CC33 – 2015

CYNGOR SIR *POWYS* COUNTY COUNCIL.

FULL COUNCIL

5th March 2015

REPORT AUTHOR: **County Councillor Dai Davies**
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 2015/16, in respect of borrowing and investments.

1.3 The report requires an appropriate strategy for borrowing and investing for the financial year 2015/16.

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 effect 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 2015/16 by the Authority's advisor is:

	Mar15	Jun15	Sep15	Dec15	Mar16	Jun16	Sep16	Dec16
Bank rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.70%	1.00%	1.25%
5yr PWLB	2.10%	2.20%	2.30%	2.50%	2.60%	2.70%	2.80%	3.00%
10yr PWLB	2.70%	2.80%	3.00%	3.10%	3.20%	3.40%	3.50%	3.60%
25yr PWLB	3.30%	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%
50yr PWLB	3.30%	3.40%	3.60%	3.80%	3.90%	4.00%	4.20%	4.30%

4. Borrowing Strategy

4.1 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 2014/15 is £220.4M. If no borrowing takes place within the remainder of the current financial year, the outstanding debt at 31st March 2015 will be £150.8M showing that the Authority is currently borrowed well below its CFR. Analysis of the balance sheet shows the Authority to be in an internally borrowed position. The current Capital budget for 2015/16 is £29.7M.

4.2 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.

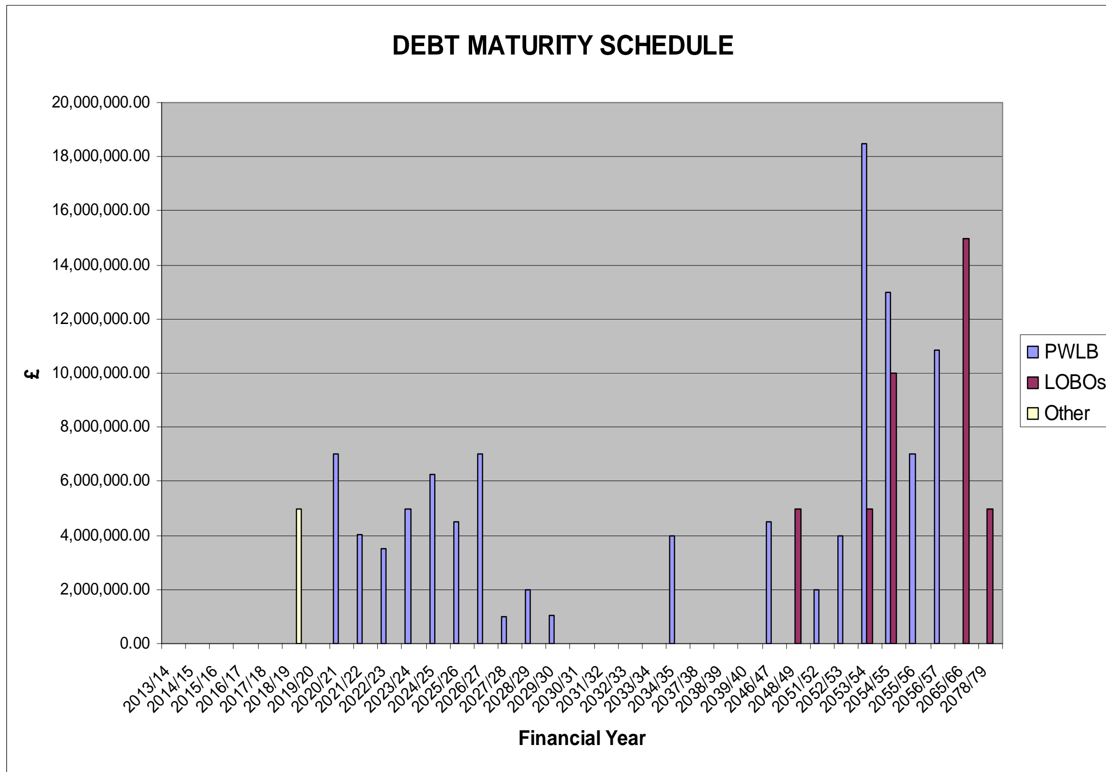
4.3 PWLB Certainty Rate:

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 01.04.15:

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



4.5 HRA Reform in Wales:

The requirement for the HRA reform settlement to be made to the Welsh government on 2nd April 2015 has required a separate consideration of a borrowing strategy. The Authority will need to have a cash settlement amount of £72.4M available for 2nd April 2015 so separate borrowing solely for this purpose is currently being detailed by officers.

