CYNGOR SIR *POWYS* COUNTY COUNCIL.

FULL COUNCIL

9th March 2016

REPORT AUTHOR:	**County Councillor Wynne Jones** **Portfolio Holder for Finance**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY STATEMENT & ANNUAL INVESTMENT STRATEGY**
REPORT FOR:	**Decision**

Summary

1. Introduction

1.1 This Treasury Management Strategy Statement and Annual Investment Strategy report is a requirement of the CIPFA Code of Practice on Treasury Management and a requirement under the Local Government Act 2003. It has regard to the 2010 Guidance on Local Government Investments issued by the Welsh Assembly Government which requires the Treasury Management Strategy Statement and Annual Investment to be approved by Full Council.

1.2 The report details the expected activities of the Treasury function in the forthcoming financial year 2016/17, in respect of borrowing and investments.

1.3 The report requires an appropriate strategy for borrowing and investing for the financial year 2016/17.

1.4 The Strategy will be monitored throughout the year and will be revised for approval by Full Council if there are any significant changes necessary due to such things as the following:-

- updates in legislation/guidance
- changes in the economy/financial outlook which may affect the Authority's Strategy
- changes in the financial position of the Authority.

2. Revised CIPFA Code of Practice on Treasury Management 2011

2.1 In 2009 CIPFA revised the Code of Practice on Treasury Management, the Cross Sectoral Guidance Notes and the template for the Treasury Management Policy Statement (see Appendix A). In December 2011 CIPFA issued a further revised edition of the Code of Practice. It is a requirement of the Code that this Authority should formally adopt the key principles of the Code and this was done by Cabinet on 14th February 2012 (see Appendix B).

2.2 The Code emphasises a number of key areas including the following:-

i. All authorities must formally adopt the revised Code
ii. The strategy report will affirm that the effective management and control of risk are prime objectives of the Authority's treasury management activities
iii. The Authority's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out
iv. Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation
v. Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support
vi. Authorities need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits
vii. Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities
viii. The main annual treasury management reports must be approved by Cabinet/Full Council
ix. There needs to be, at a minimum, a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved
x. Each Authority must delegate the role of scrutiny of treasury management strategy and policies to a specific named body
xi. Treasury management performance and policy setting should be subject to scrutiny prior to implementation
xii. Members should be provided with access to relevant training
xiii. Those charged with governance are also personally responsible for ensuring they have the necessary skills and training
xiv. Responsibility for treasury management activities must be clearly defined within the organisation
xv. Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Authority.

2.3 The Authority will adopt the following reporting arrangements in accordance with the revised Code of Practice:-

Report/Document	**Committee**	**Frequency**
Treasury Management Policy Statement and Practices	Audit Committee followed by Cabinet	When changes require
Treasury Management Strategy and Annual Investment Strategy	Full Council	Annually before the start of financial year
Treasury Management Quarterly Reports	Audit Committee followed by Cabinet	Quarterly
Treasury Management Annual Review	Audit Committee followed by Cabinet	Annually by 30th Sept after the end of financial year

3. Economic Background and Forecasts

3.1 The economic background is attached at Appendix C. The information contained therein is considered in the formulation of this Treasury Management Strategy Statement and Investment Strategy.

3.2 The most recent forecast of interest rates for 2016/17 by the Authority's advisor is:

	Mar16	Jun16	Sep16	Dec16	Mar17	Jun17	Sep17	Dec17
Bank rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%
5yr PWLB	1.70%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.60%
10yr PWLB	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%
25yr PWLB	3.20%	3.20%	3.30%	3.30%	3.50%	3.50%	3.60%	3.60%
50yr PWLB	3.00%	3.00%	3.10%	3.10%	3.30%	3.30%	3.40%	3.40%

4. Borrowing Strategy

4.1 The Authority's Capital Financing Requirement (CFR) is the amount of capital expenditure that is not financed from revenue resources, capital grants and other contributions and capital receipts. Any expenditure that is not financed from these resources increases the authority's underlying need to borrow. 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.

The Authority is currently maintaining an under borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cashflow has been used as a temporary measure. This is a prudent and cost effective approach in the current economic climate of low interest rates and is a good use of the Council's cash.

