CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
12th January 2012

CABINET
24th January 2012

REPORT AUTHOR: **County Councillor Tony Thomas**
Portfolio Holder for Finance & Infrastructure

SUBJECT: **Treasury Management Quarterly Report**

REPORT FOR: **Information**

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1. Summary

1.1 The Treasury Management Scrutiny Review recommended that quarterly reports to Board should be adopted. CIPFA also issued a Treasury Management Bulletin in March 2009 highlighting interim advice to local authorities on treasury management practices in the light of the Icelandic Banks collapse and the continuing "credit crunch". The document 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 Revised CIPFA Code of Practice on Treasury Management 2009 and the subsequent 2011 edition emphasised 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 This report, therefore, is providing information on the activities for the quarter ending 31st December 2011.

2. Economic Background and Forecasts

2.1 The economic background is attached at Appendix A.

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

	Mar 12	Jun 12	Sep 12	Dec 12	Mar 13	Jun 13	Dec 13	Mar 14
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	1.00%	1.25%
5yr PWLB	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.80%	2.90%
10yr PWLB	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.80%	4.00%
25yr PWLB	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.70%	4.80%
50yr PWLB	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.80%	4.90%

The overall balance of risks is weighted to the downside:

- the advisors expect low and modest growth in the UK to continue with a low Bank Rate continuing for at least 12 months.

- the expected longer run trend for PWLB borrowing rates is for them to rise, primarily due to the need for a high volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries. However, the current safe haven status of the UK may continue for some time, postponing any increases until 2012.

3. Treasury Management Strategy

3.1 Full Council on 2nd March 2011 approved the Investment Strategy for 2011/12 as follows:

Long Term Ratings:

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:

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

“Nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high creditworthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for Fitch to assign them an individual rating for their stand alone financial strength. Accordingly, Fitch have assigned an F rating which means that at a historical point of time, this bank failed and is now owned by the Government. However, these institutions are now recipients of an F1+ short term rating as they effectively take on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. They also have a support rating of 1; in other words, on both counts, they have the highest ratings possible.

The other situation which could arise is where the Bank has not been fully nationalised but receives substantial support (greater than 50% ownership) from the UK Government. In this case the individual rating is E i.e. the Fitch definition is “A bank which requires external support”.

In light of this Sector introduced another colour, Blue, for UK nationalised or part nationalised institutions.”

Country Limits:

Country	Maximum Investment per Country	Credit Rating/Other Assessment of Risk
AAA rated – countries (excluding the UK)	£2M	As per rating list
AAA rated – UK	No Maximum Investment	As per rating list

Group/Institutions - Counterparty Criteria/Limits:

Specified Investments:

Institution	Maximum Investment per Group/ Institution £M	Maximum Length	Credit Rating/Other Assessment of Risk
UK Banks	15	Up to 364 days	As per Sector's matrices and the Authority's definition of a high credit rating
Foreign Banks	2	Up to 364 days	As per Sector'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 (£3m limit with any one institution)	Up to 2 years	As per Sector's matrices and the Authority's definition of a high credit rating
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 3)	15	N/A	All are AAA rated

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 e.g. Lloyds TSB and BOS will have an overall limit of £15M.			

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. <u>Current Investments</u>

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 0.5% Bank Rate. The continuing Euro zone debt crisis and its potential impact on banks prompts a low risk and short term strategy which means investment returns are likely to remain low.

4.2 The Authority's investment position as at 31st December 2011 is as shown below:-

Invested with:	**Principal £000's**	**Interest Rate**	**Start Date**	**Maturity Date**
Lloyds TSB	3,000	1.80%	09.06.11	09.03.12
Lloyds TSB	3,000	2.10%	04.08.11	03.08.12
Ulster Bank (RBS)	5,000	1.05%	05.09.11	05.01.12
Lloyds TSB	5,000	1.50%	12.09.11	12.03.12
Barclays	5,000	0.87%	12.10.11	12.01.12
Barclays	5,000	0.93%	16.11.11	16.02.12
Lloyds TSB	4,000	1.40%	09.12.11	22.03.12
RBS	10,000	0.86%	N/A	Deposit A/c
HSBC	90	0.25%	N/A	Deposit A/c
Deutsche	380	0.72%	N/A	MMF
Total	**40,470**			

4.3 Due to the continuing instability in the Euro zone and the various credit rating changes over recent months the Authority is currently not making any further fixed term investments with Barclays or Ulster Banks. RBS is only being used on a deposit account basis.
There is no current rating issue with Lloyds TSB but the situation regarding making further fixed term investments with them will be reviewed when the current fixed investments start to mature in March.
The Authority has currently ceased use of the Prime Rate MMF due to a change in ownership of the Fund.

