CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
To be emailed

CABINET
30th January 2018

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

SUBJECT: **Treasury Management Qtr 3 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 31st December 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:
2.3

Link Asset Services Interest Rate View													
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

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 0.50% Bank Rate.

4.2 The Authority had no investments at 31st December 2017.

Invested with:	**Principal £000's**	**Interest Rate**	**Start Date**	**Maturity Date**
Santander	0	0.50%	N/A	Deposit A/c
HSBC	0	0.25%	N/A	Deposit A/c
Total	**0**			

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

4.6 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 December 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, members will be aware that internal borrowing is only a temporary situation and officers have advised that, based on capital estimates, it will be necessary for the Authority to borrow at stages over the next few years. The following temporary borrowing is applicable to this financial year. It is expected that temporary borrowing will be necessary on further occasions throughout the financial year.

BORROWED Date	Borrower	Type	Amount	Rate	REPAID Date
29-Sep-17	Manchester City Council	Fixed to 5/10	5,000,000	0.20000	05-Oct
20-Oct-17	Powys Pension Fund	Fixed to 23/10	730,000	0.20000	23-Oct
24-Oct-17	Powys Pension Fund	Fixed to 25/10	300,000	0.20000	25-Oct
30-Oct-17	Newport City Council	Fixed to 7/11	5,000,000	0.14000	07-Nov
31-Oct-17	Rhondda Cynon Taff CBC	Fixed to 6/11	3,000,000	0.20000	06-Nov
30-Nov-17	Scarborough Borough Council	Fixed to 5/12	4,000,000	0.35000	05-Dec
04-Dec-17	Powys Pension Fund	Fixed to 6/12	1,000,000	0.40000	06-Dec
05-Dec-17	Powys Pension Fund	Fixed to 6/12	750,000	0.40000	06-Dec
28-Dec-17	Manchester City Council	Fixed to 4/1	6,000,000	0.38000	04-Jan

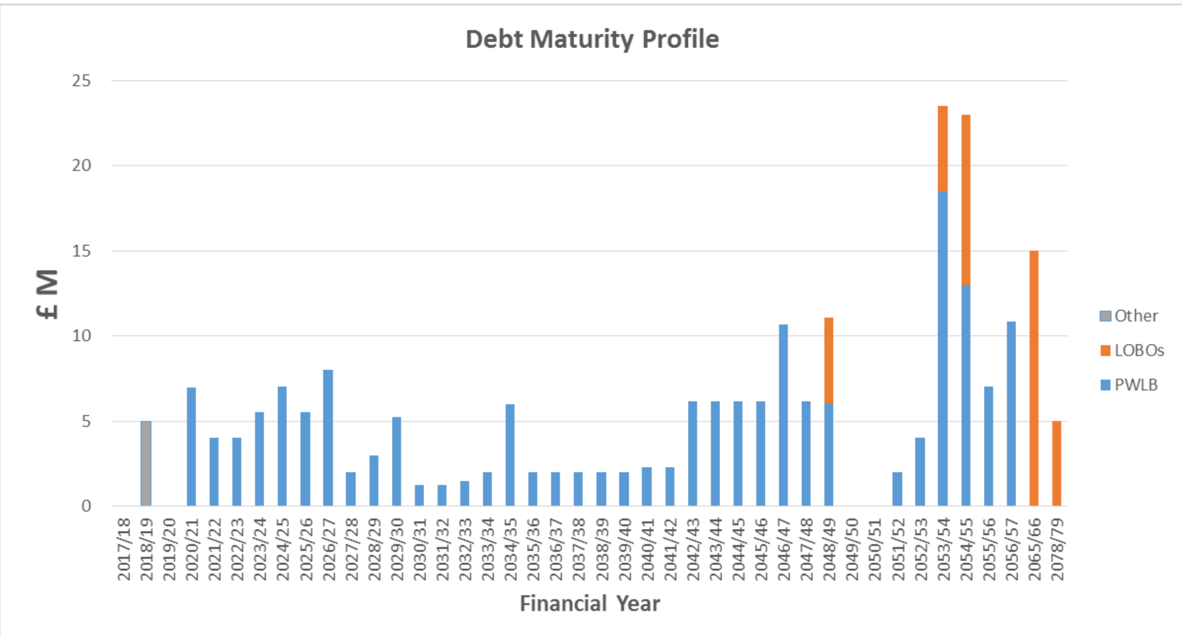
Alongside this, it is likely that some longer term borrowing will take place, if interest rates are conducive to this. This is a prudent approach to ensure some borrowing takes place whilst interest rates are at their low levels as opposed to borrowing at a future date at increased rates.

