CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
6th July 2017

CABINET
11th July 2017

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

SUBJECT: **Treasury Management Qtr 4 Report**

REPORT FOR: **Information**

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1. Summary

1.1 CIPFA's 2009 Treasury Management Bulletin suggested:

"In order to enshrine best practice it is suggested that authorities report formally on treasury management activities at least twice a year and preferably quarterly."

The CIPFA Code of Practice on Treasury Management emphasises a number of key areas including the following:-

xi. Treasury management performance and policy setting should be subject to scrutiny prior to implementation.

1.2 In line with the above this report is providing information on the activities for the quarter ending 31st March 2017.

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 17	Sep 17	Dec 17	Mar 18	Jun 18	Sep 18	Dec 18
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
5yr PWLB	1.40%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%
10yr PWLB	2.00%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%
25yr PWLB	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%
50yr PWLB	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%

3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 9th March 2016 is at Appendix A.

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

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

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

4. Current Investments

4.1 The current investment market is difficult in respect of earning the level of interest rates commonly seen in previous years as rates are very low and in line with the 0.25% Bank Rate.

4.2 The Authority's investment position as at 31st March 2017 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
Santander	20,000	0.25%	N/A	Deposit A/c
BOS	11,425	0.15%	N/A	Deposit A/c
HSBC	0	0.00%	N/A	Deposit A/c
Total	**31,425**			
Lloyds TSB - LAMS	1,000	3.20%	13.08.12	14.08.17

4.3 Interest rates on the deposit accounts decreased, as expected, following the bank rate cut in August. Since 31st March the BOS account has reduced to 0.05%. The Santander rate remains at 0.25% as a result of the original account opened with Abbey National stating that it must be at bank rate.

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

4.5 There have been no credit rating changes in the last few months in respect of the banks that the Authority utilises for deposits.

UK Sovereign Rating Action:
The following took place following Brexit:

Fitch:
- Sovereign rating downgraded by one notch, from AA+ to AA
- Outlook lowered to Negative, from Stable

Moody's:
- Sovereign rating affirmed, at Aa1 (equivalent to AA+ from Fitch / S&P)
- Outlook lowered to Negative, from Stable

Standard & Poor's (S&P):

- Sovereign rating downgraded by two notches, from AAA to AA
- Remains on Negative Outlook

4.6 Local Authority Mortgage Scheme:

In August 2012, following a Cabinet report, the Authority entered the Local Authority Mortgage Scheme with an allocation to Lloyds TSB of £1M. Under the scheme this was deemed as Capital Expenditure. However, the Wales Audit Office (WAO) opinion differed from this in that they suggested it should be treated as an investment. Unfortunately, despite meetings and extensive correspondence by Capita Treasury with the Welsh Government, Welsh Local Government Association and the Wales Audit Office, agreement on the accounting treatment for Welsh authorities has not been reached despite the provision of 3 separate legal opinions supporting the Capital Expenditure position. As such, Capita have said that they are not sure there is much more they can do in Wales. This Authority has concurred with WAO's requirement to treat this as an investment and, as such, the amount is included in the table above and is being accounted for as an investment. Council approved this investment following a retrospective report on 16th May 2013.

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

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

	Suggested Rate
2017/18	0.25%
2018/19	0.25%

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

5. Credit Rating Changes

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

5.2 The credit rating list for end of 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.

CFR Position:

	As at 31.03.16 Actual	2016/17 Original Estimate	2017/18 Original Estimate	2018/19 Original Estimate
	£M	£M	£M	£M
Capital Financing Requirement	302,363	307,313	326,288	354,093

6.3 The Authority had outstanding long-term external debt of £226.4M at 31st March 2016. In relation to the CFR figure for 31st March 2016, this equated to the Authority being under borrowed by £76M. This is a prudent and cost effective approach in the current economic climate. However, internal borrowing is only a temporary situation and, based on capital estimates, it will be necessary for the Authority to borrow at stages over the next few years. As such, the Authority needs to be mindful that it may be prudent to borrow whilst interest rates are at their low levels and carry the cost of this borrowing as opposed to borrowing at a future date at increased rates.

