CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
To be emailed

CABINET
19th September 2017

REPORT AUTHOR: **County Councillor Aled Davies**
Portfolio Holder for Finance

SUBJECT: **Treasury Management Qtr 1 Report**

REPORT FOR: **Information**

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1. Summary

1.1 CIPFA's 2009 Treasury Management Bulletin 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 2017.

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 17	Dec 17	Mar 18	Jun 18	Sep 18	Dec 18	Mar 19
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
5yr PWLB	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%
10yr PWLB	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%
25yr PWLB	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%
50yr PWLB	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%

3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 7th March 2017 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 0.25% Bank Rate.

4.2 The Authority's investment position as at 30th June 2017 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
Santander	6,160	0.25%	N/A	Deposit A/c
BOS	500	0.05%	N/A	Deposit A/c
HSBC	30	0.00%	N/A	Deposit A/c
Total	**6,690**			
Lloyds TSB - LAMS	1,000	3.20%	13.08.12	14.08.17

4.3 Interest rates on the deposit accounts decreased, as expected, following the bank rate cut in August 2016. With effect from April the BOS account has reduced to 0.05%. The Santander rate remains at 0.25% as a result of the original account opened with Abbey National stating that it must be at bank rate.

4.4 Higher return rates are difficult to achieve as the Authority is not in a position to invest its cash for more than a short period of time.

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

4.6 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 was not reached despite the provision of 3 separate legal opinions supporting the Capital Expenditure position. As such, Capita said there was little further they could 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.

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

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

	Suggested Rate
2017/18	0.25%
2018/19	0.25%

These are based on investments for up to three months duration.

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 31.03.17 Actual	2017/18 Original Estimate	2018/19 Original Estimate	2019/20 Original Estimate
	£M	£M	£M	£M
Capital Financing Requirement	307,524	326,461	357,224	382,433

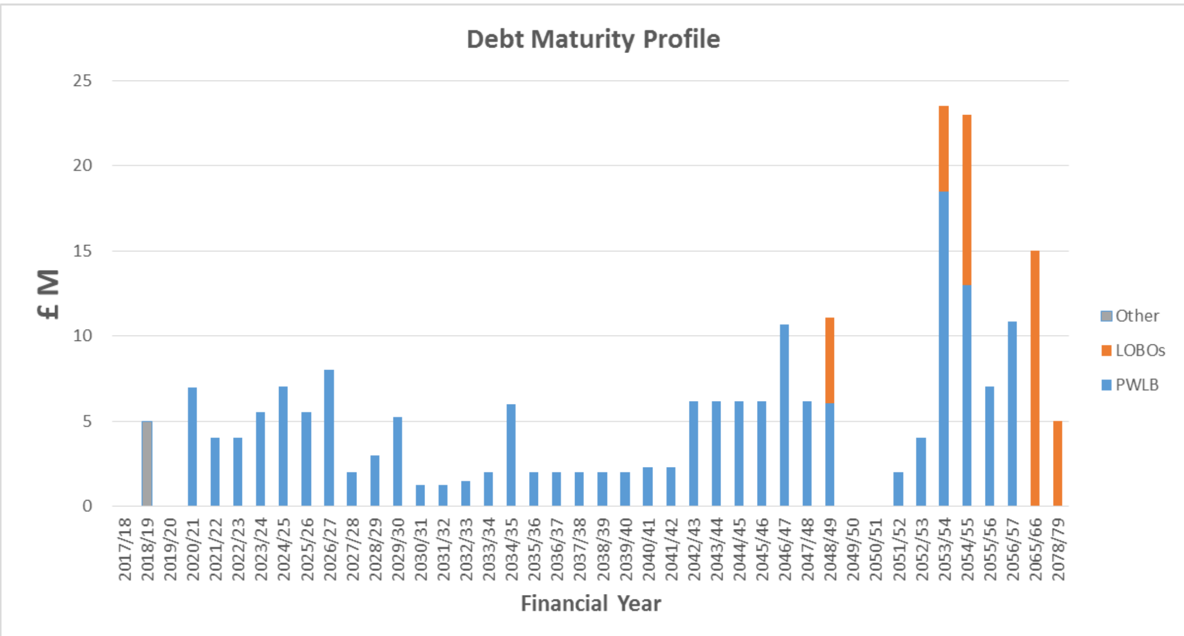
6.3 The Authority had outstanding long-term external debt of £226.4M at 31st March 2017. In relation to the CFR figure for 31st March 2017, this equated to the Authority being under borrowed by £81M. This is a prudent and cost effective approach in the current economic climate. However, internal borrowing 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**
	74,111,259			
June		92,745,511	8,748,957	9.43%
Sept				
Dec				
March				

The financing of the approved capital budget included £17.9M of Prudential borrowing in total.

6.5 *Debt Maturity Profile as at 30.06.17:*



6.6 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
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 2017.

8. VAT

8.1 The Treasury Manager acts as the authority's VAT officer. VAT can pose a risk to the authority hence the TM has been asked to include VAT information in these quarterly reports.

