

CYNGOR SIR POWYS COUNTY COUNCIL.

**AUDIT COMMITTEE
4th November 2016**

**CABINET
22nd November 2016**

**REPORT AUTHOR: County Councillor Wynne Jones
Portfolio Holder for Finance**

SUBJECT: Treasury Management Qtr 2 Report

REPORT FOR: Information

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 30th September 2016.

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:

	Dec 16	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Jun 18
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%
5yr PWLB	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%
10yr PWLB	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%
25yr PWLB	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%
50yr PWLB	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%

3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 9th March 2016 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 Sept 2016 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
Santander	2,745	0.15%	N/A	Deposit A/c
BOS	14,430	0.15%	N/A	Deposit A/c
HSBC	70	0.00%	N/A	Deposit A/c
Total	17,245	0.15%		
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. Although the HSBC account returns Nil interest, the account is still utilised in order to report on the investments position correctly; to ensure emergency funds are available as withdrawals from other accounts have an earlier cut-off point; and to manage costs where relevant as there is no CHAPS fee in respect of transfers to the HSBC account as it is an internal transaction.

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. However, following the Brexit vote, there were some changes to the Ratings Outlooks for these banks. This was due to the uncertainty around the Brexit process.

UK Sovereign Rating Action:

The following took place following Brexit:

Fitch:

- Sovereign rating downgraded by one notch, from AA+ to AA
- Outlook lowered to Negative, from Stable

Moody's:

- Sovereign rating affirmed, at Aa1 (equivalent to AA+ from Fitch / S&P)
- Outlook lowered to Negative, from Stable

Standard & Poor's (S&P):

- Sovereign rating downgraded by two notches, from AAA to AA
- Remains on Negative Outlook

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 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.

4.7 Glitnir:

The Glitnir situation concluded in September. A final report in respect of the Icelandic situation was submitted to Cabinet on 4th October.

4.8 Redemption Penalties:

There are no current fixed investments to redeem.

4.9 Investment returns in future years:

Our advisors' current suggested earning rates for investments for budgeting purposes are as follows:-

	Suggested Rate
2016/17	0.25%
2017/18	0.10%
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 Sept 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 31.03.16 Actual	2016/17 Original Estimate	2017/18 Original Estimate	2018/19 Original Estimate
	£M	£M	£M	£M
Capital Financing Requirement	302,363	307,313	326,288	354,093

6.3 The Authority had outstanding long-term external debt of £226.4M at 31st March 2016. In relation to the CFR figure for 31st March 2016, this equated to the Authority being under borrowed by £76M. 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.