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. <u>Policy on borrowing in advance of need</u>

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. <u>Investments</u>

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 taken a prudent view and adopted a position that is more risk averse than Capita's suggested list in respect of counterparties and durations.

7.4.2 As mentioned above, Capita uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors - forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays : -

- credit watches and credit outlooks from credit rating agencies
- CDS 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 Capita's modelling approach combines credit ratings, credit watches, credit outlooks and Credit Default Swap spreads in a weighted scoring system for which the end product is a series of colour code 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.

7.4.5 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Capita's weekly credit list of worldwide potential counterparties. The Authority will therefore be able to use counterparties within the following durational bands*:*

- Yellow 5 years
- 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

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

7.4.6 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.

7.4.7 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 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

7.5.2 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 2014/15 Strategy are as follows:-

Specified Investments (2014/15):

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 (2014/15):

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 2015/16.

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:

2015/16	0.60%
2016/17	1.10%

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. The current contract is until 31st March 2015 and processes for tendering are currently underway.

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 2015/16.

Please note, however, that these limits will be reviewed once the HRA Reform borrowing situation is confirmed.

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 2015/16.

Please note, however, that these limits will be reviewed once the HRA Reform borrowing situation is confirmed.

6.3.3 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 2015/16 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."

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 2015**

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

<u>THE UK ECONOMY</u>

Economic growth:

UK. After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then growth in 2014 of 0.6% in Q1, 0.8% Q2, 0.7% Q3 and 0.5% Q4 (annual rate for 2014 of 2.6%), growth is expected to gain increased momentum during 2015 and 2016 to annual rates of 2.9%, (2017 2.7%). This will be a response to two developments; firstly, the stimulative effect of the sharp fall in oil prices in quarter 4 of 2014 and then inflation potentially falling into negative territory during 2015, but anyway being near to zero until towards the end of the year. Secondly, due to an expected return to a significant rise in average wage rates due to the continuing fall in unemployment to about 5.5% by mid 2015, (the long run equilibrium level is 5.0%), and the further erosion of spare capacity, (slack), to about 0.5% of GDP. This is expected to lead to total consumer disposable income rising by no less than around 3.5% during quarter 3 2015. This would therefore strengthen consumer expenditure but without much downside to the savings ratio.

However, for this recovery to become more balanced and sustainable in the longer term, the recovery still needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. In addition, there has been a need for a major improvement in labour productivity, which has languished at dismal levels since 2008, to support longer term increases in pay rates and economic growth after the positive effect of the fall in oil prices dissipates. The February Inflation Report contained good news on that score that productivity was forecast to increase by just under 0.75% in the first three quarters of 2015.

The February Inflation Report also explained that the initial fall in the price of oil of over 50% would cause an overall reduction in CPI of about 0.8% in quarter 2 2015 and boost UK GDP by around 0.5% during the MPC's three year forecast period. It also forecast that the sharp fall in the price of oil and its knock on effects, would start falling out of the twelve month calculation of CPI inflation in quarter 4 of 2015. This is expected to result in a sharp rise in inflation from near zero in that quarter and also onward into 2016. The report also mentioned a potential risk of deflation becoming embedded, which could then require remedial action by the MPC such as a cut in Bank Rate and / or further quantitative easing, This is viewed as being a small risk given the above expected sharp increase in inflationary pressures. However, while inflation is at or near 0% for much of 2015, it is unlikely that the MPC would make a start on increasing Bank Rate. Market expectations for the first increase in Bank Rate have therefore moved from quarter 3 2015 after the November 2014 report, to around mid year 2016 during February 2015. However, the MPC is focused on where inflation will be over a 2 – 3 year time horizon so too much emphasis should not be placed on the short term inflation outlook, especially when the February report identified a slight increase in inflationary pressures on that time horizon to just above the 2% target. This treasury management report is therefore based on a forecast of a first increase in Bank Rate in quarter 1 of 2016, though it would be quite possible for it to be in quarter 4 of 2015 if events were to turn out favourably in Greece, the EZ as a whole and elsewhere.