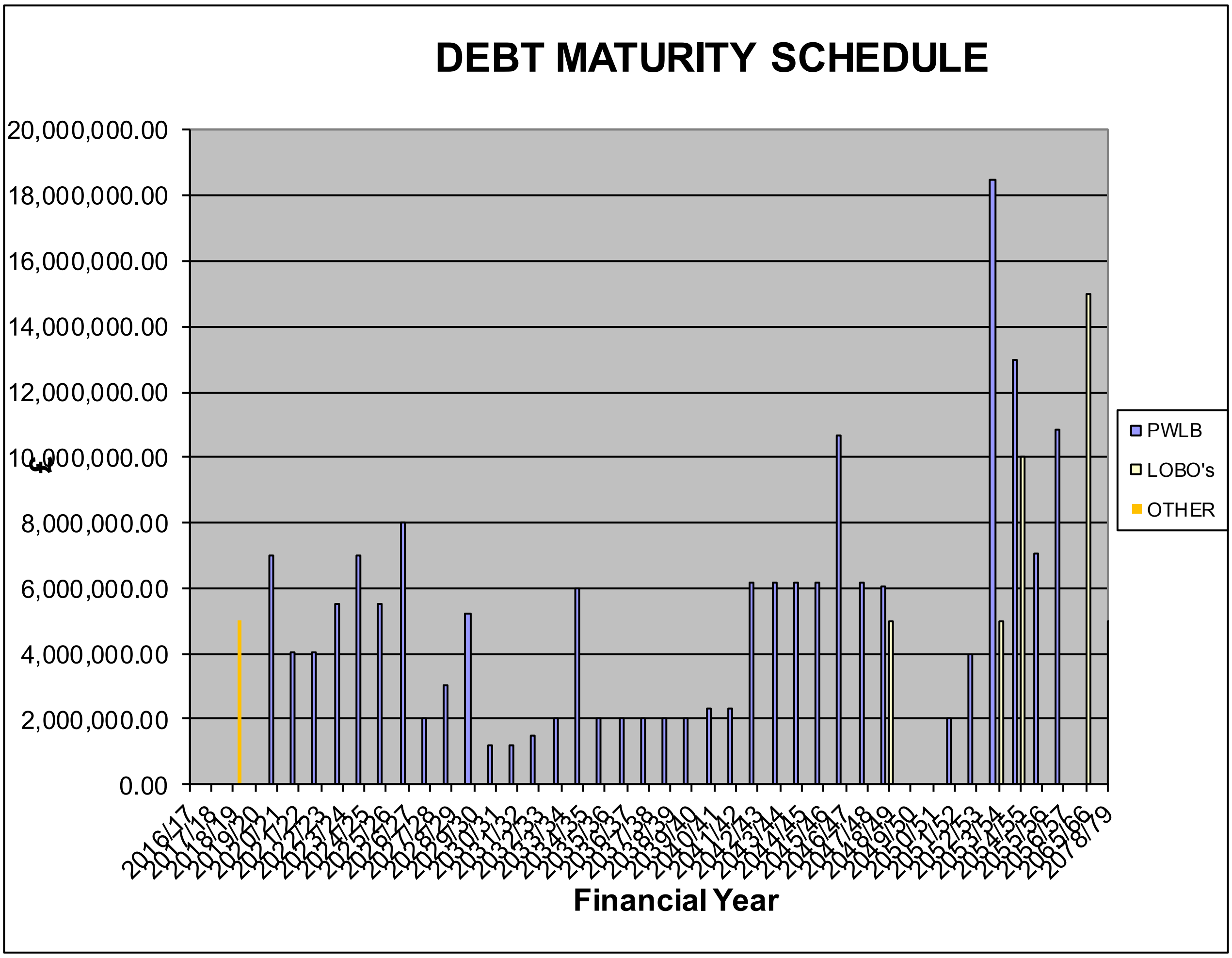
6.4 Capital Budget/Spend per efinancials:

Capital:	**Approved Budget**	**Working budget**	**Actual Capital Spend *(not including commitments)***	**%age spend**
	45,069,066			
June		52,381,477	3,087,768	5.89%
Sept		55,298,113	9,782,827	17.69%
Dec		58,855,874	17,515,538	29.80%
March		43,429,765	29,801,369	68.62%

The financing of the approved capital budget included £20.4M of Prudential borrowing in total.

