CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
11th February 2021

CABINET
16th February 2021

REPORT AUTHOR:	**COUNTY COUNCILLOR ALED DAVIES** **PORTFOLIO HOLDER FOR FINANCE**
REPORT TITLE:	**Treasury Management Quarter 3 Report**
REPORT FOR:	**Information**

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 December 2020.

2. Treasury Management Strategy

2.1 The Treasury Management Strategy approved by Full Council on 28th February 2020 is at Appendix A.

2.2 The Authority's investment priorities within the Strategy are: -

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

2.3 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.

3. Current Investments

3.1 It is now impossible to earn the level of interest commonly seen in previous decades as all short-term money market investment rates are barely above zero now that the Bank Rate is at 0.10%. Some entities are offering negative rates of return in some shorter time periods. Given this environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31st March 2024, investment returns are expected to remain low.

3.2 When looking at temporary investing, the Treasury team consider the bank fee to send the money, because of this some investments are not cost effective to lend money for very short periods of time where interest rates are circa 0.02% - 0.03%. However, the Authority does not have sufficient certainty around its cashflow to lend for longer periods where the return is higher. As such, not all available cash is earning interest.

3.3 As a result of the above the Authority had no investments on 31st December 2020.

4. Credit Rating Changes

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

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

5. Borrowing / Re-scheduling

5.1 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.

5.2 On the 25th of November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates. Both the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. There are currently no schemes for yield in the Capital Programme.

5.3 With the significant amounts of borrowing in the future Capital Programme, the inability to access PWLB borrowing will need to be a major consideration for any future purchases of assets for yield. The additional income these assets generate must be sufficient to cover the increased borrowing costs, as borrowing sources other than the PWLB are likely to be more expensive.

5.4 **The Authority's Capital Position**

5.5 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.

5.6 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 manager 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.

5.7 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.

5.8 **Original CFR Position (per original approved budget)**

£'m	As at 31st March 2020 Actual	2020/21 Original Estimate	2021/22 Original Estimate	2022/23 Original Estimate
Capital Financing Requirement	378.46	447.47	497.19	517.29

5.9 **Updated CFR position as at 31st December 2020**

£'m	As at 31st March 2020 Actual	2020/21 Current Estimate	2021/22 Current Estimate	2022/23 Current Estimate
Capital Financing Requirement	378.46	422.77	468.58	509.45

5.10 The Authority had outstanding long-term external debt of £328.2m at 31st March 2020. In relation to the CFR figure for 31st March 2020, 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.