The Authority's estimated closing Capital Financing Requirement (CFR) for 2015/16 is £307.3M. If no borrowing takes place within the remainder of the current financial year, the outstanding debt at 31st March 2016 will be £226.4M showing that the Authority is currently borrowed well below its CFR. Analysis of the balance sheet confirms the Authority to be in an internally borrowed position which, as mentioned above, is a prudent and cost effective approach in the current climate of low interest rates. The current Capital budget for 2016/17 is £48.8M.

4.2 Investment returns are likely to remain relatively low during 2016/17 and beyond. Borrowing rates were highly volatile during 2015 as alternating bouts of good and bad news promoted optimism and then pessimism in financial markets. The policy of avoiding new borrowing by running down cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when the Authority will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance matured debt. There will remain a cost of carry to new borrowing which results in increased investments (albeit temporarily) as there will be a revenue loss between borrowing costs and investment returns.

In view of the authority's position and the above interest rate forecast the Authority will monitor interest rates and will, when required, give consideration to new borrowing as follows:-

- PWLB loans for up to 15 years
- Short dated borrowing from non PWLB sources.

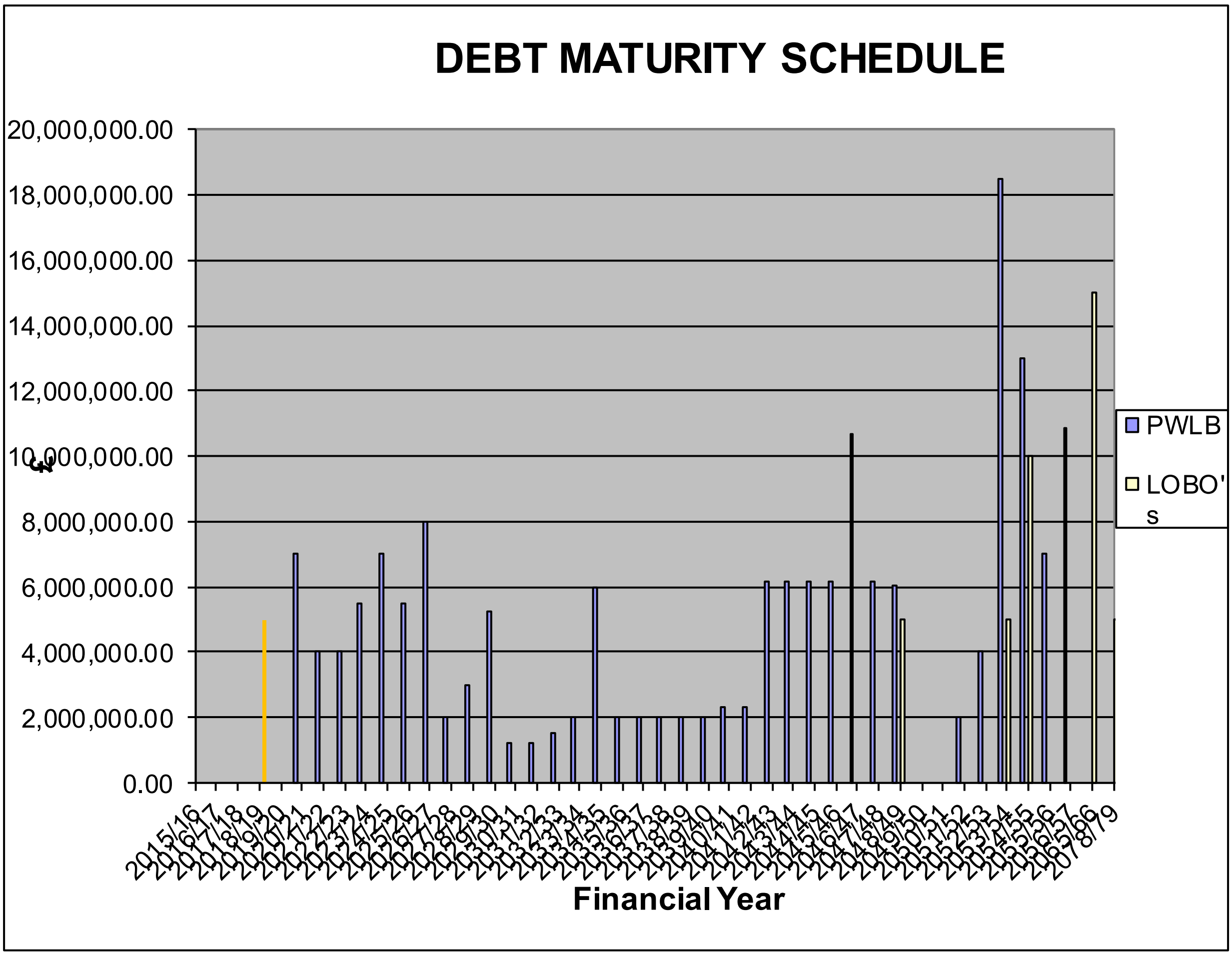
4.3 PWLB Certainty Rate:

In 2012-13, the Government introduced 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. The Government said it would also work with the local authority sector to consider the potential for an independent body to facilitate the provision of PWLB lending at a reduced rate to authorities demonstrating best quality and value for money. This certainty rate continues to be available and this Authority has registered its interest in this preferred rate option.

4.4 Estimated Debt Maturity Profile as at 01.04.16:

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

Members will see that the debt maturity profile is fairly even across the years. This maturity profile has been managed as such, so as to ensure that there is no undue preponderance in any particular year which may put the Authority's financing and cashflow position at risk.



5. Debt Rescheduling

5.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which was compounded on 20th October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than before both of these events.

5.2 However, as short term borrowing rates will be considerably cheaper than longer term rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. The cost of any debt repayment i.e. premiums incurred will also be taken into consideration.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings,
- helping to fulfil the strategy outlined in paragraph 4 above, and
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

5.3 All rescheduling will be reported to Cabinet as soon as is practicable.

6. Policy on borrowing in advance of need

6.1 The Authority will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed (this is referenced in paragraph 7.14). Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds.

6.2 In determining whether borrowing will be undertaken in advance of need the Authority will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue liabilities created and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

7. Investments

7.1 *Investment Policy:*

7.1.1 The Authority has regard to the 2011 edition of the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”) and the Welsh Assembly Government Guidance on Local Government Investments.

7.1.2 The Authority’s investment priorities are: -

(a) the security of capital and
(b) the liquidity of its investments.

7.1.3 The Authority will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Authority has been low in order to give priority to security of its investments.

7.1.4 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Authority will not engage in such activity.

7.1.5 The minimum amount that is to be held during the financial year in investments other than long-term is Nil.

7.2 *Derivatives:*

7.2.1 The 2011 Code of Practice introduced various references to the use of hedging tools such as derivatives. It is not this Authority's intention to make use of such tools.

7.3 Definition of Investments – Specified and Non-Specified:

7.3.1 The Local Government Act 2003 refers to specified and non-specified investments. The Welsh Assembly Government's Guidance on Local Government Investments, effective from 1st April 2010, defines the following:-

Specified Investments:

An investment is a specified one if all of the following apply:-

(a) it is denominated in sterling and any payments or repayments in respect of it are payable only in sterling
(b) the investment is not a long-term one i.e. one which is due to be repaid within 12 months of the date on which the investment was made or one which may require to be repaid within that period
(c) the making of the investment is not defined as capital expenditure by virtue of regulation 20(1)(d) of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [SI 3239 as amended]
(d) the investment is made with a body or in an investment scheme of * high credit quality or with one of the following public sector bodies:
    i. the UK Government
    ii. a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland
    iii. a parish or community council.

* High credit quality is defined in Paragraph 7.5 below.

Non-specified Investments:

(i) An investment is non-specified if it does not meet the above definition.

There are various innovative products on offer which fit this criteria, many of which do so because their initial and maturity value can differ. The spirit of the 2004 National Assembly for Wales guidance was to ensure that authorities had the skills to assess any such products prior to possible commitment. Our advisors have confirmed that officers within Powys have the ability and knowledge to assess the value of such products. Any such assessment will involve determining a high credit quality in line with Paragraph 7.5 below.