6.5 *Debt Maturity Profile as at 31.03.17:*

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



6.6 Rescheduling:

The Public Works Loans Board released a circular regarding rates on 20th October 2010. As a result of this, rates immediately increased by 0.87-0.88 basis points across the board. The overall impact of this circular was that it is far more difficult for authorities to reschedule debt
Members are aware that officers continue to look for interest savings on a daily basis by monitoring rates that may mean the Authority can re-schedule some of its debt or prematurely repay debt if applicable. However, PWLB interest rates have not been conducive towards rescheduling.

7. Prudential Indicators

7.1 All TM Prudential Indicators were complied with in the quarter ending 31st March 2017.

8. VAT

8.1 The Treasury Manager acts as the authority's VAT officer. VAT can pose a risk to the authority hence the TM 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 2017.

8.3 Key Performance Indicators:

The VAT KPI's for 2016/17 are attached at Appendix C.

9. Banking Contract

9.1 The current corporate banking contract with HSBC is due to expire on 30th June 2017. Following discussions and a benchmarking exercise to ensure that HSBC are competitive, a new 3 year contract has been agreed with HSBC with prices remaining the same.

10. Suppliers paid by Cheque

10.1 During the review of the banking contract and charges, Finance highlighted ways of reducing bank charges. One of these relates to cheque payments made to suppliers.

10.2 In 2016/17 2,204 creditor cheques were printed (excluding petty cash cheques for cashing by staff). The costs for producing a cheque and BACS payment are per the following table:-

	No. of cheques	Bank Charge	Postage Cost	Stationery Cost	Total Cost
Cheque	2,204	0.12p	0.38p	0.50p	£2,204.00
BACS	2,204	0.02p	Nil	Nil	£44.08
Cheques stopped as uncashed	56	£4.00			£224.00

Based on the above, the saving to the Council in 2016/17 had the relevant suppliers been paid by BACS rather than by cheque would have been £2,383.92.

10.3 Suppliers must have a bank account whether paid by cheque or BACS. Many local authorities have introduced a policy whereby they no longer pay any suppliers by cheque. It is proposed that this Authority does the same with effect from 1st September 2017. In order to achieve this, all suppliers currently paid by cheque will receive a letter informing them of the change taking place and a form for them to supply their bank details. Service areas will also be informed so that they can make relevant arrangements if and where necessary.

Proposal

1. It is proposed that the Treasury Management quarterly report is received.
2. It is proposed that the Authority ceases to pay suppliers by cheque with effect from 1st September 2017.

Statutory Officers

The Strategic Director – Resources (s151 officer) notes the content of the report and supports the recommendation. It is important that members are kept informed about this key activity. In addition, the proposal that the Authority ceases to pay suppliers by cheque (with effect from 1st September 2017) is supported, given the savings this generates. The Finance Service will ensure there is communication with suppliers about this change.

The Solicitor to the Council (Monitoring Officer) has made the following comment: "I have nothing to add to the report".

