liquidity to meet its cashflow requirements
c) to achieve the optimum yield after ensuring a) and b) above.

4. Treasury Position:

4.1 The major issue for Treasury Management in 2014-15, alongside reducing cash balances, was the continuing challenging environment of previous years i.e. low investment returns and continuing counterparty risk which meant giving heightened preference to security and liquidity of investments. This resulted in the investment portfolio being in investment instruments with lower rates of return but higher security and liquidity.

4.2 In order to balance the impact of the loss in investment income the Authority was mindful of the possibility of making premature repayments of debt if circumstances were conducive to this.

Net borrowing increased by £11.48M in the year. This increase arose as follows:

	£000s
Decrease in PWLB debt	(15)
Increase/Decrease in LOBO debt	Nil
Increase/Decrease in Market debt	Nil
Increase in Temporary Borrowing	15,000
Increase in Investments	(3,505)
	11,480

4.3 The table below summarises the borrowing and investment transactions during the year:

	Balance 01-04-14	Borrowing	Investments	Repayments	Balance 31-03-15
	£000's	£000's	£000's	£000's	£000's
PWLB *	105,804	Nil	N/A	(15)	105,789
LOBOs *	40,000	Nil	N/A	Nil	40,000
Market Loans	5,000	Nil	N/A	Nil	5,000
Temporary Borrowing	Nil	22,140	N/A	(7,140)	15,000
Total	150,804	22,140	N/A	(7,155)	165,789
Temporary Investments	(10,600)	N/A	(283,574)	280,069	(14,105)
Long Term Investments	Nil	N/A	Nil	Nil	Nil
Net Borrowing	140,204	22,140	(283,574)	272,914	151,684

Note: * Public Works Loan Board / Lender's Option Borrower's Option

4.4 A summary of the economy for 2014/15 is at Appendix A.

5. Icelandic Banks:

5.1 **Landsbanki:**
Members will be aware that this situation was concluded in 2013/14.

5.2 **Glitnir Bank HF:**
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 was earning interest of 3.11% 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.

Members 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.

6. Balance Sheet Review:

6.1 The Authority's advisors carry out an annual balance sheet review following closure of the accounts. This provides, amongst other things, information as to the internal/external borrowing position of the Authority and hence, its future need to borrow.

6.2 The review for 2014/15 is currently being undertaken. The review for 2013/14 revealed that the Authority was under borrowed by £67.1M (31% of the CFR) at 31st March 2014 compared to £68.5M (31% of the CFR) at 31st March 2013. Internal investments in the balance sheet (showing that the Authority is internally borrowed) at 31st March 2014 were £53M compared to £55M at 31st March 2013.

7. Debt Rescheduling/Repayment:

7.1 At the start of 2014/15 the expectation was that investment rates were expected to continue to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

7.2 However, the Authority was already heavily internally borrowed and short term savings by avoiding new long term external borrowing in 2014/15 would need to be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.

7.3 The Authority continued to monitor the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions but PWLB interest rates throughout the year, with an average of 1% differential between new borrowing rates and premature repayment rates, were not conducive to this.

8. Performance Measurement:

8.1 Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide.
In this context, the overall average rate of interest paid on all debt in 2014/15 was 4.32%. This compared with 4.52% in 2013/14.

8.2 The Treasury Management Policy stipulates that the Average Rate on External Investments should be compared with the 3-month uncompounded LIBID rate. This is in preference to the 7-day uncompounded LIBID rate and is in line with Sector's advice. It reflects a more realistic neutral investment position for core investments with a medium-term horizon and a rate which is more stable with less fluctuations caused by market liquidity. Historically, the 3-month rate has been slightly higher than the 7-day rate and is, therefore, more challenging for the cash manager.

8.3 In 2014/15 the average rate on external investments achieved was 0.53% (0.91% in 2013/14) compared with the 3 month uncompounded LIBID rate of 0.429%.

9. Summary Statement of Accounts

9.1 The Treasury Management Policy Statement stipulates that a summary Statement of Accounts for Treasury Management be produced at the year end and reported as part of the annual review (see Appendix B).

10. Prudential/Treasury Indicators

10.1 During the year the Authority operated the treasury limits as approved by Council.

11. Member Training

11.1 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. As such, the Authority provided one members' briefing session for treasury management in 2014/15.

12. Treasury Management Policy Statement

12.1 Any major changes to the Treasury Management Policy Statement are reported to Cabinet whilst any minor changes are circulated to members via the members' portal. The Statement is available on the Intranet at:

http://intranet.powys.gov.uk/index.php?id=4585

Proposal

It is proposed that the Treasury Management Review Report is approved.