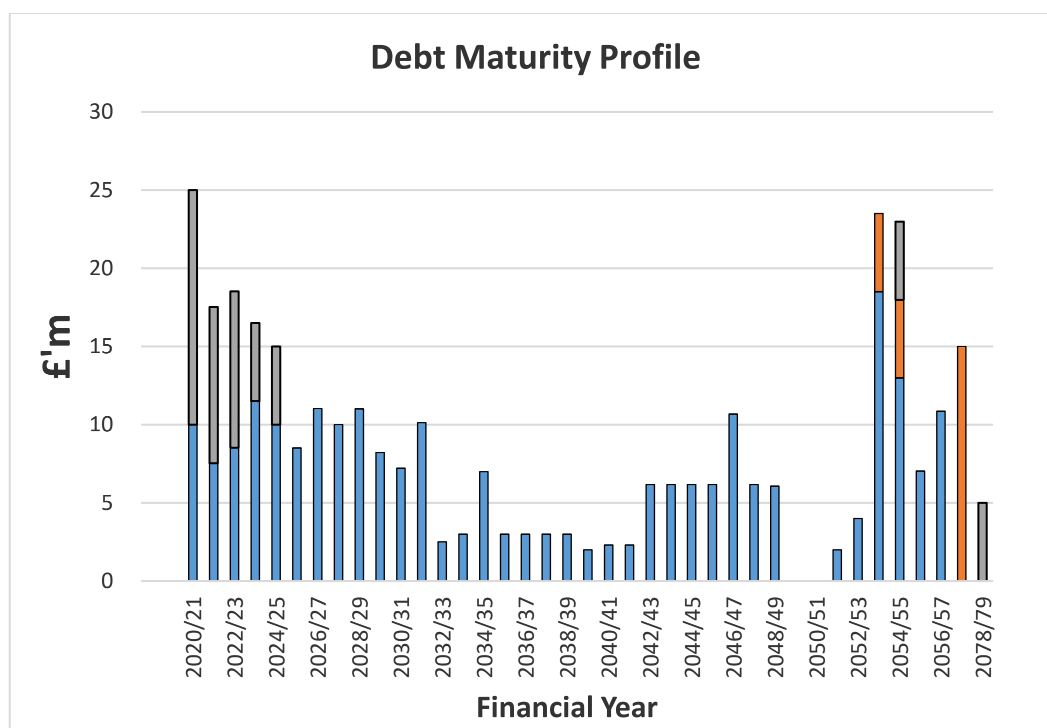
5.11 **Capital Budget/Spend**

£'m	Original Approved Budget	Revised Working Budget	Actual Capital Spend	% of Working Budget
	132.87			
30th June 2020		123.68	7.91	6.4%
30th September 2020		115.05	21.62	18.8%
31st December 2020		95.85	39.52	41.2%

5.12 The financing of the original capital budget included £56.89 million of Prudential Borrowing, following reprofiling of numerous schemes into future years this has fallen to £36.70 million.

5.13 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.

5.14 **Debt Maturity Profile as at 31st December 2020**



Key
Blue = PWLB; Grey = Market Loans including other local authorities; Orange = LOBOs

5.15 **PWLB Loans Rescheduling**

5.16 Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

6. Prudential Indicators

6.1 All TM Prudential Indicators were complied with in the quarter ending 31st December 2020.

7. Economic Background and Forecasts

7.1 The most recent forecast of interest rates by the Authority's advisor is as follows:

	Dec 20	Mar 21	Jun 21	Sep 21	Dec 21	Mar 22	Mar 23	Mar 24
Bank rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
5yr PWLB	0.78%	0.80%	0.80%	0.80%	0.80%	0.90%	0.90%	1.00%
10yr PWLB	1.08%	1.10%	1.10%	1.10%	1.10%	1.20%	1.30%	1.30%
25yr PWLB	1.64%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.80%
50yr PWLB	1.44%	1.30%	1.40%	1.40%	1.40%	1.40%	1.50%	1.60%

7.2 The economic background is attached at Appendix B.

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 this report includes VAT information.

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

8.3 **Key Performance Indicators**

The VAT KPI's for 2020/21 are attached at Appendix C.

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:

The Approved Treasury Management Strategy 2020/21 can be found here:

https://powysintranet.moderngov.co.uk/documents/s48653/Appendix%20F%20TM%20capital%20strategy%202020-21.pdf

Extracts relating to investments in 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
Foreign Banks	5	Up to 364 days	As per Link's matrices
Other Local Authorities	25	Up to 5 years	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
Foreign Banks	2	Up to 2 years	As per Link's matrices
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

During the quarter ended 31st December 2020

- The UK and EU signed a last-minute Brexit deal.
- Effective COVID-19 vaccines were announced and started to be rolled out.
- A second lockdown in November and a strict tiering system was imposed in December.
- The MPC announced an extra £150bn of Quantitative Easing (QE).
- The Chancellor announced a new fiscal package worth £55bn (2.4% of GDP) to support the economy.

The positive news on Brexit and vaccines boosted the pound and the FTSE 100.

UK. The key quarterly meeting of the Bank of England Monetary Policy Committee kept **Bank Rate** unchanged on 5.11.20. However, it revised its economic forecasts to take account of a second national lockdown from 5.11.20 to 2.12.20 which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of **quantitative easing (QE) of £150bn**, to start in January when the current programme of £300bn of QE, announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target". Its forecasts appeared, at that time, to be rather optimistic in terms of three areas:

- The economy would recover to reach its pre-pandemic level in Q1 2022.
- The Bank also expected there to be excess demand in the economy by Q4 2022.
- CPI inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".

Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.

One key addition to **the Bank's forward guidance in August** was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase, (or decrease), through to quarter 1 2024 but there could well be no increase during the next five years as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the MPC concern. **Inflation** is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short-lived factor and so not a concern.

COVID-19 vaccines. We had been waiting expectantly for news that various COVID-19 vaccines would be cleared as being safe and effective for administering to the general

public. The Pfizer announcement on 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, this vaccine has demanding cold storage requirements of minus 70c that impairs the speed of application to the general population. It has therefore been particularly welcome that the Oxford University/AstraZeneca vaccine has now also been approved which is much cheaper and only requires fridge temperatures for storage. The Government has 60m doses on order and is aiming to vaccinate at a rate of 2m people per week starting in January, though this rate is currently restricted by a bottleneck on vaccine production; (a new UK production facility is due to be completed in June).

These announcements, plus expected further announcements that other vaccines could be approved soon, have enormously boosted confidence that **life could largely return to normal during the second half of 2021**, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels; this would help to bring the unemployment rate down. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could start to be eased, beginning possibly in Q2 2021 once vulnerable people and front-line workers have been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% in 2021 instead of 9%.

Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. It is likely that the one-month national lockdown that started on 5th November, will have caused a further contraction of 8% m/m in November so the economy may have then been 14% below its pre-crisis level.

December 2020 / January 2021. Since then, there has been rapid backtracking on easing restrictions due to the spread of a new mutation of the virus, and severe restrictions were imposed across all four nations. These restrictions were changed on 5.1.21 to national lockdowns of various initial lengths in each of the four nations, as the NHS was under extreme pressure. It is now likely that wide swathes of the UK will remain under these new restrictions for some months; this means that the near-term outlook for the economy is grim. However, the distribution of vaccines and the expected consequent removal of COVID-19 restrictions, should allow GDP to rebound rapidly in the second half of 2021 so that the economy could climb back to its pre-pandemic peak as soon as late in 2022. Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant caveat is if another mutation of COVID-19 appears that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development and vaccine production facilities are being ramped up around the world.

Brexit. The final agreement on 24.12.20 has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the

forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

Monetary Policy Committee meeting of 17th December. All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks but they were still sufficiently concerned that they voted to extend the availability of the Term Funding Scheme, (cheap borrowing), with additional incentives for small and medium size enterprises for another six months from 30.4.21 until 31.10.21. (The MPC had assumed that a Brexit deal would be agreed.)

US. The Democrats won the presidential election in November, and now that they have won two Senate seats in Georgia in early January, they have effective control of both Congress and the Senate, although power is more limited in the latter. This is likely to enable the Democrats to provide more fiscal stimulus to the economy and so help the speed of economic recovery.

The economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave - impacting widely across the US this time. This latest upturn poses a threat that the recovery in the economy could stall. This is **the single biggest downside risk** to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

The restrictions imposed to control the spread of the virus are once again weighing on the economy with employment growth slowing sharply in November and retail sales dropping back. The economy is set for further weakness in December and into the spring. However, a $900bn fiscal stimulus deal passed by Congress in late December will limit the downside. GDP growth is expected to rebound markedly from the second quarter of 2021 onwards as vaccines are rolled out on a widespread basis and restrictions are loosened.

After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

The Fed's meeting on **16 December** tweaked the guidance for its monthly asset quantitative easing purchases with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that inflation will only get back to 2.0% in 2023, the vast majority expect the fed funds rate to

be still at near-zero until 2024 or later. Furthermore, officials think the balance of risks surrounding that median inflation forecast are firmly skewed to the downside. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping Treasury yields low – **which will also have an influence on gilt yields in this country.**

EU. In early December, the figures for **Q3 GDP** confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year. In Q2, GDP was 15% below its pre-pandemic level. But in Q3 the economy grew by 12.5% q/q leaving GDP down by "only" 4.4%. That was much better than had been expected earlier in the year. However, growth is likely to stagnate during **Q4 and in Q1 of 2021**, as a second wave of the virus has affected many countries: it is likely to hit hardest those countries more dependent on tourism.