Future Status of the Report

Not applicable

Recommendation:		**Reason for Recommendation:**	
That the Treasury Management Quarterly Report be received **That Cabinet agree to cease paying suppliers by cheque wef 1st September 2017**		**To ensure Cabinet remains informed about current Treasury Management performance** **To reduce bank and other charges to the Authority**	
Relevant Policy (ies):		Treasury Management Policy	
Within Policy:	**Y**	**Within Budget:**	**N/A**
Person(s) To Implement Decision:		**N/A**	
Date By When Decision To Be Implemented:		**1st September 2017**	

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Background Papers used to prepare Report:

CIPFA Code of Practice on Treasury Management and Cross Sectoral Guidance Notes
Treasury Management Policy Statement
Advisors' Information
WAG Guidance on Local Government Investments 2010
PWLB circulars

<u>Appendix A:</u>

Approved Treasury Management Strategy 2016/17:

7.5 "High" credit quality:

7.5.1 It is proposed that the Authority continue with the following in respect of defining a "high" credit quality. If a rating is not available from any of the rating agencies then the available ratings will be used. Members will note that this proposal excludes investments with some banks off the advisors' suggested list:-

Long Term Ratings (in respect of long-term investments):

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
AAA	Aaa	AAA
AA+	Aa1	AA+
AA	Aa2	AA
AA-	Aa3	AA-

Short Term Ratings (in respect of short-term investments):

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
F1+	N/A	A-1+
F1	P-1	A-1

7.6 Country limits:

7.6.1 It is proposed that the Authority will use approved counterparties from the UK and approved counterparties from other countries with the following sovereign credit ratings:-

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
AAA	Aaa	AAA

Country	**Maximum Investment per Country**	**Credit Rating/Other Assessment of Risk**
AAA countries	£20M (held in call accounts)	As per rating list
UK	No Maximum Investment	As per rating list

7.7 *Group/Institutions - Counterparty Criteria/Limits:*

Specified Investments:

Institution	Maximum Investment per Group/Institution £M	Maximum Length	Credit Rating/Other Assessment of Risk
UK Banks	20 (a maximum £10M to be held in fixed term investments)	Up to 364 days	As per Capita's matrices and the Authority's definition of a high credit rating
Foreign Banks	5	Up to 364 days	As per Capita's matrices and the Authority's definition of a high credit rating
Other Local Authorities	25	Up to 364 days	N/A

Non-Specified Investments:

Institution	Maximum Investment per Group/Institution £M	Maximum Length	Credit Rating/Other Assessment of Risk
UK Banks	10 (£2M limit with any one institution)	Up to 2 years	As per Capita's matrices and the Authority's definition of a high credit rating
Lloyds Bank (as a mortgage lender in the LAMS scheme)	5	Up to 5 years	N/A
Foreign Banks	2	Up to 2 years	As per Sector's matrices and the Authority's definition of a high credit rating
Money Market Funds (max. of 5)	10	N/A	All are AAA rated plus the parents/owners must meet the Authority's short term investment criteria
Other Local Authorities	10	Up to 2 years	N/A
European Investment Bank Bonds	3	2-3 years	N/A
Note: Limits for Specified and Non-Specified are combined limits. The maximum limit will also apply to a banking group as a whole.			

Appendix B

Economic Background

With many hypothetical scenarios on the table, given the shock election results, Theresa May has reshuffled her cabinet, appointing some notable ministers. Damian Green, a well-known Europhile has been appointed as the Prime Minister's deputy, prompting speculation that the government could be shifting towards a softer Brexit. There were also rumours emerging from Northern Ireland that the Democratic Unionist Party is insisting on a soft Brexit and greater investment in Northern Ireland in return for supporting a minority Conservative government… although these rumours have since been quashed by political insiders. In light of Theresa May's narrow victory, it is highly likely that controversial legislative proposals, such as the so called "dementia tax", will not be put forward in a trimmed-down legislative programme.