8.2 The monthly VAT returns were submitted within the required deadlines during the quarter ending 30th June 2017.

8.3 Key Performance Indicators:

The VAT KPI's for 2017/18 are attached at Appendix C.

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 members are kept informed about this key activity. The report notes that, given the low interest environment, we may need to reflect whether we take out borrowing. This will be kept under review and continue to be discussed with our advisor.

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

<table>
<tr><td colspan="2">Recommendation:</td><td colspan="2">Reason for Recommendation:</td></tr>
<tr><td colspan="2">That the Treasury Management Quarterly Report be received</td><td colspan="2">To ensure Cabinet remains informed about current Treasury Management performance</td></tr>
<tr><td colspan="2">Relevant Policy (ies):</td><td colspan="2">Treasury Management Policy</td></tr>
<tr><td>Within Policy:</td><td>Y</td><td>Within Budget:</td><td>N/A</td></tr>
<tr><td colspan="2">Person(s) To Implement Decision:</td><td colspan="2">N/A</td></tr>
<tr><td colspan="2">Date By When Decision To Be Implemented:</td><td colspan="2">N/A</td></tr>
</table>

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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

Appendix A:

Approved Treasury Management Strategy 2017/18:

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	£20M (held in call accounts)	As per rating list
UK	No Maximum Investment	As per rating list

7.7 *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 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 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

Throughout the year, Brexit has been ever present in economic discussions and June was no different as economic stability appeared more uncertain.

The first economic releases of June were of sombre viewing as the UK Purchasing Managers Index (PMI) survey figures were released. While still in expansion territory, manufacturing activity fell to a 3 month low of 54.3 from a downwardly revised 56.3. This drop in activity was a result of poor Q1 GDP growth and a sharp increase in inflation. Export orders also rose at their slowest pace for five months as the UK struggled to benefit from the weaker sterling, as some hoped they would. The Construction PMI also signified a slowing of activity as it fell to 54.8 in June from the 18 month high of 56 in May. Again, the survey results were a product of political and economic uncertainty. The slowing of activity was also reflected in the Services sector which saw its PMI fall to 53.4 from 53.8 in June, a four month low. As a result of these individual declines, the composite PMI reading has almost fallen to its 2011 lows. Growth in export orders also hit a nine month low as the economy started to see the effects of Brexit. Other data showed that industrial production fell by 0.2% on an annual basis in May, an improvement from its 0.8% fall in April. Manufacturing rose by 0.4% on the year. In all, these figures gave the economy an uncertain outlook as the quarter came to a close.

June employment figures painted a positive picture as unemployment fell to a 42 year low of 4.5%. However, it was a case of all work and no pay as average weekly earnings, including bonuses, fell by 0.7% when adjusted for inflation. This left economists concerned about the potential impact on consumer confidence. The Bank of England is keeping a close eye on wage growth as they try to observe whether increased inflation is leaving a longer term impact on prices. The fall in real wages makes an interest rate rise significantly less likely as Bank of England Governor Mark Carney stated that interest rates would probably need to rise if wages were to grow more strongly.

On the prices front, there was a particularly surprising piece of news as Consumer Price Inflation (CPI) fell to 2.6% from the four year high of 2.9% in May. This was in contrast to economists' predictions of an unchanged rate. The fall in inflation was primarily a result of falling oil prices. However, inflation is expected to pick up again as a result of the falling pound causing imports to be more expensive. However, the Bank of England have stated they expect this effect to only be temporary. Retail Price Inflation (RPI) fell to 3.5% from 3.7%. The high inflation is expected to have a negative effect on consumer spending as it eats away at disposable income.

There was one cause for optimism as, after a poor start to the year, retail sales rebounded, rising 0.6% in June after a 1.1% fall in May. In the three months to June, sales rose by 1.5% offsetting the 1.4% drop in the first quarter of 2017. Thanks to the unseasonably warm weather, there was a rise in purchasing of clothes, offsetting the fall in sales of food and oil. Despite the apparent boost, some surveys noted that confidence took a slight knock as Prime Minister Theresa May lost her majority in the May election, creating fresh political uncertainty to add to that for the overall economy. Economists also predict that sluggish consumer demand is likely to slow growth, while stronger exports and investment are hoped to compensate. Despite the increase in retail sales, consumer confidence fell to -12, a twelve month low.

UK public finances were majorly hit by inflation as the deficit rose to £6.854 billion, 43% higher than at the same point the previous year. In Q1, the budget deficit also widened to

£22.8 billion, increasing 8.9% compared to the last year. Spending on debt jumped up by 33% on the previous year to £4.9 billion as a higher inflation increased the cost of index linked bonds. The budget deficit is expected to widen to 2.9% of GDP from 2.4% of GDP last year. Chancellor Phillip Hammond is still looking to balance the deficit by the middle of the next decade but remains willing to be flexible as Britain continues the process of leaving the European Union.