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		96,322,803	19,174,168	19.91%
Dec		88,805,658	31,465,783	35.40%
March				

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

6.5 *Debt Maturity Profile as at 31.12.17:*



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 31st December 2017.

8. VAT

8.1 The Technical Section of Finance act as the authority's VAT section. 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 31st December 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 Head of Financial Services (acting s151 officer) notes the content of the report and supports the recommendation.

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**	

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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

<u>Appendix A:</u>

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:

<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

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

UK. After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 was disappointingly weak in the first half of the year; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y), which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has, in turn, caused a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure.

Growth picked up in quarter 3 to 0.4% and in quarter 4 there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole. Growth in quarter 4 is expected to be around 0.4% again which would see annual growth in 2017 coming in at around 1.7 – 1.8%, almost as strong as the recently upwardly revised figure for 2016 of 1.8%, (which meant that the UK was equal to Germany as having the strongest GDP growth figure for the G7 countries in 2016).

The Monetary Policy Committee (MPC) meeting on 14th September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in its words warning that Bank Rate will need to rise. Recent Bank of England Inflation Reports have flagged up that they expected CPI inflation to peak at just over 3% in late 2017 before falling back to near to its target rate of 2% in two years' time. Inflation actually came in at 3.1% in November. The reason why the MPC became so aggressive with its wording in September and November around increasing Bank Rate, was due to an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

It was therefore no surprise that the MPC increased Bank Rate by 0.25% to 0.5% in November. However, their forward guidance of two more increases of 0.25% by 2020 was viewed as being more dovish than markets had expected. However, some forecasters are flagging up that they expect growth to improve significantly in 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weaker services sector growth. If this scenario was to materialise, then the MPC would have added reason to embark on more than one increase in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

EU. Economic growth in the EU, (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and 0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in November inflation was only 1.2%. It is therefore unlikely to start on an upswing in rates until possibly towards the end of 2019.

USA. Growth in the American economy has been volatile in 2015 and 2016. 2017 followed that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.2%, the first time since 2014 that two successive quarters have been over 3%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1% in November, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on an upswing in rates with four increases since December 2016 to lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. In October, the Fed became the first major western central bank to make a start on unwinding quantitative easing by phasing in a start to a gradual reduction of reinvesting maturing debt.

Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus and medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

Japan. GDP growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However, it is still struggling to get inflation anywhere near to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

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	171	4	2.34%
Aug-17	182	27	4.84%
Sep-17	181	11	6.08%
Oct-17	197	11	5.58%
Nov-17	186	18	9.68%
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	4,627	17	0.37%
Aug-17	3,134	12	0.38%
Sep-17	3,423	6	0.18%
Oct-17	5,316	14	0.26%
Nov-17	4,077	6	0.15%
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	27	4	14.81%
Aug-17	37	8	21.62%
Sep-17	44	18	40.91%
Oct-17	45	7	15.56%
Nov-17	35	3	8.57%
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	126	6	33	£4,321.97	3	3.23%	£442.14
Aug-17	156	56	48	£3,050.46	10	9.26%	£281.63
Sep-17	121	4	8	£1,605.17	9	7.96%	£458.18
Oct-17	115	9	11	£2,125.70	3	2.88%	£72.15
Nov-17	123	6	7	£852.07	2	1.72%	£72.68
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 are 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
11-Jan-17	£15,223.65	Fleet - Pool cars	£3,152.43
30-Jan-17	£20,592.34	Regen - YFC Billing	N/A
15-Nov-17	£34,315.54	Home to School Transport	not yet known

Chargebacks to service areas

As a result of the monthly Creditor invoice checking, Treasury Management produce a 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 document. Failure to do this results in the relevant budget being charged with the vat amount that cannot be reclaimed due to the lack of a proper document.
The total charged back in 2017/18 at the end of December is £49,614.52