As per Prudential Indicator 16.3.3 below the Authority has a maximum limit for investments held for a period of over 364 days.
As per Paragraph 7.7 below the Authority has a maximum limit to be held in Money Market Funds of £50M.

7.4 Creditworthiness policy:

7.4.1 This Authority uses the creditworthiness service provided by Capita Asset Services although the Authority has adopted a position that is slightly more risk averse than Capita's suggested list in respect of counterparties and durations.

7.4.2 Capita uses a sophisticated modelling approach with credit ratings from all three main rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays: -

- credit watches and credit outlooks from credit rating agencies
- CDS (credit default swap) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries.

7.4.3 This approach is in line with the CIPFA Code of Practice which states that "credit ratings should only be used as a starting point when considering credit risk". Authorities should also use financial press, market data, information on government support for banks and the credit ratings of that government support.

7.4.4 The main rating agencies have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors such as regulatory capital levels. In some cases these factors have "netted" each other off to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the Fitch Support and Viability ratings and have seen the Moody's Financial Strength rating withdrawn by the agency.

7.4.5 In keeping with the agencies' new methodologies, the rating element of Capita's credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard and Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress, however, that the other key elements of the process i.e. the assessment of Rating Watch and Outlook information as well as the CDS overlay have not changed.

7.4.6 The evolving regulatory environment in tandem with the rating agencies' new methodologies, also means that sovereign ratings are now of lesser importance in the assessment process. Where, through the crisis, authorities typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this Authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating (per 7.6.1 below).

7.4.7 It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less creditworthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks as they are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now.

7.4.8 Capita's modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes can be used by the Authority to determine the suggested duration for investments and are therefore referred to as durational bands:-

- Yellow - 5 years
  for UK Government debt or its equivalent, money Market funds and collateralised deposits where the collateral is UK Government debt
- Dark pink - 5 years
  for Enhanced Money Market Funds with a credit score of 1.25
- Light pink - 5 years
  for Enhanced Money Market Funds with a credit score of 1.5
- Purple - 2 years
- Blue - 1 year
  only applies to nationalised or semi nationalised UK Banks
- Orange - 1 year
- Red - 6 months
- Green - 100 days
- No Colour - not to be used

7.4.9 A copy of the current full credit rating list is being sent to members alongside this report for information regarding which banks fall into each duration.

7.4.10 The 2011 revised Code of Practice advises that authorities have regard for all the ratings issued by all three main agencies and to make their decisions based on all ratings. The advisors' creditworthiness service corresponds with this as it uses the ratings from all three agencies but, by using a scoring system, does not give undue preponderance to just one agency's ratings.

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 Moody's 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 Moody's Ratings	Permitted S&P Ratings
F1+	N/A	A-1+
F1	P-1	A-1

7.5.2 All credit ratings will be monitored daily. The Authority is alerted to changes to ratings of all three agencies through its use of the advisors' creditworthiness service.

7.5.3 Any institution which drops below any of the above ratings will be removed from the Authority's counterparty list for investments. Any investments held with the counterparty will also be reviewed in order to establish whether the premature maturity of the investment should be sought.

7.5.4 In addition to the use of Credit Ratings the Authority will also be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's investment list. Any investments held with the counterparty will also be reviewed in order to establish whether the premature maturity of the investment should be sought.

7.5.5 Sole reliance will not be placed on the use of this external service. In addition the Authority will also use market data and information, information on government support for banks and the credit ratings of that government support.

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

The list of countries (excluding the UK) that qualify using this credit criteria as at the date of this report are shown in Appendix D. This list will be added to or deducted from by officers should ratings change.

7.6.2 Our advisor's view is that all Authorities should avoid a concentration of investments in too few counterparties or countries but that a suitable spreading approach in itself is likely to be sufficient given the safeguards already built into its creditworthiness service.

As such the following limits are proposed:-

Country	Maximum Investment per Country	Credit Rating/Other Assessment of Risk
AAA countries (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:*

The current limits per the 2015/16 Strategy are as follows:-

Specified Investments (2015/16):

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 (2015/16):

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.			

It is proposed that the limits above remain the same for 2016/17.

