

CYNGOR SIR POWYS COUNTY COUNCIL.

**AUDIT COMMITTEE
3rd November 2017**

**CABINET
7th November 2017**

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

SUBJECT: Treasury Management Qtr 2 Report

REPORT FOR: Information

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 September 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:

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

This forecast is due to be updated shortly based on recent informed speculation that a bank rate rise will be agreed at the November Bank of England's MPC meeting.

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 September 2017 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
Santander	825	0.25%	N/A	Deposit A/c
BOS	15	0.05%	N/A	Deposit A/c
HSBC	0	0.00%	N/A	Deposit A/c
Total	840			

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 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. The £1M the Authority had in this scheme matured in August.

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
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 Moody's updated their ratings for several UK banks on 28th September. However, this did not have any consequence for the Authority's investment situation.
- 5.2 The credit rating list for end of September is attached as a separate file to this report.
- 5.3 Moody's also updated their UK Sovereign rating in September by downgrading it from Aa2 to Aa1 and changing the outlook from Negative to Stable. The reasons for this were as follows:-
- The outlook for the UK's public finances has weakened significantly since the negative outlook on the Aa1 rating was assigned, with the government's fiscal consolidation plans increasingly in question and the debt burden expected to continue to rise
 - Fiscal pressures will be exacerbated by the erosion of the UK's medium-term economic strength that is likely to result from the manner of its departure from the European Union and by the increasingly apparent challenges to policy-making given the complexity of Brexit negotiations and associated domestic political dynamics.

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					REPAID	
Date	Borrower	Type	Amount £000	Rate%	Date	Amount
28-Mar-17	Derbyshire Pension Fund	Fixed to 4/4	0	0.50	04-Apr	10,000,000
29-Mar-17	Edinburgh City Council	Fixed to 5/4	0	0.50	05-Apr	10,000,000
29-Mar-17	City of London	Fixed to 5/4	0	0.50	05-Apr	5,000,000
29-Sep-17	Manchester City Council	Fixed to 5/10	5,000	0.20	05-Oct	5,000,000

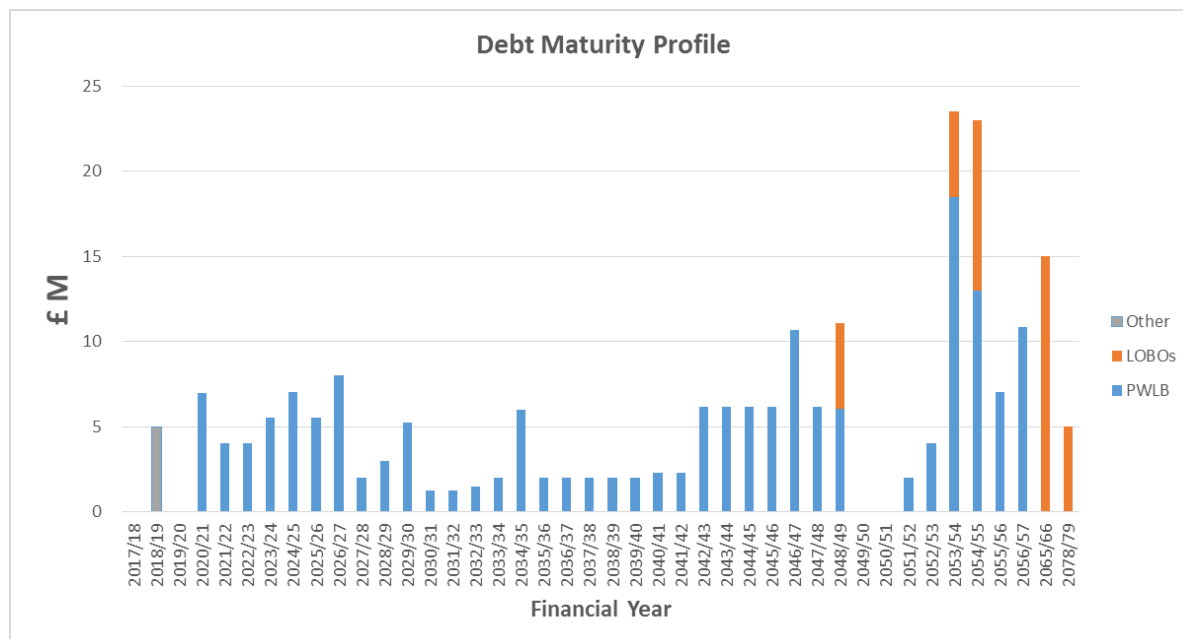
Alongside this, it is likely that some longer term borrowing will take place. This is a prudent approach to ensure some borrowing takes place whilst interest rates are at their low levels as opposed to borrowing at a future date at increased rates.

- 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				
March				

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

6.5 Debt Maturity Profile as at 30.09.17:



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 September 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 September 2017.

8.3 Due to the current large capital spend on the 21st Century Schools in the Gwernyfed area and the Culture Hub in Brecon, the Authority's VAT claims are higher than usual. As such, HMRC carried out a sample check on the June return by requesting certain purchase and sales information. They were satisfied with the

data and, as such, released payment to us. At the time of writing this report they have requested a check on the August return but have asked for substantially more information including a hard copy of every debtor invoice raised (2,896). Based on the fact that the June return check was satisfactory and that the explanation for the higher returns remains the same, we have approached HMRC in respect of the amount of data they have requested and the fact that is required in paper format. Members will be updated verbally at Committee and Cabinet regarding this situation.

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

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 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

UK. After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak. 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 caused, in turn, 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. However, more recently, 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.

The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September MPC meeting. This marginal revision can hardly justify why the MPC became so aggressive with its wording. Rather, the focus was on 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 the 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 therefore looks very likely that the MPC will increase Bank Rate to 0.5% in November or, if not, in February 2018. The big question after that will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 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 weak services sector growth. If this scenario were to

materialise, then the MPC would have added reason to embark on a series of slow but gradual increases 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), has 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 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter 2 (2.3% 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 August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

USA. Growth in the American economy has been volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1%, resulting in an overall annualised figure of 2.1% for the first half year. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.4%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with three increases since December 2016; and there could be one more rate rise in 2017 which would then lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. At its June meeting, the Fed strongly hinted that it would soon begin to unwind its \$4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; 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 is struggling to stimulate consistent significant growth and to get inflation up 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			
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	4,627	17	0.37%
Aug-17	3,134	12	0.38%
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	27	4	14.81%
Aug-17	37	8	21.62%
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	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							
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 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
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 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 September is £13,235.07.