The headline inflation rate for the UK touched a four year high, as the rising cost of foreign package holidays, food, games and toys helped bump up the UK Consumer Price Index (CPI) to 2.9% in May, from 2.7% previously. Retailers have seemingly been more willing to pass off the higher cost of imports onto consumers in an attempt to maintain existing margins. However, there are signs that input price pressures are relaxing as Producer Prices increased by 11.6%, a slowdown from 15.6% recorded in the previous month.
To add to the doom and gloom, the squeeze on UK households intensified as wage growth continued to slow, meaning that real wages (which take account of inflation) are falling at their fastest pace in three years. The UK average weekly earnings, including bonuses, slipped to 2.1% from a revised 2.3%. Meanwhile, excluding bonuses, wages grew by 1.7%, lower than the consensus of 2%. Depending on consumer resilience, falling real wages has the potential to lead the UK into a consumption driven economic slowdown.
Further afield, US retail sales registered their biggest drop for 16 months in May, amid dwindling purchases of motor vehicles and discretionary spending. The Commerce Department reported a drop in retail sales of 0.3%, following an unrevised increase of 0.4% in April. Core Retail Sales, which strips out volatile food and energy, also registered a drop of 0.3% in the same period.

The release came in alongside the much anticipated US consumer price data, which also came in below market expectations. US CPI fell by 0.1% on the month in May, whilst core consumer prices rose by a paltry 0.1%, relative to the consensus of 0.2%. The year-on-year gain in the CPI in May was still larger than the 1.6% average annual increase over the past 10 years. However, muted price pressures have resulted in investors revaluating the likelihood of further rate hikes this year. As a result, the US dollar trade weighted index fell alongside US T-bill yields, whilst stock index futures pared gains.

Back on the domestic front, data showed that retail sales grew at their slowest rate in four years in May. The release by the Office for National Statistics stated that sales volumes fell by 1.2% on the month, falling more than the 0.8% forecasted by the market. The figures follow the exceptional 2.3% gain recorded the previous month, although economists have warned that the April figure was distorted by the timing of the Easter holidays. The FTSE 250, which encompasses a high proportion of consumer-focused businesses, fell by 1.3% on the back of the release.

After a two day meeting, the US Federal Reserve announced that it was raising short term interest rates by 25 basis points, marking the third consecutive quarterly increase. The Federal Funds target rate now stands at 1.00% - 1.25% and the 'data dependent' Fed expects economic conditions to improve in the upcoming months, thereby warranting another 25 basis point increase before the end of the year. The central bank also noted that they would be taking steps to “normalise” their balance sheet. This ballooned after the financial crisis of 2007-2008 prompted the use of unconventional monetary policy, leading the Fed to amass $4.5tn worth of bonds, including $1.8tn in mortgage securities. The statement by the Fed highlights their view that the recent sombre tone to hard data is viewed as a temporary blip. Whether this is the case remains to be seen and the sole dissenter, Minneapolis Federal Reserve Bank President Neel Kashkari, does not seem to think so.

Policymakers at the Bank of England narrowly voted in favour of keeping interest rates on hold at their current levels. The vote was split at 5-3 as Kristin Forbes, Ian McCafferty and Michael Saunders cited unsustainable levels of inflation as their rationale for an immediate rate hike. The split vote was unexpected by capital markets and placed an upward pressure on gilt yields and sterling, which has been recently undermined by the snap election outcome.

As expected, Eurozone inflation slowed in May, primarily as a result of weakening energy prices. While the headline inflation rate remained at 1.4% in May, the core inflation, which excludes energy, food, alcohol & tobacco, slipped to 0.9% from an unrevised 1.2%. The readings, which are below the 2% target, will add weight to the European Central Bank’s cautious approach, despite being pressurised by Germany to remove its stimulus measures.

