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

**AUDIT COMMITTEE**
**4th February 2016**

**CABINET**
**23rd February 2016**

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

**SUBJECT:** **Treasury Management Qtr 3 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 31st December 2015.

## 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 16 | Jun 16 | Sep 16 | Dec 16 | Mar 17 | Jun 17 | Sep 17 | Dec 17 |
|---|---|---|---|---|---|---|---|---|
| **Bank rate** | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.25% | 1.50% | 1.50% |
| **5yr PWLB** | 2.40% | 2.60% | 2.70% | 2.80% | 2.80% | 2.90% | 3.00% | 3.20% |
| **10yr PWLB** | 3.00% | 3.10% | 3.20% | 3.30% | 3.40% | 3.50% | 3.60% | 3.70% |
| **25yr PWLB** | 3.70% | 3.80% | 3.90% | 4.00% | 4.10% | 4.10% | 4.20% | 4.30% |
| **50yr PWLB** | 3.60% | 3.70% | 3.80% | 3.90% | 4.00% | 4.00% | 4.10% | 4.20% |

**This forecast is due for revision in January.**

## 3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 5th March 2015 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 2015 is as shown below:-

| Invested with: | Principal £000's | Interest Rate | Start Date | Maturity Date |
|---|---|---|---|---|
| Santander | 7,260 | 0.40% | N/A | Deposit A/c |
| BOS | 1,495 | 0.40% | N/A | Deposit A/c |
| HSBC | 50 | 0.25% | N/A | Deposit A/c |
| **Total** | **8,805** | **0.40%** | | |
| | | | | |
| 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 variety of currencies in March 2012. An element of the distribution was in Icelandic Kroner (ISK) which was placed in an escrow account in Iceland. 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.

Cabinet will be aware that this Authority did not take up a sale of escrow option but decided to retain the money in escrow until such time as there is further information forthcoming from the Icelandic government.

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 |
|---|---|---|
| 2015/16 | 0.50% | 0.50% |
| 2016/17 | 0.90% | 0.90% |
| 2017/18 | 1.50% | 1.50% |

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. Minimum Revenue Provision for the Redemption of Debt

6.1 Under regulation 21 of the Local Authorities Regulation 2003, local authorities must charge to a revenue account a minimum revenue provision (MRP) in respect of capital expenditure incurred in a prior year. Regulation 22 states "A local authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent? It is for an individual authority to determine what is a "prudent" MRP".

6.2 The authority has sought advice from its treasury management advisor (Capita) and this confirms that the current 4% MRP can be reduced to a 2% straight line MRP. This will require a Cabinet decision. The position will be reflected in the budget.

## 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.

CFR Position:

| | As at 31.03.15 Actual | 2015/16 Original Estimate | 2016/17 Original Estimate | 2017/18 Original Estimate |
|---|---|---|---|---|
| | £M | £M | £M | £M |
| Capital Financing Requirement | 224,482 | 227,799 | 319,727 | 329,533 |

7.3 The Authority had outstanding long-term external debt of £150.8M at 31st March 2015. In relation to the CFR figure for 31st March 2015, this equated to the Authority being under borrowed by £73.7M. 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.

