CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
29th January 2015

CABINET
10th February 2015

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

SUBJECT: **Treasury Management Half Year Report**

REPORT FOR: **Information**

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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 31st December 2014.

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:

	Mar 15	**Jun 15**	**Sep 15**	**Dec 15**	**Mar 16**	**Jun 16**	**Sep 16**	**Dec 16**
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%
5yr PWLB	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%
10yr PWLB	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%
25yr PWLB	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%
50yr PWLB	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%

3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 5th March 2014 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 31st December 2014 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
Santander	2,165	0.40%	N/A	Deposit A/c
HSBC	590	0.25%	N/A	Deposit A/c
Total	**2,755**	**0.37%**		
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 basket of currencies in March 2012. An element of the distribution was in Icelandic Kroner

which was placed in an escrow account in Iceland and is earning interest of 4.2% as at 31/03/14. 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.

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
2014/15	0.50%	0.60%
2015/16	0.60%	1.00%
2016/17	1.25%	1.60%

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 31.03.14 Actual	2014/15 Original Estimate	2015/16 Original Estimate	2016/17 Original Estimate
	£M	£M	£M	£M
Capital Financing Requirement	220,383	236,446	241,480	249,017

6.3 The Authority had outstanding external debt of £150.8M at 31st March 2014. In relation to the CFR figure for 31st March 2014, this equated to the Authority being under borrowed by £69.6M. 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:

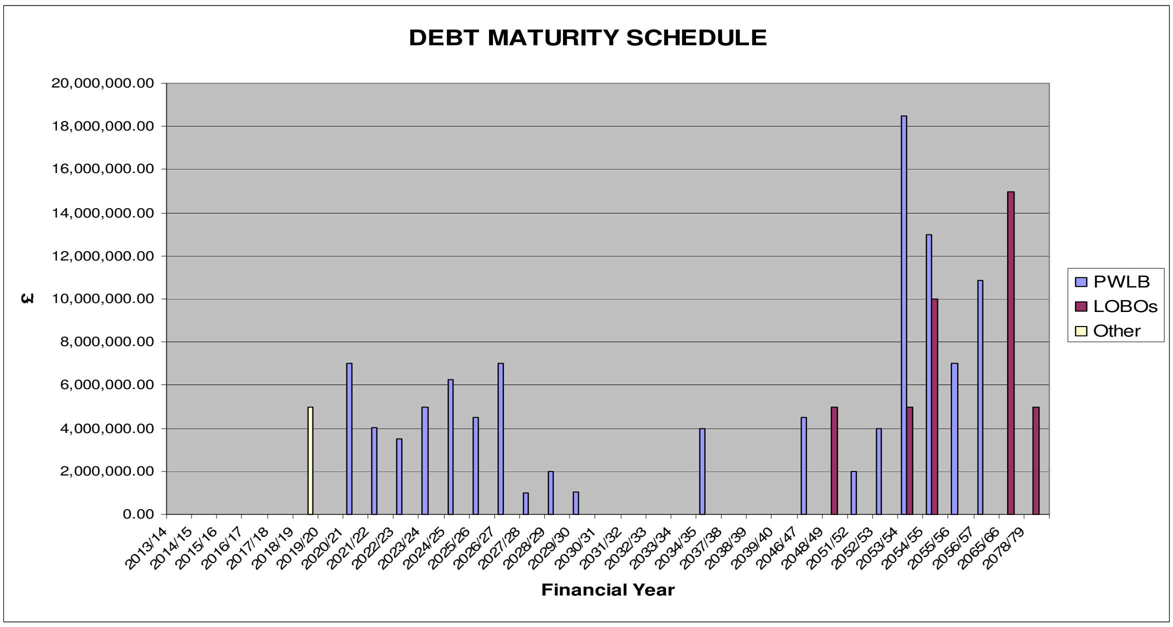
Capital:	**Approved Budget**	**Working budget**	**Capital Spend**	**%age spend**
	47,642,983			
June		53,174,278	2,775,606	5.20%
Sept		57,083,520	12,992,540	22.76%
Dec		57,341,365	19,760,096	34.46%

The spend figures above do not include commitments. A percentage of the capital budget will be internal spend which obviously does not affect the cashflow forecast.

The financing of the approved capital budget includes £13.4M of Prudential borrowing.

6.5 *Debt Maturity Profile as at 31.12.14:*

(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 31.12.14	Borrowing rate at time of writing report 19.01.15	Target borrowing rate now	Target borrowing rate previous
5 year	2.27%	2.08%	2.70%	2.70%
10 year	2.84%	2.58%	3.40%	3.70%
25 year	3.50%	3.20%	4.00%	4.40%
50 year	3.49%	3.19%	4.00%	4.40%

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.

6.9 PWLB Certainty Rate:

In the March 2012 budget report the Government announced that it would introduce in 2012-13, a 20 basis points (bps) discount on loans from the Public Works Loan Board (PWLB) under the prudential borrowing regime for those principal local authorities providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans. This discount continues to be available in 2014/15 and the Authority registered its interest in this preferred rate option.

7. Prudential Indicators

7.1 All TM Prudential Indicators were complied with in the quarter ending 31st December 2014.

8. Projects Update

8.1 Income Management System:
As reported previously, TM was taking the lead role in the acquirement of a replacement income management/cash receipting system. Replacement was necessary due to support being withdrawn for the current system and members will appreciate that this is a vital corporate system. Successful implementation took place in the first week of November with only 12 hours downtime overnight.
The second smaller phase of introducing chip and pin terminals in main offices and libraries is now underway.

8.2 TM continues to work with other service areas on projects/improvements. This currently includes Income and Awards and the Schools Service/Catering.

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

<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 2014/15:

Long Term Ratings:

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:

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
F1+	N/A	A-1+
F1	P-1	A-1

Further to the ratings above the Strategy includes using UK nationalized or part nationalized institutions based on the following explanation:

"Nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high creditworthiness. These institutions, however, are recipients of an F1+ short term rating as they have effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.

Country Limits:

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

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 of this 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 Capita'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 strong UK GDP growth in 2013 at an annual rate 2.7%, and then 0.7% in Q1 2014 and 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014, leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting and, particularly, of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The Monetary Policy Committee is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November and 0.5% in December, the joint lowest rate on record. Forward indications are that inflation is likely to remain low for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently predicted that the first increase in the Fed rate will occur by the middle of 2015.

The Eurozone is facing an increasing threat from deflation. In November the inflation rate fell to 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the European Central Bank did take some rather limited action in June and September to loosen monetary policy in order to promote growth and is currently expected to embark on quantitative easing early in 2015 to counter this threat of deflation and to stimulate growth.