8. The Local Authority Mortgage Scheme (LAMS)

8.1 The Authority is currently participating in the cash backed mortgage scheme which requires the Authority to place a five year deposit matched to the life of the indemnity. This is outlined in the investment criteria above.

9. Investment Strategy

9.1 In-house funds*:*
The majority of the Authority's in-house managed funds are cash flow derived. However, this has and will continue to decrease as per the information in 4.1 above.

9.2 The suggested budgeted investment returns from the Authority's advisors are:

2016/17	0.60%
2017/18	1.25%

Members should be aware that these returns are unlikely to be achieved by this Authority whilst cash levels are low and hence being kept in liquid accounts.

9.3 The Authority currently has no investments that are longer-term. It is unlikely that the Authority will lock into further longer term deals while investment rates are down at historically low levels and due to the reduction in cash balances.

9.4 For its cash flow generated balances, the Authority will seek to utilise its business reserve accounts, fixed term deposits (if appropriate) and money market funds.

10. Policy on the use of external service providers

10.1 The Authority currently uses Capita Asset Services as its external treasury management advisors. This contract was awarded following a competitive process and runs to 31st August 2018.

10.2 The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed on external service providers.

10.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review. This review will incorporate assessing the following:-

- level of technical expertise/advice
- appropriateness of advice given
- value of information provided i.e. market commentaries, forecasts, etc.
- value of training given
- attendance at meetings

11. Scheme of delegation

11.1 (i) Full Council

- approval of annual strategy

(ii) Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

(iii) Cabinet

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of amendments to the Authority's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers.

12. Role of the section 151 officer (Chief Financial Officer)

12.1 The S151 officer will have responsibility for:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

13. Treasury Management Training

13.1 The Authority recognises that relevant individuals will need appropriate levels of training in treasury management due to its increasing complexity. There are two categories of relevant individuals: -

- treasury management staff employed by the Authority
- members charged with governance of the treasury management function.

13.2 All treasury management staff should receive appropriate training relevant to the requirements of their duties at the appropriate time. All treasury management staff are required to be members of an appropriate professional body and, in line with the continuing professional development requirements of these professional bodies, the Authority operates a Professional Development Review system which identifies the training requirements of individual members of staff engaged on treasury related activities. Additionally, training is also provided in the job and it is the s the level of training appropriate to their duties.

13.3 Details of Approved Training Courses

Treasury management staff and members will go on courses provided by our treasury management advisors, CIPFA, etc.

13.4 Records of Training received by Treasury Staff

As required by their relevant professional bodies, treasury management staff will maintain records of training they receive.

13.5 Approved Qualifications for Treasury Staff

It is the Authority's policy that the Treasury Manager and the Senior Accountancy Assistants are qualified to at least AAT level.

13.6 Members

The CIPFA Code of Practice states that members charged with governance (all members as the annual strategy requires approval by Full Council) have a personal responsibility to ensure that they have the appropriate skills and training for their role. To aid this, the Authority holds two briefing sessions per year for members and members should ensure that they attend at least one of these each year.

14. Pension Fund Cash

The Authority will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1st Jan 2010. From 1st April 2010 the Pension fund has its own bank accounts although, due to use of the Authority's financial systems, a small amount of pension fund cash remains pooled with the Authority's cash balances for investment purposes. Any investments made by the pension fund directly with this local authority will comply with the requirements of SI 2009 No 393.

15. Treasury Management Budget

A requirement of the Authority's Treasury Management Policy Statement is that a summary treasury management budget is included in the Strategy report. This is attached at Appendix E.

16. CIPFA Prudential Code - Prudential and Treasury Indicators

16.1 The following indicators, required by the CIPFA Prudential Code, are included as part of the annual budget report :-

- authorised limit for external debt
- operational boundary for external debt
- actual external debt

16.2 Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy and, as such, the indicators required to be included as part of this strategy are as follows:-

16.3.1 *Interest Rate Exposure:*

The setting of upper and lower limits for interest rate exposures has the effect of creating ranges within which the Authority will limit its exposure to both fixed and variable interest rate movements.

