CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
7th May 2020

CABINET
12th May 2020

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Portfolio Holder for Finance

REPORT TITLE: **Treasury Management Qtr 4 Report**

REPORT FOR: **Information**

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1. Purpose

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 31st March 2020.

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 20	Sep 20	Dec 20	Mar 21	Jun 21	Sep 21	Dec 21
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
5yr PWLB	1.90%	1.90%	1.90%	2.00%	2.00%	2.00%	2.10%
10yr PWLB	2.10%	2.10%	2.10%	2.20%	2.20%	2.20%	2.30%
25yr PWLB	2.50%	2.50%	2.50%	2.60%	2.60%	2.60%	2.70%
50yr PWLB	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%

3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 7th March 2019 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 as rates are very low and in line with the 0.10% Bank Rate.

4.2 The Authority had the following investments at 31st March 2020:-

Invested with:	**Principal £000's**	**Interest Rate**	**Start Date**	**Maturity Date**
HSBC	9,405	0.00%		
Thurrock BC	10,000	0.80%	12-Mar-20	30-Apr-20
Total	**19,405**			

None of the Authority's deposit accounts are paying interest since bank rate was reduced to 0.10%. Further lending to other local authorities for short periods of time and the use of Money Market Funds will be reviewed when further assessment of the receipt of income to the Authority has taken place.

4.3 Higher return rates have been difficult to achieve as the Authority is not in a position to invest its cash for more than a short period of time.

4.4 Investment returns in future years:
Our advisors' are not currently suggesting earning rates for investments for budgeting purposes. Previous suggested rates were per below:-

2019/20	0.75%
2020/21	0.75%
2021/22	1.00%

These were 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 March is attached as a separate file to this report.

6. Borrowing / Re-scheduling

6.1 Effective management of the Authority's debt is essential to ensure that the impact of interest payable is minimised against our revenue accounts whilst maintaining prudent borrowing policies.

6.2 The Authority's Capital Position:

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the current year's unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through external borrowing or utilising temporary cash resources within the Council.

Net external borrowing (borrowings less investments) should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current year and next two financial years. This allows some flexibility for limited early borrowing for future years.

Original CFR Position (per original approved budget):

	As at 31.03.19 Actual	2019/20 Original Estimate	2020/21 Original Estimate	2021/22 Original Estimate
	£M	£M	£M	£M
Capital Financing Requirement	349,530	401,581	446,140	465,145

Updated CFR position as at 31.03.20:

	As at 31.03.19 Actual	2019/2020 Current Estimate	2020/21 Current Estimate	2021/22 Current Estimate
	£M	£M	£M	£M
Capital Financing Requirement	349,530	386,527	448,627	497,536

6.3 The Authority had outstanding long-term external debt of £299.2m at 31st March 2019. In relation to the CFR figure for 31st March 2019, this equated to the Authority being under borrowed by £50.3m. Using cash reserves as opposed to borrowing has been a prudent and cost effective approach over the last few years. 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.

6.4 On 9th October 2019 HM Treasury increased the margin that applies to new PWLB loans by 100bps with no prior discussion. This led to increased borrowing rates for local authorities.

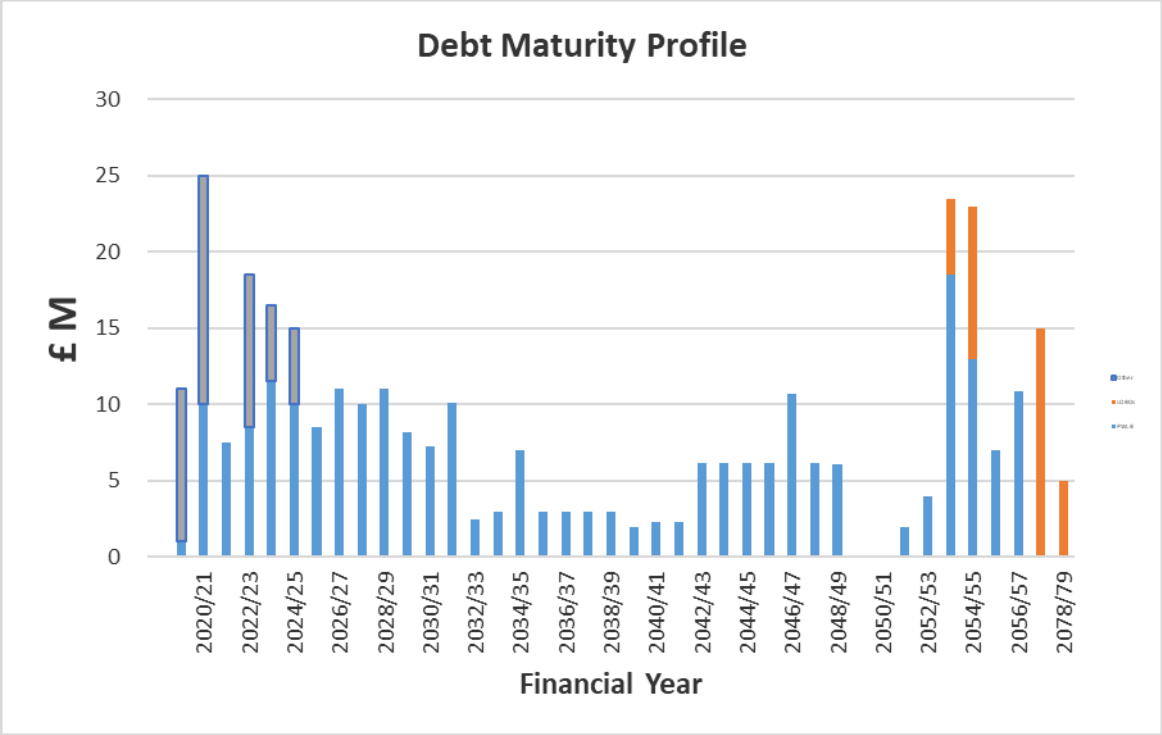
6.5 Capital Budget/Spend per efinancials:

Capital:	**Original Approved Budget £**	**Working Budget £**	**Actual Capital Spend *(not including commitments)* £**	**%age Actual Spend**
	92,234,000			
Qtr 1 end of June		123,568,153	6,655,314	5.39%
Qtr 2 end of Sept		102,036,287	21,973,109	21.53%
Qtr 3 end of Dec		76,226,654	39,298,294	51.55%
Qtr 4 end of Mar		72,435,084	61,461,671	84.85%

The financing of the approved capital budget included £51m of Prudential Borrowing and Supported Borrowing of £13.72m.

It remains a significant challenge to manage the Authority's cashflow and its need to borrow when the Capital working budget increases/decreases significantly during the financial year and, despite this, actual spend continues to be significantly below the working budget. This challenge is currently further magnified by the Covid 19 situation resulting in some Capital projects on hold.

6.5 *Debt Maturity Profile as at 31.03.20:*



6.6 PWLB Loans 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. PWLB interest rates in the last quarter have not been conducive towards any rescheduling.

7. Prudential Indicators

7.1 All TM Prudential Indicators were complied with in the quarter ending 31st March 2020.

8. VAT

8.1 The Technical Section of Finance act as the authority's VAT section. VAT can pose a risk to the authority hence the Treasury Manager has been asked to include VAT information in these quarterly reports.

8.2 The monthly VAT returns were submitted within the required deadlines during the quarter ending 31st March 2020.

8.3 Key Performance Indicators:

The VAT KPI's for 2019/20 are attached at Appendix C. The KPI's for debtor invoices are showing an improvement compared to previous years due to the introduction of a workflow process for checking debtor invoices implemented as part of the new financial system in April. Further to this,

this process is now ensuring correct vat treatment prior to invoices being raised as opposed to after.

Advice

N/A

Resource Implications

N/A

Legal implications

N/A

Comment from local member(s)

N/A

Integrated Impact Assessment

N/A

Recommendation

It is recommended that this report be accepted.

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Appendix A:

Approved Treasury Management Strategy 2019/20:

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	30	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

Economic Background

UK. Economic growth in 2019 was very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the coronavirus outbreak. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

Although the UK left the EU on 31 January 2020, we still have much uncertainty as to whether there will be a reasonable trade deal achieved by the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on the deadline of agreeing a deal by then.

After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75%, therefore, occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase **in quantitative easing (QE),** essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government has introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. This is a rapidly evolving situation so there may be further measures to come from the Bank and the Government. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit from about 2% to nearly 11%. The ratio of debt to GDP is also likely to increase from around 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the

economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly and the lock down is eased, it is hoped that there would be a sharp recovery but one that would take a prolonged time to fully recover previous lost momentum.

Inflation is not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure; wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

Employment had been growing healthily through the last year but it will obviously be heading for a big hit in the coming months. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power has been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

USA. Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Fed cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once coronavirus started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%. Near the end of March, Congress agreed a $2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to $6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of $1,200 to individuals.

The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost $367bn and 100% of the cost of lost wages for four months will also be covered. In addition, there will be $500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including $50bn for airlines.

However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15m by the end of March.

EUROZONE. The annual rate of growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it

aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs; this provides banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak. This resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China had put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

JAPAN has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It appears to have missed much of the domestic impact from coronavirus in 2019-20 but the virus is at an early stage there.