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-16	169	5	2.96%
May-16	131	3	2.29%
Jun-16	165	10	6.06%
Jul-16	156	8	5.13%
Aug-16	220	8	3.64%
Sep-16	183	4	2.19%
Oct-16	155	8	5.16%
Nov-16	188	8	4.26%
Dec-16	171	7	4.09%
Jan-17	196	14	7.14%
Feb-17	189	12	6.35%
Mar-17	284	17	5.99%

Cash Receipting Entries

VAT return for	No of cash receipting entries checked by formula per the ledger account code used	No of cash receipting entries needing follow up check	%age of cash receipting entries needing follow up check
Apr-16	3,770	6	0.16%
May-16	4,059	8	0.20%
Jun-16	4,283	10	0.23%
Jul-16	3,794	7	0.18%
Aug-16	2,888	10	0.35%
Sep-16	3,994	8	0.20%
Oct-16	4,263	19	0.45%
Nov-16	4,301	28	0.65%
Dec-16	3,515	20	0.57%
Jan-17	2,800	6	0.21%
Feb-17	2,539	15	0.59%
Mar-17	1,373	7	0.51%

Debtor Invoices

VAT return for	No of Debtor invoices checked (value >£5k)	No of checked debtor invoices with incorrect VAT code used	%age of debtor invoices with incorrect VAT code
Apr-16	52	3	5.77%
May-16	34	9	26.47%
Jun-16	38	15	39.47%
Jul-16	32	6	18.75%
Aug-16	29	6	20.69%
Sep-16	39	5	12.82%
Oct-16	65	12	18.46%
Nov-16	55	11	20.00%
Dec-16	36	6	16.67%
Jan-17	54	11	20.37%
Feb-17	49	11	22.45%
Mar-17	74	16	21.62%

Purchase Cards

VAT return for	No of Purchase Card transactions for previous month for which paperwork requested for checking	No of Amazon invoices included in Purchase card check	No of Purchase Card transactions for which no response received within timescale	Value of VAT potentially claimable but recharged to budget due to non-response	No of Purchase Card transactions where VAT claimed incorrectly	%age of Purchase Card transactions available to be checked where VAT was claimed incorrectly	Value of VAT incorrectly claimed hence recharged to budget
Apr-16	0					#DIV/0!	
May-16	0					#DIV/0!	
Jun-16	0					#DIV/0!	
Jul-16	0					#DIV/0!	
Aug-16	0					#DIV/0!	
Sep-16	0					#DIV/0!	
Oct-16	0					#DIV/0!	
Nov-16	0					#DIV/0!	
Dec-16	110	22	16	£643.41	20	21.28%	£416.93
Jan-17	129	61	18	£787.97	24	21.62%	£847.21
Feb-17	143	53	41	£2,723.93	10	9.80%	£274.62
Mar-17	67	14	13	£1,448.71	5	9.26%	£14.96

Note: Purchase card checking re-commenced when a temporary extra resource was made available to the Treasury Management team in January.

Voluntary Declarations

Per HMRC regulations, any vat errors discovered can be adjusted in the current VAT account if they are:

- below the reporting threshold (>£10,000 or up to 1% of the VAT return Box 6 figure up to a maximum of £50,000)
- not deliberate
- for an accounting period that ended less than 4 years ago.

Any errors that do not meet these conditions have to be reported to HM Revenue and Customs and are referred to as voluntary declarations. The following have been reported during this financial year. No penalties have been applied by HMRC but interest has been charged.

Date of declaration	Value of voluntary declaration	Service Area	Interest charged by HMRC
25-Aug-16	£35,229.04	Newtown High School	£698.95
01-Dec-16	£119,560.81	Leisure – BSU	)
11-Jan-17	£15,223.65	Fleet - Pool cars	)
30-Jan-17	£20,592.34	Regen – invoices to YFC's	) £2,277.23

Chargebacks to service areas

As a result of the Creditor invoice checking, Treasury Management produce a monthly list of Creditor payments for which a "proper" vat document has not been received. Any VAT amounts on these invoices are held in the vat account and are not claimed until such time as a valid invoice is received. During the majority of the year, the list was posted on the Intranet and service areas had three months to source a valid document, after which time and on no receipt of a valid document, the vat amount is recharged to the service area cost centre. Towards the end of the year this process changed so that the relevant budget holder is emailed the details and asked to source a correct invoice within one month.

At 31st March 2017 the amount recharged to revenue service areas in this respect for the financial year was £22,985.12. The amount recharged to capital projects was £7,868.27.