The current limits are as follows:-

Fixed rates	140%
Variable rates	60%

As dictated by the Code of Practice this indicator for fixed and variable limits is calculated by looking at the net position between debt and investments. The following table shows an example of the Authority's position and clearly shows what the Indicator is trying to achieve in that the investments we hold in variable rate contracts easily outweigh those in fixed rates:

	Debt	Investments	Net Debt
	£,000	£,000	£,000
Total at Fixed Rates	115,804	4	115,800
Total at Variable Rates	35,000	25,295	9,705
Total	150,804	25,299	125,505
	%	%	%
Fixed Debt less investments (net position)	76.79%	0.02%	92.27%
Variable Debt less investments (net position)	23.21%	99.98%	7.73%

It is proposed that the limits above remain the same for 2016/17.

16.3.2 Maturity Structure of Borrowing:

Local authorities are exposed to the risk of having to refinance debt at a time in the future when interest rates may be volatile or uncertain. This indicator is designed to assist authorities in avoiding large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time. It is recommended that the Authority sets upper and lower limits in each period as a percentage of its total borrowings.

The current limits are as follows:-

	Upper Limit	Lower Limit
Under 12 months	40%	0%
12 months to 2 years	40%	0%
2 years to 5 years	40%	0%
5 years to 10 years	40%	0%
10 years to 20 years	40%	0%
20 years to 30 years	40%	0%
30 years to 40 years	40%	0%
40 years to 50 years	40%	0%

It is proposed that the limits above remain the same for 2016/17.

16.3.3 Principal sums invested for periods longer than 364 days:

This indicator is used to demonstrate that the Authority has taken into account all the resources available for investment. This is to minimise the possibility that longer-term investments will need to be realised early which might have disadvantageous results. This indicator is also used to demonstrate that the Authority is not borrowing more than it needs to, or in advance of its needs, purely to profit through investment from the extra borrowing.

The current limit is set at £10M.

It is proposed that this limit remains at £10M for 2016/17 although it is unlikely to be utilised.

Proposal

It is proposed that Council approves the Treasury Management Strategy Statement and Annual Investment Strategy.

Statutory Officers

The Strategic Director – Resources (s151 officer) has made the following comment:

"The Treasury Management Strategy Statement and Annual Investment Strategy forms a key part of the Council`s overall approach to borrowing and investments. The report ensures the authority complies with relevant legislation and the Code of Practice on Treasury Management."

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 Council approves the Treasury Management Strategy Statement and Annual Investment Strategy		**Statutory Requirement**	
Relevant Policy:		Treasury Management Policy	
Within Policy:	**Y**	**Within Budget:**	**Y**
Person(s) To Implement Decision:		**Ann Owen – Treasury Manager**	
Date By When Decision To Be Implemented:			**1st April 2016**

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

Appendix A:

Treasury Management Policy Statement

1. This organisation defines its treasury management activities as: “The management of the authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.

2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage these risks.

3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.”

Appendix B:

1. This Authority adopts the key principles of CIPFA's *Treasury Management in the Public Services : Code of Practice (2011 Edition),* as described in Section 4 of that Code as follows:-

   Key Principle 1:
   Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

   Key Principle 2:
   Their policies and practices should make clear that the effective management and control of risks are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.

   Key Principle 3:
   They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that, within the context of effective risk management, their treasury management policies and practices should reflect this.

   In framing these recommendations, CIPFA acknowledges the difficulties of striving for effective risk management and control, whilst at the same time pursuing value for money. This code does not seek to be prescriptive about how this issue should be handled, particularly since it covers such a wide variety of organisations. However, where appropriate, the sector specific guidance notes give suitable advice. CIPFA recognises that no two organisations in the public services are likely to tackle this issue in precisely the same manner but success in this area of treasury management is likely to be viewed, especially in value for money terms, as an indicator of a strongly performing treasury management function.

   Even though it dates back to 1991, CIPFA considers that the report by the Treasury and Civil Service Committee of the House of Commons on the BCCI closure is still pertinent, wherein it was stated that:

   In balancing risk against return, local authorities should be more concerned to avoid risks than to maximise returns.

   Indeed this view was supported by the Communities and Local Government Select Committee report into local authority investments in 2009.
   It is CIPFA's view that throughout the public services the priority is to protect capital rather than to maximise return. The avoidance of all risk is neither appropriate nor possible. However, a balance must be struck with a keen responsibility for public money.