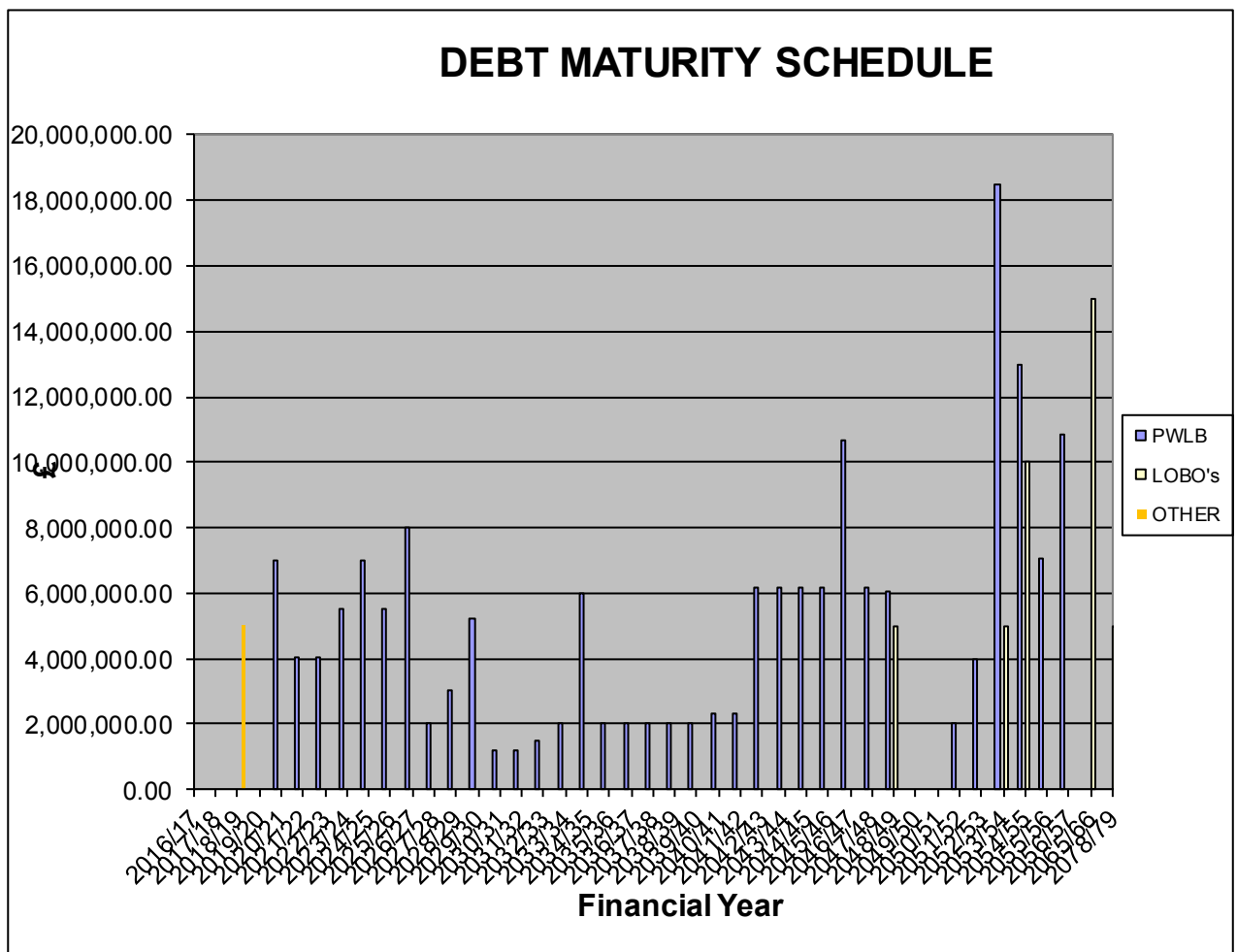
6.4 Capital Budget/Spend per efinancials:

Capital:	Approved Budget	Working budget	Actual Capital Spend (not including commitments)	%age spend
	45,069,066			
June		52,381,477	3,087,768	5.89%
Sept		55,298,113	9,782,827	17.69%
Dec				
March				

The financing of the approved capital budget included £20.4M of Prudential borrowing in total.

6.5 Debt Maturity Profile as at 30.09.16:

(please click on the graph below and increase the percentage in the toolbar above for an enhanced view)



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 Sept 2016.

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

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	
Contact Officer Name:	Tel:	Fax:	Email:
Ann Owen	01597 826327	01597 826290	ann.owen@powys.gov.uk

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 2016/17:

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

The UK GDP growth rate of 1.8% for 2015 was disappointing although it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back to +0.4% in quarter 1 of 2016 before bouncing back again to +0.7% (2.1% y/y) in quarter 2. During most of 2015, the economy had faced difficulties for exporters from the appreciation during the year of sterling against the Euro; weak growth in the EU; China and emerging markets; plus the dampening effect of the Government's continuing austerity programme. The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that, although the economy will now avoid flat lining, growth will be weak through the second half of 2016 and in 2017.

The Bank of England meeting on August 4th addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access (i.e. without tariffs) to the EU single market. He also warned that the Bank could not do all the heavy lifting and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor Phillip Hammond announced after the referendum result that the target of achieving a budget surplus in 2020 will be eased in the Autumn Statement on November 23rd.

The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years. However, the MPC is expected to look through a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

The American economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 disappointed at +0.8% on an annualised basis while quarter 2 improved, but only to a lacklustre +1.4%. However, forward indicators are pointing towards a pickup in growth in the rest of 2016. The Federal Bank embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase which is now strongly expected in December this year.

In the Eurozone, the ECB commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in quarter 1 2016 (1.7% y/y) but slowed to +0.3%

(+1.6% y/y) in quarter 2. This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in their economies and economic growth.

Japan is still bogged down in weak growth and making little progress on fundamental reform of the economy while Chinese economic growth has been weakening and medium term risks have been increasing.