4.4 The table above excludes investments still held in Iceland. The Icelandic court granted preferential creditor status for these type of investments in April 2011 and the Supreme Court upheld this decision in October. The court cases were based on certain test cases and the claims regarding non-test case claims were due to be settled or determined by the Court in December. 100% Glitnir and 98% Landsbanki monies are currently expected back.
Arrangements are taking place for Glitnir repayments to be made, the latest suggested timescale for this is early February. Landsbanki have made their first repayment into an "escrow" account. This amounted to 31.2149% of the total due and was made in four separate currencies. Monies in the escrow account are accruing interest.
As soon as the non-test case Creditors' claims have been settled or determined by the Court, the non-ISK funds currently being held in escrow will be paid out to the relevant Creditors. The payment of ISK funds will be made when arrangements have been put in place by the Bank of Iceland to allow transfer of ISK outside of Iceland.
Costs to date in respect of the legal representation amount to £29,606.64.

4.5 Redemption Penalties:
The fixed investments listed in the table above are not available for early redemption.

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

	Suggested Rate now	Suggested Rate previous
2012/13	0.70%	1.10%
2013/14	1.00%	2.20%
2014/15	1.60%	3.30%
2015/16	3.30%	3.90%

5. Market rates

5.1 Current market rates available for fixed term deposits are attached at Appendix B for information.

6. Credit Rating Changes

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

7. Borrowing / Re-scheduling

7.1 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.

7.2 The Authority's Capital Position:

	As at 31.03.11	2011/12 Estimate	2012/13 Estimate
	£M	£M	£M
Capital Finance Requirement	192,908	200,691	225,269

The Capital Financing Requirement (CFR) denotes the Authority's underlying need to borrow for capital purposes. 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.

7.3 The Authority currently has outstanding external debt of £145.8M. In relation to the CFR as at 31st March 2011, this means the Authority is under borrowed by £47M. In relation to the current year's estimated CFR and, based on no new borrowing taking place, the Authority is under borrowed by £54.8M.

7.4 Capital Budget/Spend:

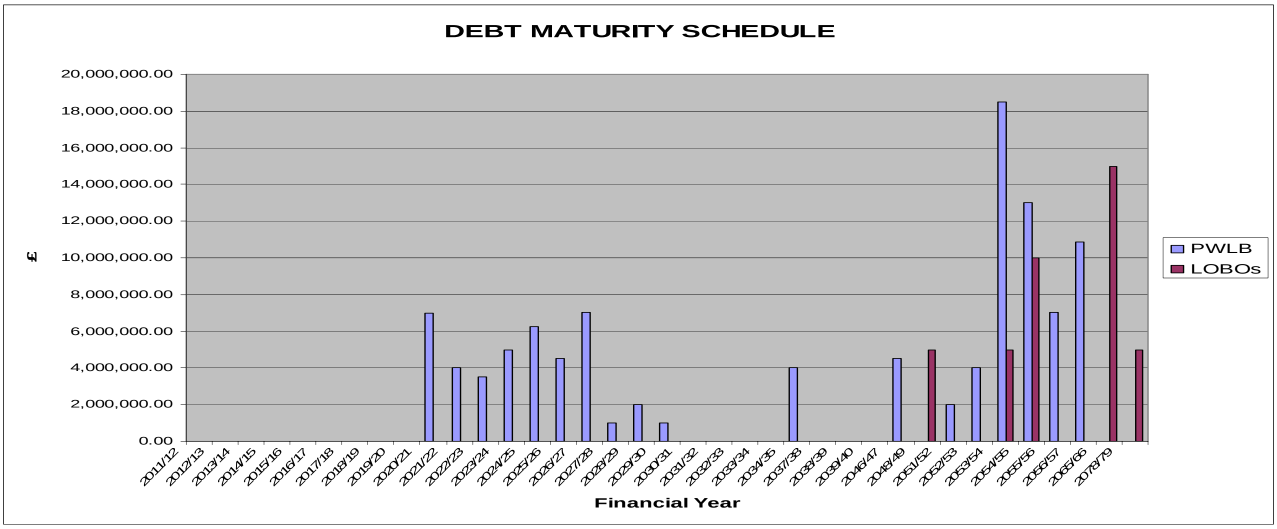
2011/12 Original Budget £M	2011/12 Revised Budget £M	2011/12 Actual at 31st Dec (provisional figure) £m
51,751	66,491 now 47,526	20,014

The actual figure at 31st December represents a 42.1% spend of the working budget.