7.4 Capital Budget/Spend per efinancials:

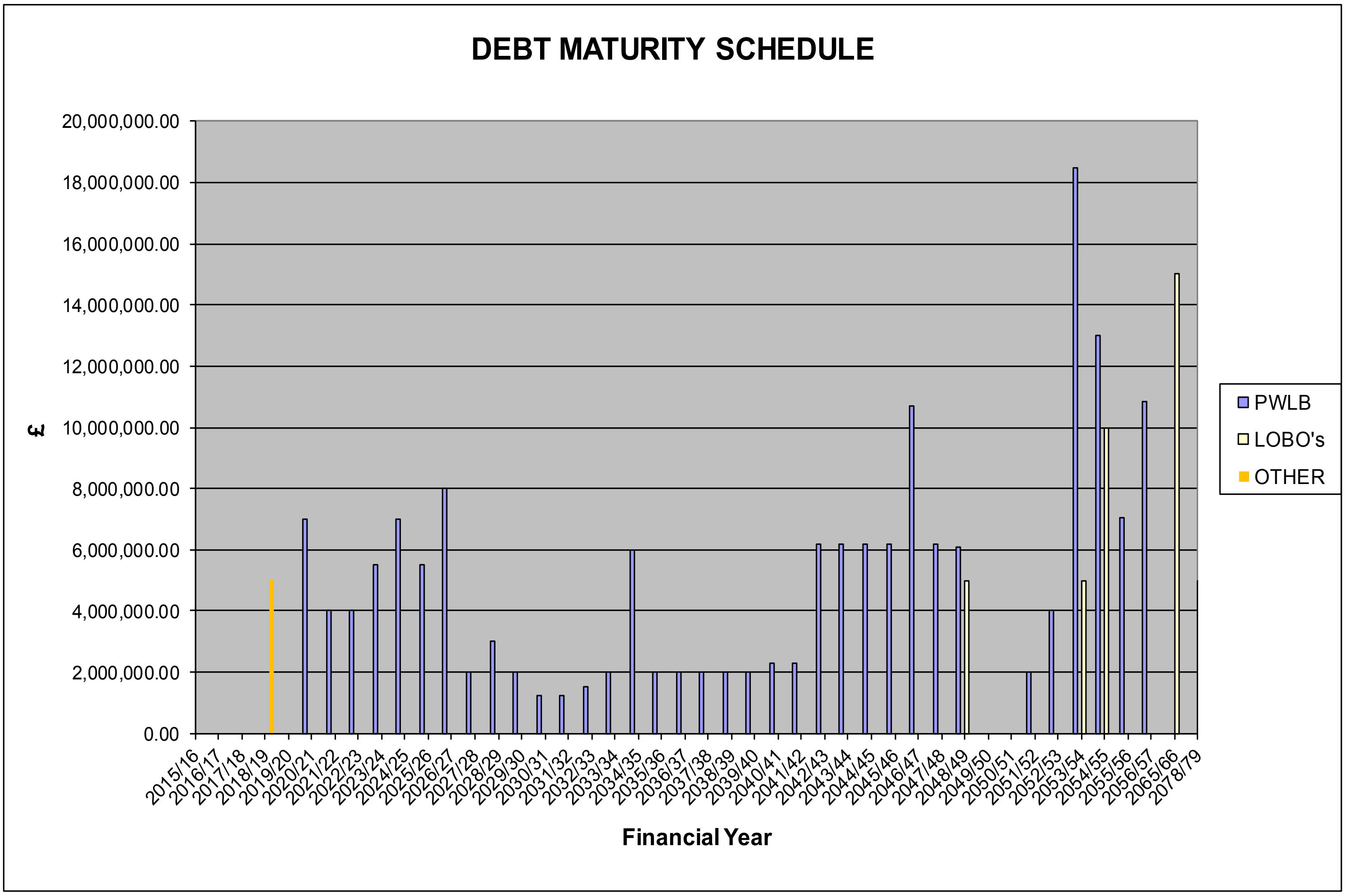
| **Capital:** | **Approved Budget** | **Working budget** | **Actual Capital Spend (not including commitments)** | **%age spend** |
|---|---|---|---|---|
| | 128,931,594 | | | |
| June | | 136,989,764 | 75,576,339 | 55.17% |
| Sept | | 141,157,883 | 83,517,819 | 59.20% |
| Dec | | 126,548,605 | 93,174,660 | 73.63% |

The figures above include the figures for the self-financing of the HRA.

The financing of the approved capital budget included £97.4M of Prudential borrowing in total. £72.4M was borrowed on 2nd April in respect of the self-financing of the HRA.
The exact structure of loans arranged for the HRA purpose reflected the requirements of the HRA business plan, the overall requirements of the Council and certain limitations (e.g. the minimum average duration of any borrowing) put in place by the Welsh Government. The loans were, therefore, arranged at a set of bespoke, higher PWLB interest rates that applied only to Welsh HRA self-financing authorities and may make these loans less flexible, from a restructuring point of view, than would normally be the case.

7.5 *Debt Maturity Profile as at 31.12.15:*

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



7.6 Target rates:

Our advisors' target rates and current PWLB rates are set out below:

| Period | Borrowing rate at 31.12.15 | Target borrowing rate now | Target borrowing rate previous |
|---|---|---|---|
| 5 year | 2.16% | 2.30% | 2.40% |
| 10 year | 2.79% | 2.90% | 3.00% |
| 25 year | 3.49% | 3.60% | 3.60% |
| 50 year | 3.31% | 3.50% | 3.60% |

7.7 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

7.8 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.

## 8. Prudential Indicators

8.1 All TM Prudential Indicators were complied with in the quarter ending 31st December 2015.

## 9. Internal Audit

9.1 TM was audited by internal audit in Sept 2015. The result of this was Substantial Assurance with only one action to initial deposit account bank statements when checked.

