**CYNGOR SIR *POWYS* COUNTY COUNCIL.**

**AUDIT COMMITTEE**
**To be emailed**

**CABINET**
**31st July 2018**

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

**SUBJECT:** **Treasury Management Qtr 1 Report**

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**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 2018.

## 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:

| | **Jun 18** | **Sep 18** | **Dec 18** | **Mar 19** | **Jun 19** | **Sep 19** | **Dec 19** |
|---|---|---|---|---|---|---|---|
| **Bank rate** | 0.50% | 0.50% | 0.75% | 0.75% | 0.75% | 1.00% | 1.00% |
| **5yr PWLB** | 1.90% | 2.00% | 2.00% | 2.10% | 2.20% | 2.20% | 2.30% |
| **10yr PWLB** | 2.40% | 2.40% | 2.50% | 2.60% | 2.60% | 2.70% | 2.80% |
| **25yr PWLB** | 2.70% | 2.80% | 2.90% | 3.00% | 3.10% | 3.20% | 3.30% |
| **50yr PWLB** | 2.40% | 2.50% | 2.60% | 2.70% | 2.80% | 2.90% | 3.00% |

## 3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 8th March 2018 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. Welsh Authorities – New Regulations

4.1 The 2018 No.325 (W.61) Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 have been issued which have introduced some changes to the treatment of certain types of treasury management investments. Details of this are at Appendix B.

## 5. Current Investments

5.1 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.

5.2 The Authority had the following investments at 30th June 2018:-

| **Invested with:** | **Principal £000's** | **Interest Rate** | **Start Date** | **Maturity Date** |
|---|---|---|---|---|
| Santander | 16,070 | 0.50% | N/A | Deposit A/c |
| HSBC | 175 | 0.25% | N/A | Deposit A/c |
| **Total** | **16,245** | | | |
| | | | | |

5.3 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.

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

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

| | Suggested Rate |
|---|---|
| 2018/19 | 0.75% |
| 2019/20 | 1.00% |

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

## 6. Credit Rating Changes

6.1 There have been no credit rating changes relevant to this Authority's position during the last quarter.

6.2 The credit rating list for end of June is attached as a separate file to this report.

## 7. Borrowing / Re-scheduling

7.1 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.

7.2 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.

Original CFR Position:

| | As at 31.03.18 Actual | 2018/19 Original Estimate | 2019/20 Original Estimate | 2020/21 Original Estimate |
|---|---|---|---|---|
| | £M | £M | £M | £M |
| Capital Financing Requirement | 318,036 | 382,916 | 416,618 | 434,710 |

Updated CFR position as at 30.06.18:

| | As at 31.03.18 Actual | 2018/19 Current Estimate | 2019/20 Current Estimate | 2020/21 Current Estimate |
|---|---|---|---|---|
| | £M | £M | £M | £M |
| Capital Financing Requirement | 318,036 | 383,958 | 430,495 | 449,446 |