WORLD GROWTH. The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around most countries in the world and have a major impact in causing a world recession in growth in 2020.

Appendix C

VAT - Key Performance Indicators:

Creditor Invoices

VAT return for	No of high value Creditor invoices checked	No of Creditor invoices highlighted as requiring "proper" document for VAT recovery	%age of creditor invoices checked requiring "proper" document for VAT recovery
Apr-19	102	3	2.94%
May-19	184	1	0.54%
Jun-19	224	0	0.00%
Jul-19	235	1	0.43%
Aug-19	226	1	0.44%
Sep-19	177	1	0.56%
Oct-19	199	2	1.01%
Nov-19	214	2	0.93%
Dec-19	188	1	0.53%
Jan-20	206	2	0.97%
Feb-20	190	2	1.05%
Mar-20	Not yet completed		

Income Management Entries

VAT return for	No of entries checked by formula per the ledger account code used	No of entries needing follow up check (but not necessarily incorrect)	%age of entries needing follow up check
Apr-19	645	17	2.64%
May-19	676	4	0.59%
Jun-19	947	3	0.32%
Jul-19	974	7	0.72%
Aug-19	590	12	2.035
Sep-19	877	13	1.48%
Oct-19	1,088	5	1.01%
Nov-19	893	13	1.46%
Dec-19	718	7	0.97%
Jan-20	1131	6	0.53%
Feb-20	1024	5	0.49%
Mar-20	Not yet completed		

Debtor Invoices

VAT return for	No of Debtor invoices checked	No of checked debtor invoices with incorrect VAT code used	%age of debtor invoices with incorrect VAT code
Apr-19	50	0	0.00%
May-19	57	1	1.75%
Jun-19	72	6	8.33%
Jul-19	119	23	19.33%
Aug-19	74	3	4.05%
Sep-19	89	11	12.36%
Oct-19	59	5	8.47%
Nov-19	81	8	9.88%
Dec-19	64	9	14.06%
Jan-20	98	18	18.37%
Feb-20	70	3	4.29%
Mar-20	Not yet completed		

Purchase Cards

VAT return for	No of transactions for which paperwork requested for checking	No of Amazon invoices included in check	Resolvable errors discovered	No of transactions for which no response received within timescale	Value of VAT potentially claimable but recharged to budget due to non-response	No of transactions where VAT claimed incorrectly	%age of transactions available to be checked where VAT was claimed incorrectly	Value of VAT incorrectly claimed hence recharged to budget
Apr-19	243	26	15	12	£1,161.13	11	4.76%	£1,162.23
May-19	302	25	21	20	£1,849.63	22	7.80%	£1,035.51
Jun-19	348	23	31	16	£1,677.68	12	3.61%	£730.63
Jul-19	279	0	19	11	£1,331.95	9	3.365	£1,856.52
Aug-19	132	0	9	4	£726.08	6	4.69%	-£35.05
Sep-19	256	0	15	11	£1,503.81	9	3.67%	£4,703.92
Oct-19	274	0	8	6	£1,170.47	10	3.73%	£1,799.96
Nov-19	266	0	9	N/A	N/A	N/A	2.63%	-£124.05
Dec-19	299	0	24	23	£763.98	7	2.54%	£539.61
Jan-20	190	0	17	17	£1,328.33	7	4.05%	£613.44
Feb-20	199	0	3	3	£208.50	5	2.55%	£99.15
Mar-20	Not yet completed							

Chargebacks to service areas

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 as there is no evidence to support the vat recovery.
Any other VAT errors that come to light as a result of the various checks are also charged to the relevant service areas.

Budget holders are able to see this clearly as chargebacks are coded to account code EX400600 and the activity code used alongside this gives the reason why this chargeback has occurred.

The total amount charged back to service areas in 2019/20 to end of March is £76,541.16. The breakdown of this is as follows:-

Reason	**£**
Not a tax invoice	6,422.82
Not a tax invoice – no response from service area	2,201.93
PCC not the named customer	5,769.38
No VAT registration number on invoice	142.00
No invoice uploaded to Barclaycard system	11,437.11
Invoices uploaded do not match the payment	675.62
No evidence supplied to enable vat recovery	1,040.01
Foreign VAT (not recoverable)	75.69
No VAT amount on invoice in first place	4,127.62
Supplier not vat registered	273.79
Supply not to PCC	38,469.04
Overaccounting for VAT	5,906.15
PCC Internal payment	0
Document spoilt	0
Total	**76,541.16**

Of the above £27,688.87 was potentially recoverable. £21k of the errors listed above were in relation to schools. The £38.4k where the supply was not to PCC was correction of errors in relation to payments for elections as vat is only recoverable on the Council's own elections.