CYNGOR SIR *POWYS* COUNTY COUNCIL

AUDIT COMMITTEE
Via email

CABINET
19th Sept 2017

REPORT BY:	**Cllr. Aled Davies** **Portfolio Holder for Finance**
SUBJECT:	**Treasury Management Review 2016/17**
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 2016/17:

3.1 At the start of 2016/17 the Authority had an estimated Capital Financing Requirement of £307.3m, projected to rise by £74.5m during the course of the following four years to £379.8m. The Authority's external borrowing at 1st April 2016 stood at £226.4m. In relation to the CFR figure of £307.3m, this equated to the Authority being under borrowed by £80.9m. This compared to £77M at 1st April 2015.

3.2 The expectation for interest rates within the strategy for 2016/17 anticipated low but rising Bank Rate (starting in Qtr 1 of 2017) and gradual rises in medium and longer term fixed borrowing rates during 2016/17. 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.
In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.
The actual movement in gilt yields meant that there was major volatility in PWLB rates with rates falling during quarters 1 and 2 to reach historically low levels in July and August, before rising significantly during quarter 3 and then partially easing towards the end of the year.

3.3 The Capital Programme for 2016/17 incorporated £12.3m 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 1.90% for 5 year borrowing, 2.40% for 10 year borrowing, 3.20% for 25 year borrowing and 3.00% for 50 year borrowing. This was revised several times during the year before ending at 1.60% for 5 year borrowing, 2.30% for 10 year borrowing, 2.90% for 25 year borrowing and 2.70% 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 2016-17, 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 £1.352M in the year. This increase arose as follows:

	£000s
Decrease in PWLB debt	(18)
Increase/Decrease in LOBO debt	Nil
Increase/Decrease in Market debt	Nil
Increase in Temporary Borrowing	24,345
Increase in Investments	(22,975)
	1,352

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

	Balance 01-04-16	Borrowing	Investments	Repayments	Balance 31-03-17
	£000's	£000's	£000's	£000's	£000's
PWLB *	181,396	Nil	N/A	(18)	181,378
LOBOs *	40,000	Nil	N/A	Nil	40,000
Market Loans	5,000	Nil	N/A	Nil	5,000
Temporary Borrowing	655	25,000	N/A	(655)	25,000
Total	227,051	25,000	N/A	(673)	251,378
Temporary Investments	(8,450)	N/A	(268,630)	245,655	(31,425)
Long Term Investments	Nil	N/A	Nil	Nil	Nil
Net Borrowing	218,601	25,000	(268,630)	244,982	219,953

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

4.4 A summary of the economy for 2016/17 is at Appendix A.

5. Icelandic Banks:

5.1 **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 4.22% at 31/03/16. On 16th June 2016 the Authority took part in the final Icelandic Central Bank currency auction as a result of which the ISK held in escrow was sold at the best price available. Settlement was made in Euros (€475k) to a Euro bank account held by the Authority in the UK. This gave the Authority control over the timing of the currency exchange. A decision was made on 2nd September 2016 to convert the Euros to GBP (£399k). As such, the Glitnir situation was concluded.

6. Debt Rescheduling/Repayment:

6.1 No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

7. Performance Measurement:

7.1 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 2016/17 was 4.10%. This compared with 4.46% in 2015/16.

7.2 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 Capita'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.

7.3 In 2016/17 the average rate on external investments achieved was 0.59% (0.63% in 2015/16) compared with the 3 month uncompounded LIBID rate of 0.322%.

8. <u>Summary Statement of Accounts</u>

8.1 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).

9. <u>Prudential/Treasury Indicators</u>

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

10. <u>Member Training</u>

10.1 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 2016/17.

11. <u>Treasury Management Policy Statement</u>

11.1 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 two major landmark events that had a significant influence on financial markets in the 2016-17 financial year were the UK EU referendum on 23rd June and the election of President Trump in the USA on 9th November. The first event had an immediate impact in terms of market expectations of when the first increase in Bank Rate would happen, pushing it back from quarter 3 2018 to quarter 4 2019. At its 4th August meeting, the Monetary Policy Committee (MPC) cut Bank Rate from 0.5% to 0.25% and the Bank of England's Inflation Report produced forecasts warning of a major shock to economic activity in the UK, which would cause economic growth to fall almost to zero in the second half of 2016. The MPC also warned that it would be considering cutting Bank Rate again towards the end of 2016 in order to support growth. In addition, it restarted quantitative easing with purchases of £60bn of gilts and £10bn of corporate bonds, and also introduced the Term Funding Scheme whereby potentially £100bn of cheap financing was made available to banks.