With inflation expected to be unlikely to get much above 1% over the next two years, **the ECB** has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. The ECB's December meeting added a further €500bn to the PEPP scheme, (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities for an additional year until December 2023. Three additional tranches of TLTRO, (cheap loans to banks), were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank's forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022. The total PEPP scheme of €1,850bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore **unlikely to be a euro crisis** while the ECB is able to maintain this level of support. However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle before later in quarter 2 of 2021.

China. After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth.

Japan. A third round of fiscal stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That is huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of GDP this year. Coupled with Japan's relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government's latest fiscal effort should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone.

World growth. World growth will have been in recession in 2020. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

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	% of creditor invoices checked requiring "proper" document for VAT recovery
Apr-20	171	3	1.75%
May-20	132	0	0.00%
Jun-20	172	1	0.58%
Jul-20	189	1	0.53%
Aug-20	161	1	0.62%
Sep-20	222	1	0.45%
Oct-20	216	2	0.93%
Nov-20	201	1	0.50%
Dec-20	221	1	0.45%
Jan-21			
Feb-21			
Mar-21			

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).	% of entries needing follow up check
Apr-20	648	1	0.15%
May-20	555	6	1.08%
Jun-20	711	21	2.95%
Jul-20	709	4	0.56%
Aug-20	705	3	0.43%
Sep-20	902	5	0.55%
Oct-20	909	0	0.00%
Nov-20	803	1	0.12%
Dec-20	697	0	0.00%
Jan-21			
Feb-21			
Mar-21			

Debtor Invoices

VAT return for	No of Debtor invoices checked	No of checked debtor invoices with incorrect VAT code used	% of debtor invoices with incorrect VAT code
Apr-20	49	6	12.24%
May-20	41	0	0.00%
Jun-20	70	0	0.00%
Jul-20	79	10	12.66%
Aug-20	84	1	1.19%
Sep-20	77	0	0.00%
Oct-20	71	0	0.00%
Nov-20	70	1	1.43%
Dec-20	72	0	0.00%
Jan-21			
Feb-21			
Mar-21			

Note: Debtors VAT checking is carried out by Finance via a work process prior to the invoice being raised hence the improvement in errors compared to previous years

Purchase Cards

VAT return for	No of transactions for which paperwork requested for checking	Resolvable errors discovered	Value of VAT potentially claimable but recharged to budget due to non- response	No of transactions where VAT claimed incorrectly	% of transactions available to be checked where VAT was claimed incorrectly	Value of VAT incorrectly claimed hence recharged to budget
Apr-20	128	9	£2,314.57	7	5.47%	£418.08
May-20	89	0	£0.00	5	5.62%	£268.05
Jun-20	99	2	£812.00	4	4.04%	£357.51
Jul-20	142	3	£321.90	8	5.63%	£542.96
Aug-20	66	3	£706.86	4	6.06%	£48.63
Sep-20	216[1]	6	£1,287.12	34	15.74%	£1,074.67
Oct-20	171	13	£1,050.57	17	9.94%	£314.34
Nov-20	207	3	£641.47	18	8.70%	£1,048.13
Dec-20	174	8	£979.34	16	9.20%	£356.33
Jan-21						
Feb-21						
Mar-21						

[1] Please note that the amount previously listed (2,016) was due to a typo in the KPI spreadsheet. As such the other stats for this period have been updated to reflect the corrected figures.

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 2020/21 to end of December is £30,705.89. The breakdown of this is as follows:

Potentially correctable errors

Reason	Amount £
Not a tax invoice	9,186.87
Powys County Council is not the named customer	68.53
No invoice uploaded to purchase card system	16,145.53
Invoice(s) do not match payment	883.34
No evidence to back recovery	133.33
Total	**26,417.60**

Other errors

Reason	Amount £
Non-domestic VAT	145.85
No tax on invoice	1,343.18
Supply not to Powys County Council	916.47
Over-accounting for VAT	1,879.13
Internal payments	3.66
Total	**4,288.29**