## 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

**<u>Appendix A:</u>**

**Approved Treasury Management Strategy 2015/16:**

*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<br>(listed at Appendix D) | £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 recovery showed signs of some acceleration but the imbalances remain. Q3 GDP saw solid domestic demand growth continue but the drag from net trade was the largest on record. In particular, trade with the Eurozone deteriorated further. Nevertheless, the services Purchasing Managers Index (PMI) strengthened in November although there was weakening in both the manufacturing and construction numbers. This is not the ideal form of recovery and the services sector looks set to take responsibility for the overall health of the economy for a while yet.

The surge in US October non-farm payrolls allayed concerns that the recent slowing could possibly be the start of a downturn. With the unemployment rate slipping to 5%, it is now at the lower end of the Fed's range for equilibrium unemployment. Meanwhile, the number of involuntary part time workers is also on the decline and now stands at a seven year low. With full employment getting nearer, there are also signs that wage growth is gathering pace and the unexpected strength of the latter, along with core inflation, is now looking likely to be a feature of 2016. That combination could see the Fed pushed into "normalising" policy more rapidly than initially expected by the market.

In the Eurozone, while early indications seem to confirm that Q3 GDP growth slowed further, it does appear that there has been some improvement in early Q4 data, with the PMIs pointing to some acceleration. Growth, though, will remain modest at best and inflationary pressures are negligible.

Asia remains an area of concern with the two main economies, China and Japan, struggling to generate the required levels of growth.

### UK

The first update on Q3 GDP confirmed quarterly growth of 0.5% but the breakdown showed that household spending has continued to provide the main support for growth, while the drag on performance from net trade was the largest that has ever been seen. Business investment posted a solid quarterly pick up to push annual growth to 6.6% and survey investment intentions indicate that this healthy growth should continue, at least in the near future. The decline in the manufacturing PMI points to the strength seen in the October survey having been a blip. However, the robust services PMI ensured that the composite measure is consistent, with growth accelerating a touch in the final quarter. As noted, household spending has proved resilient, rising 0.8% for a third successive quarter, with retail sales volumes gains equally healthy as consumer confidence remains at elevated levels. The high street battle for business has led to heavy discounting, benefiting consumer purchasing power but depressing nominal retail sales. The British Retail Consortium shop price index indicates that annual prices fell at an increased rate. Consumer services nominal spending has been more consistent, as has the housing market. Mortgage approvals rose by an annualised 0.9% in October and, with excess demand, prices are likely to be pushed higher. The trade deficit did improve in September but widened significantly over Q3, from £3.5bn to £8.5bn. As a result, net trade wiped 1.5% from quarterly GDP growth, its greatest negative impact, which more than reversed the 1.3% it added in Q2. Q3 export volumes growth of 0.9% was dwarfed by the 5.5% seen in imports. While the November manufacturing PMI offers upbeat export orders' indications, other surveys remain weak. There are significant difficulties facing exporters with Sterling rising by 2.5% since the start of October on a trade weighted basis. Reducing Sterling prices has helped to reduce the impact on sales but margins cannot be squeezed indefinitely, or indeed further.

Strong employment gains in Q3 pulled the unemployment rate down to 5.3%, the lowest for nine years, though it remains above the all-time low of 4.7% seen in 2005. Underlying the headline figure is a less positive picture as part time work drove the job figure rise and self-employment is picking up once more. Furthermore, the timelier claimant count unemployment measure pushed higher in October. Also less positive was the slowing of annual average earnings growth from 3.2% to 2.0% in September and output per worker has eased in Q3. However, hourly productivity rose by 0.6% q/q to back up the near 1% gain in Q2.

CPI of -0.1% m/m in October was the joint lowest since the 1960's but this is likely to be the last month of deflation as inflation should pick up as the sharp decline in petrol prices a year ago drop out of the calculations. More stable oil prices should limit further falls in petrol prices in coming months. Food prices should also add to the pot as the influence of previous falls in agricultural commodity prices and Sterling gains in the supply chain starts to wane.

Overall, analysts do not foresee inflation breaching BoE target levels in 2016. Monetary indicators point to the pace of recovery being maintained with annual money growth (M4) rising at 4.5% in October which would equate to annual real GDP growth of 2%. Lending has also picked up, driven by households, but corporate lending remained weak with growth having only just sneaked into positive territory. Small and Medium-sized Enterprises' (SME) lending has been stronger than that for larger firms and it has been smaller firms where subdued lending has been problematic as large firms have the benefit of being able to raise funds through bond issuance. Interest rate expectations have been pushed back further with markets looking as far ahead as the start of Q2 2017 for the first Bank Rate rise.