The original financing of the capital budget included £13M of Prudential borrowing. This was revised to circa £1.3M by July and £300k by August.

7.5 *Debt Maturity Profile as at 31.12.11:*

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



7.6 As illustrated in the graph above, the Authority may borrow from the Public Works Loans Board or the market (external borrowing). It may also borrow from internal balances on a temporary basis (internal borrowing). The figures in 7.3 above illustrate that the Authority is currently internally borrowed. This is a prudent and cost effective approach in the current economic climate. However, internal borrowing is only a temporary situation and, based on current capital estimates, the Authority will need to borrow in the foreseeable future. The Authority needs to be mindful therefore 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.

7.7 Target rates:

Our advisors' target rates and current PWLB rates are set out below:

Period	Current borrowing rate 06.10.11	Target borrowing rate now	Target borrowing rate previous
5 year	2.26%	2.30%	2.50%
10 year	3.27%	3.30%	3.80%
25 year	4.19%	4.20%	5.00%
50year	4.34%	4.3%	5.00%

7.8 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
- the PWLB will no longer necessarily be the first option for local authority borrowing as more favourable rates are likely to be available via the commercial sector.

7.9 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. PWLB interest rates have not been conducive towards rescheduling. However, as mentioned previously, the Authority is currently borrowed well below its CFR at present.

8. Prudential Indicators

8.1 All Prudential Indicators were complied with in the quarter ending 31st December 2011.

9. Code of Practice

9.1 CIPFA released a 2011 edition of its Treasury Management Code of Practice in November. The Authority's TM Policy Statement is currently being updated accordingly and will be reported to Cabinet shortly.

Proposal

It is proposed that the Treasury Management Quarterly Report is received.

Statutory Officers

Chief Finance Officer's comment:
"The CFO supports the recommendation of the report".

Future Status of the Report

Not applicable

Recommendation:		**Reason for Recommendation:**	
That the Treasury Management Quarterly Report be received			
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:		**N/A**	

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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 circular

Appendix A:

Economic Background

General Economy:

The Chancellor announced the Autumn Statement which provides an update on the Government's plans for the economy based on the latest forecasts from the Office for Budget Responsibility (OBR). Growth will be slower than previously forecast with the OBR projecting the trend rate of growth to average 1.1% in 2011 and 1.24% in 2012, rising to 2.0% in 2013 and 2.3% thereafter. Borrowing is expected to be £112bn more over the next four years than previously forecast. On the upside, debt interest payments are £22bn less than expected. The Bank of England restarted its quantitative easing programme with a plan to buy £75bn more of government bonds. They also kept bank rate on hold at 0.5%.

In Q3 the economy grew in line with previous estimates at 0.5%, largely driven by an increase in firms' inventories. However, economists forecast that economic expansion is likely to slow rapidly due to the implications of the euro zone debt crisis and ongoing government cuts for the UK economy.

The PMI Manufacturing Index fell to 47.6 in November from an upwardly revised 47.8 in October.

Consumer confidence recovered slightly to -31 in November from -32 in October. However, given the pessimism surrounding the UK economy and the euro zone crisis, the one point increase reflected a minor variation rather than an uplift in confidence.

CPI rose 0.1% in October taking annual inflation rate to 5% from a three year high of 5.2% in September. The slowdown was driven by lower food, air transport and petrol inflation.

Retail sales unexpectedly rose by 0.6% in October as early pre-Christmas promotions drove up volumes at their fastest pace since June.

The jobless rate hit its highest rate in 15 years. This added pressure on to the government, constrained by Britain's huge budget deficit, to boost the struggling UK economy.

The housing market has proved highly resilient in recent months despite the weak economic recovery and the deterioration in the outlook for both the UK and global economies. According to Halifax, house prices in the three months to October were 0.3% lower than in the preceding three months. However, Nationwide showed house prices rising 0.4% in November.

Appendix B:

MARKET RATES AVAILABLE

Banks:

Duration	**%**
Overnight	0.70 – 0.55
1 Week	0.80 – 0.55
2 Week	0.80 – 0.57
1 Month	0.85 – 0.70
2 Month	0.95 – 0.80
3 Month	1.05 – 0.95
4 Month	1.10 – 1.00
5 Month	1.15 – 1.05
6 Month	1.25 – 1.20
9 Month	1.55 – 1.45
10 Month	1.60 – 1.50
11 Month	1.65 – 1.55
12 Month	1.75 – 1.65