The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed, being only a fraction lower than the previous year through to December 2014. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated. The flight to quality in January 2015 has seen gilt yields fall to incredibly low levels, which will reduce interest costs on new and replacement government debt.

Eurozone (EZ). The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In January 2015, the inflation rate fell further, to reach a low of -0.6%. However, this is an average for all EZ countries and includes some countries with even higher negative rates of inflation. Initially, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. As this failed to have much of a discernible effect, the ECB launched a massive €1.1 trillion programme of quantitative easing in January 2015 to buy up high credit quality government debt of selected EZ countries. This programme will run to September 2016.

Concern in financial markets for the Eurozone had subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause for concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US.

Greece: the general election on 25 January 2015 has brought to power a coalition which is anti EU imposed austerity. Although it is not certain that Greece will leave the Euro, the recent intractability of the troika (the EU, ECB and IMF), to finding a negotiated compromise with the new Greek government leaves this as a real possibility. However, if Greece was to leave the EZ, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. Nevertheless, the indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is much more difficult to gauge. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries which have high unemployment rates. Of particular concern is the fact that Spain and Portugal have general elections coming up in late 2015. This will give ample opportunity for anti austerity parties to make a big impact.

There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti austerity policies. Any loss of market confidence in

either of the two largest Eurozone economies, after Germany, would present a huge challenge to the resources of the ECB to defend their debt.

USA. The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 of 4.6%, Q3 of 5.0% and Q4 of 2.6%, (overall 2.4% during 2014 as a whole), provides great promise for strong growth going forward. It is confidently forecast that the first increase in the Fed. rate will occur by the end of 2015.

China. Government action in 2014 to stimulate the economy almost succeeded in achieving the target of 7.5% growth but recent government statements have emphasised that growth going forward will slow marginally as this becomes the new normal for China. There are concerns that the Chinese leadership has only just started to address an unbalanced economy, which is heavily over dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

Japan. Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession. The Japanese government already has the highest debt to GDP ratio in the world.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data transpires over 2015. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing 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.

There has been exceptionally high volatility in gilt yields and PWLB rates during January and February 2015. It is likely that this trend could continue through 2015 and that there could be swings of 50 basis points, (0.50%), during even one quarter.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. 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.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and

the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the larger countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

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

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.

- UK strong economic growth is weaker than we currently anticipate.

- Weak growth or recession in the UK’s main trading partners - the EU, US and China.

- 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 to 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: -

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the EU, economic and debt management policies adopted by the new government.

- The ECB severely disappointing financial markets with a programme of asset purchases which proves insufficient to significantly stimulate growth in the EZ.

- The commencement by the US Federal Reserve of increases in the Fed. funds rate in 2015, 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. There could also be a sharp fundamental reassessment of investments in the debt and equities of emerging countries which have chased higher yields during a prolonged period when yields and returns in western countries have been heavily suppressed; countries such as Brazil and Russia are already in recession and facing major economic and political challenges.

- 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
- Norway
- Singapore
- Sweden
- Switzerland

Appendix E:

Summary Treasury Management Budget

	2015/16 £	2014/15 £
Employees	160,000	161,180
Transport	3,250,000	3,256,750
Supplies and Services	190,000	194,139
Interest Paid	7,050,000	7,057,993
Debt Management Expenses	6,000	6,000
Gross Expenditure	**10,656,000**	**10,676,062**
Interest Received	0	0
Gross Income	**0**	**0**
Net Expenditure	**10,656,000**	**10,676,062**

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 2015/16 does not include Prudential Borrowing costs nor the borrowing costs of HRAS Reform.

- 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.