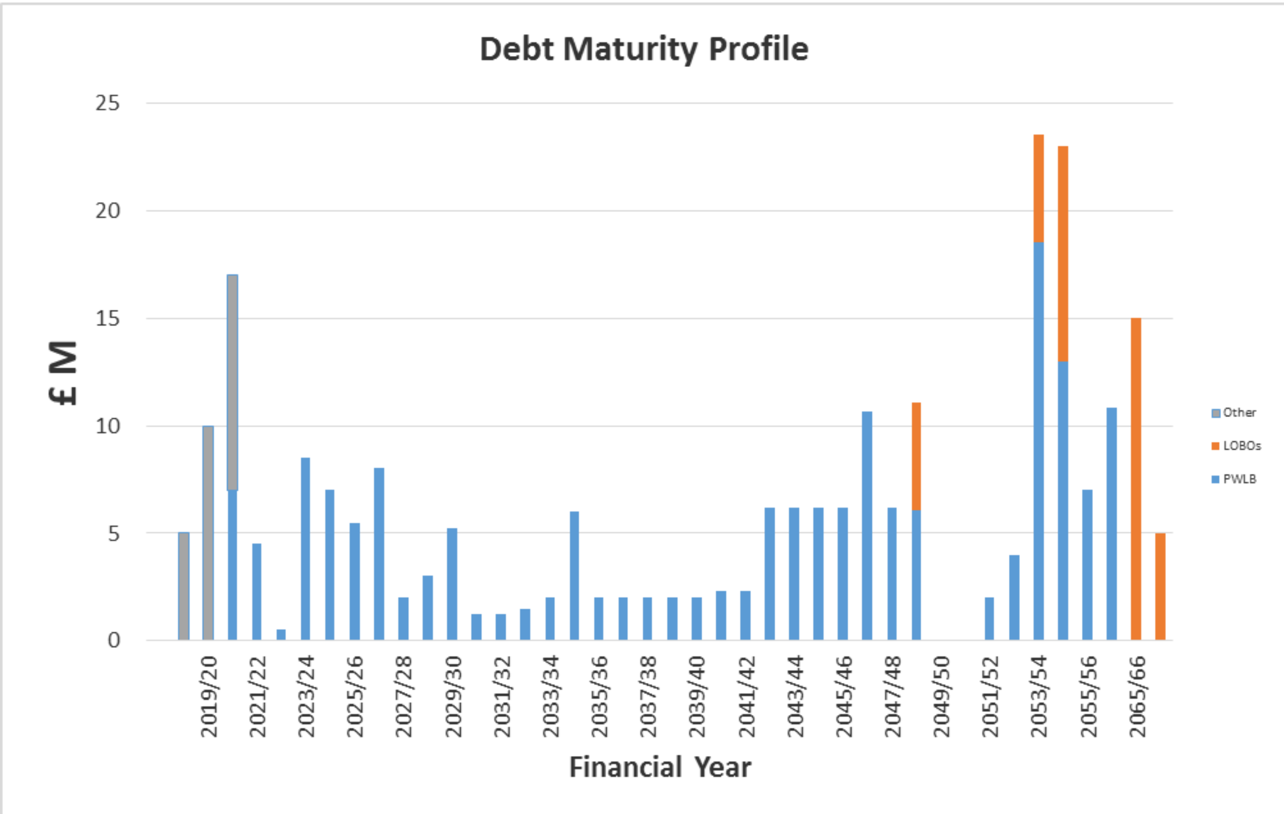
7.3 The Authority had outstanding long-term external debt of £251.4M at 31st March 2018. In relation to the CFR figure for 31st March 2018, this equated to the Authority being under borrowed by £66.6M. This is a prudent and cost effective approach in the current economic climate. However, members will 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. In line with this, £10M of longer-term borrowing has taken place in the current financial year. This was 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.

7.4 Capital Budget/Spend per efinancials:

| **Capital:** | **Approved Budget £** | **Working Budget £** | **Actual Capital Spend *(not including commitments)* £** | **%age spend** |
|---|---|---|---|---|
| | 85,725,189 | | | |
| June | | 124,856,235 | 6,518,210 | 5.22% |

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

7.5 *Debt Maturity Profile as at 30.06.18:*



7.6 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.

## 8. Prudential Indicators

8.1 All TM Prudential Indicators were complied with in the quarter ending 30th June 2018.

## 9. VAT

9.1 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.

9.2 The monthly VAT returns were submitted within the required deadlines during the quarter ending 30th June 2018.

9.3 Key Performance Indicators:

The VAT KPI's for 2018/19 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** | | **N/A** | |

| **Implemented:** | | | |
|---|---|---|---|
| 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 2018/19:**

*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 Link's matrices and the Authority's definition of a high credit rating |
| Foreign Banks | 5 | Up to 364 days | As per Link'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 (£5M limit with any one institution) | Up to 2 years | As per Link's matrices and the Authority's definition of a high credit rating |
| Foreign Banks | 2 | Up to 2 years | As per Link'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 |
| Other Local Authorities | 10 | Up to 5 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

**Regulations 2018:**

The 2018 No.325 (W.61) Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 have been issued which have introduced some changes to the treatment of certain types of treasury management investments. Paragraph 9 now makes clear that the following types of investment are not to be treated as being capital expenditure: -

1. A treasury investment involving the acquisition of loan capital, through a bond issued via grant or for financial assistance for a capital purpose will remain capital expenditure;
2. An investment in a money market fund;
3. An investment in the shares of a company to which Part 12 of the Corporation Tax Act 2010(**1**) (real estate investment trusts) applies;
4. The acquisition of shares in an investment scheme approved by the Treasury under section 11(1) of the Trustee Investments Act 1961(**2**) (local authority investment schemes).