In the second half of 2016, the UK economy confounded the Bank's pessimistic forecasts of August. After a disappointing quarter 1 of only +0.2% GDP growth, the three subsequent quarters of 2016 came in at +0.6%, +0.5% and +0.7% to produce an annual growth for 2016 overall, compared to 2015, of no less than 1.8%, which was very nearly the fastest rate of growth of any of the G7 countries. Needless to say, this meant that the MPC did not cut Bank Rate again after August but, since then, inflation has risen rapidly due to the effects of the sharp devaluation of sterling after the referendum. By the end of March 2017, sterling was 17% down against the dollar but had not fallen as far against the euro. In February 2017, the latest CPI inflation figure had risen to 2.3%, above the MPC's inflation target of 2%. However, the MPC's view was that it would look through near term supply side driven inflation, (i.e. not raise Bank Rate), caused by sterling's devaluation, despite forecasting that inflation would reach nearly 3% during 2017 and 2018. This outlook, however, is dependent on domestically generated inflation, (i.e. wage inflation), continuing to remain subdued despite the fact that unemployment is at historically very low levels and is on a downward trend. Market expectations for the first increase in Bank Rate moved forward to quarter 3 2018 by the end of March 2017 in response to increasing concerns around inflation.

USA. Quarterly growth in the US was very volatile during 2016 but a strong performance since mid-2016, and strongly rising inflation, prompted the Fed into raising rates in December 2016 and March 2017. The US is the first major western country to start on a progressive upswing in rates. Overall growth in 2016 was 1.6%.

EU. The EU is furthest away from an upswing in rates; the European Central Bank (ECB) cut rates into negative territory, provided huge tranches of cheap financing and carried out major quantitative easing purchases of debt during 2016-17 in order to boost growth from consistently weak levels and to get inflation up from near zero towards its target of 2%. These purchases have resulted in depressed bond yields in the EU but, towards the end of 2016, yields rose, probably due at least in part to rising political concerns around the positive prospects for populist parties and impending general elections in 2017 in the Netherlands, France and Germany. The action taken by the ECB has resulted in economic growth improving significantly in the Eurozone to an overall figure of 1.7% for 2016, with Germany achieving a rate of 1.9% as the fastest growing G7 country.

On the other hand, President Trump's election and promise of fiscal stimulus, which are likely to increase growth and inflationary pressures in the US, have resulted in Treasury yields rising sharply since his election. Gilt yields in the UK have been caught between these two influences and the result is that the gap in yield between US treasuries and UK gilts has widened sharply during 2016/17 due to market perceptions that the UK is still likely to be two years behind the US in starting on an upswing in rates despite a track record of four years of strong growth.

Japan struggled to stimulate consistent significant growth with GDP averaging only 1.0% in 2016 with current indications pointing to a similar figure for 2017. It is also struggling to get inflation up to its target of 2%, only achieving an average of -0.1% in 2016, despite huge monetary and fiscal stimulus, though this is currently expected to increase to around 1% in 2017. It is also making little progress on fundamental reform of the economy.

China and emerging market counties. At the start of 2016, there were considerable fears that China's economic growth could be heading towards a hard landing, which could then destabilise some emerging market countries particularly exposed to a Chinese economic slowdown and / or to the effects of a major reduction in revenue from low oil prices. These fears have largely subsided and oil prices have partially recovered so, overall, world growth prospects have improved during the year.

Equity markets. The result of the referendum, and the consequent devaluation of sterling, boosted the shares of many FTSE 100 companies which had major earnings which were not denominated in Sterling. The overall trend since then has been steeply upwards and received further momentum after Donald Trump was elected President as he had promised a major fiscal stimulus to boost the US economy and growth rate.

Appendix B:

Statement of Accounts
Treasury Management

		2016/17	2016/17	2015/16
		Actual	Budget	Actual
		£	**£**	**£**
Employees		160,103	165,000	160,103
Transport	*1	1,537,011	1,788,000	1,253,283
Supplies & Services		199,815	193,000	165,704
Interest Paid	*2	9,924,698	10,185,000	10,060,890
Debt Management Expenses		0	6,000	25,992
Gross Expenditure		**11,821,627**	**12,337,000**	**11,665,972**
Interest Received	*3	140,032	0	123,228
Gross Income		**140,032**	**0**	**123,228**
Net Expenditure		**11,681,595**	**12,337,000**	**11,542,744**

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: Supplies and Services was over the original budget due to the change in Dr/Cr card charges rules which increased card charges.

Note 3: A surplus of £140k on interest received was achieved as the Authority carried higher cash balances than expected during the year.