The last big data release of the month was the first Q2 GDP estimates. This showed that the economy grew by 0.3%, up from 0.2% during the first quarter. However, Brexit did lead to a fall in sterling, pushing up inflation which is eating away at consumers finances this year. Resultantly, the International Monetary Fund downgraded the economic outlook of Britain by more than any other G7 country, predicting growth of 1.7%, down from their previous forecast of 2.0%.

The Eurozone is carrying on a steady recovery. The unemployment rate of 9.3%, while higher than market expectations, remains unchanged and is still the lowest rate in Europe since 2009 as they slowly recover from the effects of the financial crisis. The European Central Bank (ECB) also decided to keep policy rates unchanged while carrying on their monthly €60 billion monetary stimulus until at least December. German inflation rose by 1.6%, which was stronger than expected, suggesting a brighter future only days after ECB head Mario Draghi suggested a less accommodating ECB policy in 2018.

June was a good month for the US which saw the unemployment rate come in at 4.4%. While this is a rise from the 16 year low 4.3%, this is down to more people looking for jobs. Non-farm payrolls saw accelerating growth, jumping up by 220,000. The increased labour market activity suggests confidence in the labour market. These encouraging figures could lead the US central bank to begin the process of reducing its portfolio of bonds and securities later in the year. However, markets do not expect it to increase interest rates until at least December, due to the US having low inflation at 1.6%. Growth accelerated at 2.6% in Q2 with boosts in consumers spending and firms investing. This is despite Congress being unable to make any headway on President Trump's fiscal initiatives.

Appendix C

VAT - Key Performance Indicators:

Creditor Invoices

VAT return for	No of high value Creditor invoices checked	No of Creditor invoices highlighted as requiring "proper" document for VAT recovery	%age of creditor invoices checked requiring "proper" document for VAT recovery
Apr-17	159	5	3.14%
May-17	123	9	7.32%
Jun-17	203	11	5.42%
Jul-17			
Aug-17			
Sep-17			
Oct-17			
Nov-17			
Dec-17			
Jan-18			
Feb-18			
Mar-18			

Cash Receipting Entries

VAT return for	No of cash receipting entries checked by formula per the ledger account code used	No of cash receipting entries needing follow up check	%age of cash receipting entries needing follow up check
Apr-17	3,429	11	0.37%
May-17	4,785	5	0.10%
Jun-17	4.497	9	0.20%
Jul-17			
Aug-17			
Sep-17			
Oct-17			
Nov-17			
Dec-17			
Jan-18			
Feb-18			
Mar-18			

Debtor Invoices

VAT return for	No of Debtor invoices checked (value >£5k)	No of checked debtor invoices with incorrect VAT code used	%age of debtor invoices with incorrect VAT code
Apr-17	32	8	25.00%
May-17	47	7	14.89%
Jun-17	25	2	8.00%
Jul-17			
Aug-17			
Sep-17			
Oct-17			
Nov-17			
Dec-17			
Jan-18			
Feb-18			
Mar-18			

Purchase Cards

VAT return for	No of Purchase Card transactions for previous month for which paperwork requested for checking	No of Amazon invoices included in Purchase card check	No of Purchase Card transactions for which no response received within timescale	Value of VAT potentially claimable but recharged to budget due to non-response	No of sampled Purchase Card transactions where VAT claimed incorrectly	%age of Purchase Card transactions available to be checked where VAT was claimed incorrectly	Value of VAT incorrectly claimed hence recharged to budget
Apr-17	62	18	40	£3,747.61	4	18.18%	£7.31
May-17	79	9	22	£3,330.52	3	5.26%	£266.96
Jun-17	157	114	14	£3,967.04	10	6.99%	£347.36
Jul-17							
Aug-17							
Sep-17							
Oct-17							
Nov-17							
Dec-17							
Jan-18							
Feb-18							
Mar-18							

Voluntary Declarations

Per HMRC regulations, any vat errors discovered can be adjusted in the current VAT account if they are:

- below the reporting threshold (>£10,000 or up to 1% of the VAT return Box 6 figure up to a maximum of £50,000)
- not deliberate
- for an accounting period that ended less than 4 years ago.

Any errors that do not meet these conditions have to be reported to HM Revenue and Customs and are referred to as voluntary declarations. The following have been reported and/or ongoing in 2017. No penalties have been applied by HMRC but interest has been charged.

Date of declaration	Value of voluntary declaration	Service Area	Interest charged by HMRC
01-Dec-16	£119,560.81	Leisure – BSU	To be confirmed by HMRC
11-Jan-17	£15,223.65	Fleet - Pool cars	To be confirmed by HMRC
30-Jan-17	£20,592.34	Regen – invoices to YFC's	£2,277.23

Chargebacks to service areas

As a result of the Creditor invoice checking, Treasury Management produce a monthly list of Creditor payments for which a "proper" vat document has not been received. Any VAT amounts on these invoices are held in the vat account and are not claimed until such time as a valid invoice is received. The relevant budget holder is emailed the details and asked to source a correct invoice within one month. A chargeback for Apr – July is due to take place in August.