**Appendix C**

**Economic Background**

UK

Growth in quarter 1 of 2018 was disappointing although, on the first revision, the rate improved from 0.1 to 0.2% to allay fears that the economy may have started a prolonged period of very weak growth. Initial indications in quarter 2 are that growth may have picked up to around 0.4%. The main reason for weak growth during 2017 and 2018 has been due to inflation exceeding pay growth until recently, meaning that there has been negative growth in consumer disposable income when consumer expenditure is the biggest driver of the services sector which accounts for about 75% of GDP. The manufacturing sector was the bright spot in the economy in 2017 in terms of strong growth but quarter 1 2018 was the weakest quarter for 1½ years and forward indicators do not suggest a return to strong growth is likely.

During January and February, financial markets were viewing a bank Rate increase at the May MPC meeting as likely to be a near certainty after strong growth in the second half of 2017. However, the ensuing weeks before the meeting saw opinion turn right around and the MPC did not disappoint by leaving rates unchanged due to concerns as to whether the weak growth in quarter 1 was indicative of the start of a prolonged slow down or just a temporary blip, to which the bad weather had been just one contributor. Since May opinion has again turned to suggest that an August Bank Rate increase is back on the cards.

However, there remains much uncertainty around the Brexit negotiations, consumer spending levels and business investment, so it is still far too early to be confident about how strong growth and inflationary pressures will be over the next two years and, therefore, the pace of any rate increases.

EU

A recovery to strong growth in 2016 and 2017 looks as if it will weaken somewhat going forward. Despite providing massive monetary stimulus, the ECB has been struggling to get inflation up to its 2% target. However, in April, the headline Eurozone rate jumped up from 1.4% to 1.9% although the core inflation rate was still subdued in rising from 0.7% to 1.1%. At its June meeting, the ECB announced it would halve its monthly quantitative easing purchases from €30bn to €15bn and then end all purchases after December. It is unlikely to make a start on increasing interest rates until late in 2019.

USA

Growth in the American economy was volatile in 2015, 2016 and 2017. The annual rate of growth for 2017 was 2.3% and quarter 1 2018 came in at 2.0%, down from 2.9% in the previous quarter. The Trump $1.5 trillion income tax cut package coming into effect in January 2018 is likely to boost growth to the Trump administration's 3% target. However, it is also likely to boost inflation at a time when spare capacity in the economy is minimal and unemployment, in particular, has fallen to the lowest level for 17 years at 3.8% in May. The Fed has started on an upswing in rates with seven increases since the first one in December 2015. The latest one, in June 2018, lifted the rate to between 1.75% and 2.00%. There could be a further two or more increases in 2018. In October 2017 the Fed became the first major Western central bank to make a start on unwinding quantitative easing by phasing in a gradual reduction in respect 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's best economic run (positive growth for eight quarters) since the 1980s came to an end in quarter 1 2018 with a contraction of 0.6% which was blamed on weak exports.  However, it is still struggling to get inflation up to its target rate of 2% despite huge monetary and fiscal stimulus with inflation falling to only 0.4% in May. It is also making little progress on fundamental reform of the economy.

# 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-18 | 130 | 17 | 13.08% |
| May-18 | 108 | 5 | 4.63% |
| Jun-18 | Not yet completed | | |

**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-18 | 907 | 15 | 1.65% |
| May-18 | 810 | 8 | 0.99% |
| Jun-18 | Not yet completed | | |

**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-18 | 38 | 7 | 18.42% |
| May-18 | 50 | 4 | 8.00% |
| Jun-18 | Not yet completed | | |

**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-18 | 260 | 13 | | | | | |
| May-18 | 240 | 10 | | | | | |
| Jun-18 | Not yet completed | | | | | | |

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.

There are no voluntary declarations to date in 2018/19.

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.

Further to the above, the upload of appropriate documents to the Barclaycard purchase card system to enable vat recovery was made mandatory in September 2017 as a result of the lack of response from service areas/establishments to provide documents when requested. Where no document has been uploaded, any VAT amount input against the transaction is charged to the service area.

The total amount charged back in 2018/19 quarter 1 is £11,957.26. The majority of this is in respect of purchase card transactions. The total amount charged back in 2017/18 in respect of the two occurrences above was £71,655.28. The majority of this was also in respect of purchase card transactions.