Statutory Officers

Chief Finance Officer's comment:
The Strategic Director Resources (S151 Officer) notes the report's contents and that by receiving the report before 30th September the Cabinet has met the Council's responsibility under the code of practice.

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:**
The contents of this report are approved.	Statutory requirement
Person(s) To Action Decision	
Date By When Decision To Be Actioned:	
Relevant Policy (ies):	Financial Regulations, Treasury Management Policy

Within Policy:	**Y**	**Within Budget:**	**N/A**
Contact Officer Name:	**Tel:**	**Fax:**	**Email:**
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Background Papers used to prepare Report:

Treasury Management Policy Statement
CIPFA Code of Practice on Treasury Management and Cross Sectoral Guidance Notes
Advisor's Papers

Appendix A:

The original market expectation at the beginning of 2014/15 was for the first increase in Bank Rate to occur in Qtr 1 2015 as the unemployment rate had fallen much faster than expected through the Bank of England's initial forward guidance target of 7%. In May, however, the Bank revised its forward guidance. A combination of very weak pay rises meant that consumer disposable income was still being eroded and, in August, the Bank halved its forecast for pay inflation in 2014 from 2.5% to 1.25%. Expectations for the first increase in Bank Rate therefore started to recede as growth was still heavily dependent on buoyant consumer demand.

During the second half of 2014 financial markets were caught out by a halving of the oil price and the collapse of the peg between the Swiss franc and the euro. Fears also increased considerably that the European Central Bank (ECB) was going to do too little too late to ward off the threat of deflation and recession in the Eurozone.

By the end of 2014 it was clear that inflation in the UK was going to head towards zero in 2015 and possibly even turn negative. In turn, this made it clear that the MPC would have great difficulty in starting to raise Bank Rate in 2015 while inflation was around zero and so market expectations for the first increase receded back to around Qtr 3 of 2015.

Gilt yields were on a falling trend for much of the last eight months of 2014/15 but were then pulled in different directions by increasing fears after the anti-austerity parties won power in Greece in January. Developments since then have increased fears that Greece could be heading for an exit from the euro. While the direct effects of this would be manageable by the EU and the ECB, it is very hard to quantify quite what the potential knock-on effects would be on other countries in the Eurozone once the so called impossibility of a country leaving the Eurozone has been disproved. Another downward pressure on gilt yields was the announcement in January that the ECB would start a major programme of quantitative easing, purchasing Eurozone government and other debt in March. On the other hand, strong growth in the US caused an increase in confidence that the US was well on the way to making a full recovery from the financial crash and would be the first country to start increasing its central bank rate, probably by the end of 2015. The UK would be closely following it due to strong growth over both 2013 and 2014 and good prospects for a continuation into 2015 and beyond. However, there was also an increase in concerns around the political risk from the general election due in May 2015.

The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing in 2014/15.

The UK coalition government maintained its tight fiscal policy stance but strong economic growth and falling gilt yields led to a reduction in the forecasts for total borrowing in the March budget.

The EU sovereign debt crisis had subsided since 2012 until the Greek election in January 2015 sparked a resurgence of fears. While the UK and its banking system has little direct exposure to Greece, it is much more difficult to quantify quite what effects there would be if contagion from a Greek exit from the euro were to severely impact other major countries in the Eurozone and cause major damage to their banks.

Appendix B

Statement of Accounts
Treasury Management

		2014/15	2014/15	2013/14
		Actual	Budget	Actual
		£	**£**	**£**
Employees		158,395	161,180	172,234
Transport	*1	2,382,149	3,256,750	3,107,782
Supplies & Services		184,289	194,139	187,620
Interest Paid	*2	7,031,129	7,057,993	6,919,005
Debt Management Expenses		113	6,000	28
Gross Expenditure		**9,756,075**	**10,676,062**	**10,386,669**
Interest Received	*3	95,127	0	242,145
Gross Income		**95,127**	**0**	**242,145**
Net Expenditure		**9,660,948**	**10,676,062**	**10,144,524**

Note 1: Transport relates to the cost of leasing across the Authority and is included in the Treasury Management Statement of Accounts as leasing is classed as a Treasury Management activity.

Note 2: Interest paid was under budget as the budget included calculations for Prudential borrowing in 2014/15 which did not take place.

Note 3: A surplus of £95k on interest received was achieved as the Authority carried higher cash balances than expected during the year due to a significant proportion of the Capital programme spend not taking place until late in the financial year or being rolled forward to 2015/16.