2. Accordingly, the Authority will create and maintain, as the cornerstones for effective treasury management:

- a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities

- suitable treasury management practices (TMPs) setting out the manner in which the Authority will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Authority. Such amendments will not result in the Authority materially deviating from the Code's key principles.

3. The Authority will also have regard for the Guidance on Local Government Investments issued by the Welsh Assembly Government and effective from 1st April 2010.

4. Full Council will receive the annual strategy report as recommended in the Welsh Assembly Guidance on Local Government Investments and the Authority's Cabinet will receive reports on its treasury management policies, practices and activities, including, as a minimum, a mid year review and an annual report after its close, in the form prescribed in its TMPs.

5. The Authority delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Chief Financial Officer, who will act in accordance with the Authority's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

6. The Authority nominates Audit Committee to be responsible for ensuring effective scrutiny of treasury management policies, practices and performance.

Appendix C:

ECONOMIC BACKGROUND

UK UK GDP growth rates of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country. The 2014 growth rate was also the strongest UK rate since 2006 and, although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2.2%. Quarter 1 2015 was weak at +0.4% (+2.9% y/y), although there was a slight increase in quarter 2 to +0.5% before weakening again to +0.4% (+2.1% y/y) in quarter 3 and then picking up to +0.5% (2.2%) in quarter 4.

The Bank of England's February Inflation Report included a forecast for growth to remain around 2.2% – 2.4% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.1%.

Since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK. Bank of England Governor Mark Carney has set three criteria that need to be met before he would consider making a start on increasing Bank Rate. These criteria are patently not being met at the current time, (as he confirmed in a speech on 19 January):

- *Quarter-on-quarter GDP growth is above 0.6% i.e. using up spare capacity. This condition was met in Q2 2015, but Q3 came up short and Q4 looks likely to also fall short.*
- *Core inflation (stripping out most of the effect of decreases in oil prices), registers a concerted increase towards the MPC's 2% target. This measure was on a steadily decreasing trend since mid-2014 until November 2015 @ 1.2%. December 2015 saw a slight increase to 1.4%.*
- *Unit wage costs are on a significant increasing trend. This would imply that spare capacity for increases in employment and productivity gains are being exhausted, and that further economic growth will fuel inflationary pressures.*

The MPC (Monetary Policy Committee) has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. However, it is unlikely that the MPC would start raising rates until wage inflation was expected to consistently stay over 3%, as a labour productivity growth rate of around 2% would mean that net labour unit costs would still only be rising by about 1% y/y. The November 2015 Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. However, the first round of falls in oil, gas and food prices in late 2014 and in the first half of 2015, will fall out of the 12 month calculation of CPI during late 2015/early 2016 but only to be followed by a second, subsequent round of falls in fuel and commodity prices which will delay a significant tick up in inflation from around zero. According to the February 2016 Inflation Report, CPI inflation is now expected to get back to around 1% by the end of 2016 but not get near to 2% until the latter part of 2017.

However, with the price of oil having fallen further in January 2016, and with sanctions having been lifted on Iran enabling it to sell oil freely into international markets, there could well be some further falls still to come in 2016. The price of other commodities exported by emerging countries could also have downside risk and several have seen their currencies already fall by 20-30%, (or more), over the last year. These developments have led to the Bank of England lowering the pace of increases in inflation in its February 2016 Inflation Report. On the other hand, the start of the national living wage in April 2016 (and further staged increases until 2020), will raise wage inflation. However, it could also result in a decrease in employment so the overall inflationary impact may be muted. For now, the Bank of England is forecasting further falls in unemployment to circa 4.8%.

Confidence is another big issue to factor into forecasting. Recent volatility in financial markets could dampen investment decision making as corporates take a more cautious view of prospects in the coming years due to international risks. This could also impact in a slowdown in increases in employment. However, consumers will be enjoying the increase in disposable incomes as a result of falling prices of fuel, food and other imports from emerging countries, so this could well feed through into an increase in consumer expenditure and demand in the UK economy, (a silver lining!). Another silver lining is that the UK may not be affected as much as some other western countries by a slowdown in demand from emerging countries, as the EU and US are our major trading partners.

There is, therefore, considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, accordingly, arguments that rates ought to rise sooner and quicker, so as to have some options available for use if there was another major financial crisis in the near future. However, it is unlikely that either would aggressively raise rates until they are sure that growth was securely embedded and ‘noflation’ was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively over the last year from Q4 2015 to Q1 2017. Increases after that are also likely to be at a much slower pace and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008. The referendum on membership of the EU in June 2016 could impact on MPC considerations to hold off from a first increase until the uncertainty caused by this has passed.

The Government’s revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

USA GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded remarkably strongly in Q2 to 3.9% (annualised) before falling back to +2.0% in Q3 and then retreating to +0.7% in Q4.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed would start to increase rates in September. The Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong while November was also reasonably strong (and December was outstanding). This, therefore, opened up the way for the Fed to embark on its first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate and, to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

EZ In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. The initial reading for Q4 is 0.3% also. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Greece During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the initial resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

Portugal and Spain The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. A left wing / communist anti-austerity coalition has won a majority of seats in Portugal. The general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

China and Japan Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of 1.1% during Q1, but then came back to +0.3% in Q3 after the first estimate had indicated that Japan had fallen back into recession; this would have been the fourth recession in five years. Japan has been hit hard by the downturn in China during 2015 and there are continuing concerns as to how effective efforts by the Abe government to stimulate growth and increase the rate of inflation from near zero, are likely to prove when it has already fired the first two of its 'arrows' of reform but has dithered about firing the third i.e. deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very active during 2015 and the start of 2016 in implementing several stimulus measures to try to ensure the economy hits the growth target of about 7% for 2015. It has also sought to bring some stability after the major fall in the onshore Chinese stock market during the summer and then a second bout in January 2016. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, there are growing concerns about whether the Chinese economy could be heading for a hard landing and weak progress in rebalancing the economy from an over dependency on manufacturing and investment to consumer demand led services. There are also concerns over the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September and again in January 2016, which could lead to a flight to quality to bond markets. In addition, the international value of the Chinese currency has been on a steady trend of weakening and this will put further downward pressure on the currencies of emerging countries dependent for earnings on exports of their commodities.

Emerging countries There are also considerable concerns about the vulnerability of some emerging countries and their corporates, which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis, (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries), there is now a strong flow back to those western economies with strong growth and a path of rising interest rates and bond yields.

The currencies of emerging countries have therefore been depressed by both this change in investors' strategy, and the consequent massive reverse cash flow, and also by the expectations of a series of central interest rate increases in the US which has caused the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed by a simultaneous downturn in demand for their exports and a deterioration in the value of their currencies. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Capita Asset Services undertook its last review of interest rate forecasts on 12 February 2016. Our Bank Rate forecasts (and also MPC decisions) will be liable to further amendment depending on how economic data evolves over time. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 1 of 2017.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. At some future point in time, an increase in investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently to the downside, given the number of potential headwinds that could be growing on both the international and UK scene. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in February 2016, (based on short sterling), for the first Bank Rate increase are currently around quarter 1 2018.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a flight to safe havens
- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- Uncertainty around the risk of a UK exit from the EU.The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Appendix D:

Approved Countries for Investment

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

Appendix E:

Summary Treasury Management Budget

	2016/17 £	2015/16 £
Employees	165,000	160,000
Transport	1,788,000	3,250,000
Supplies and Services	193,000	190,000
Interest Paid	10,185,000	7,050,000
Debt Management Expenses	6,000	6,000
Gross Expenditure	**12,337,000**	**10,656,000**
Interest Received	0	0
Gross Income	**0**	**0**
Net Expenditure	**12,337,000**	**10,656,000**

Notes:

- Transport is the Authority's leasing costs – leasing is classified as a Treasury Management activity.

- Supplies and Services includes the following main items:-

  Bank and card charges 175k
  Treasury /Leasing Advice 15k

- The Interest Paid figure for 2016/17 does not include Prudential Borrowing costs.

- Interest Received has no budget as cash balances have significantly reduced. Any interest received in respect of cash surpluses may need to be used to offset borrowing costs for negative cash balances.