CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
13th April 2012

CABINET
17th April 2012

REPORT AUTHOR: **County Councillor Tony Thomas**
Portfolio Holder for Resources, Workforce and Housing

SUBJECT: **Treasury Management Quarterly Report**

REPORT FOR: **Information**

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 March 2012.

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:

	Jun 12	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
5yr PWLB	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%
10yr PWLB	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%
25yr PWLB	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%
50yr PWLB	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%

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. 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 0.5% Bank Rate. The continuing Euro zone debt uncertainty 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 March 2012 is as shown below:-

Invested with:	**Principal £000's**	**Interest Rate**	**Start Date**	**Maturity Date**
Lloyds TSB	5,000	1.40%	12.03.12	12.06.12
Lloyds TSB	3,000	2.10%	04.08.11	03.08.12
Lloyds TSB	2,000	1.75%	15.03.12	17.09.12
RBS	15,000	0.86%	N/A	Deposit A/c
HSBC	770	0.25%	N/A	Deposit A/c
Deutsche	10,000	0.%	N/A	MMF
Blackrock	3,025	0.%	N/A	MMF
Total	**38,795**			

4.3 Due to the uncertainty 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 any bank other than Lloyds TSB.

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 with 100% Glitnir and 98% Landsbanki monies expected back.
The Council has to date received a first distribution from the Winding-Up Board of Landsbanki Bank of £607k equating to approximately one third of the claim and a payment from the Winding-Up Board of Glitnir Bank of £1.6M. Part of the deposits owing are held in ISK. The payment of these 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 £34,994.55.

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 March 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
Revised CFR figures		197,342	224,457

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 latest CFR figure for 31st March 2012, this means the Authority is under borrowed by £51.5M.

7.4 Capital Budget/Spend:

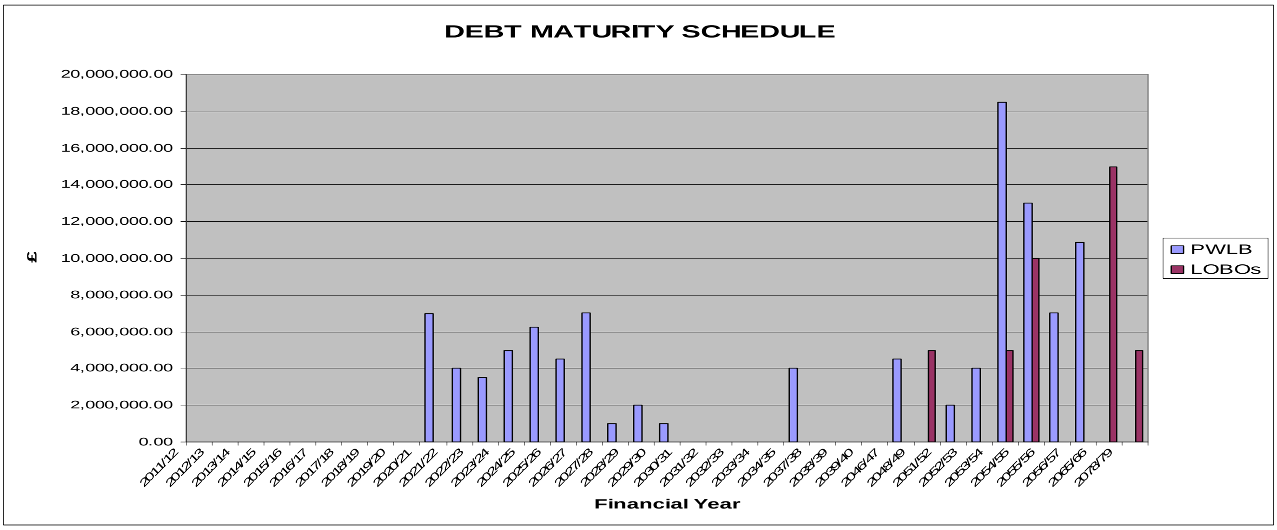
2011/12 Original Budget £M	2011/12 Revised Budget £M	2011/12 Actual at 31st March £M
51,751	66,491 31st Dec figure 47,526 31st March figure 40,014	37,101

The actual figure at 31st March represents a 7.3% underspend 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 31.03.12:*

(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 28.03.12	Target borrowing rate now	Target borrowing rate previous
5 year	2.26%	2.30%	2.50%
10 year	3.37%	3.30%	3.80%
25 year	4.37%	4.20%	5.00%
50 year	4.40%	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.

7.10 Budget 2012:

In the recent budget report the Government announced that it will introduce in 2012-13, 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 will also work with the local authority sector to consider the potential for an independent body to facilitate the provision of PWLB lending at a further reduced rate, to authorities demonstrating best quality and value for money.

Our advisors have been made aware that there will be no immediate rush with this, meetings are due to be held with Debt Management Office, Dept. for Communities and Local Government, Local Government Association, etc. before this gets introduced.

8. Prudential Indicators

8.1 All Prudential Indicators were complied with in the quarter ending 31st March 2012.

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:

<u>Economic Background</u>

General Economy:

With the UK experiencing a slump in growth of 0.2% in the final quarter of 2011, 17 year high unemployment figures and the situation in the Euro zone not showing any signs of significant improvement , the need for a loosening of the government's austerity drive was necessary. The Bank of England did just that at February's Monetary Policy Committee meeting by expanding Quantitative Easing a further £50bn to a total of £325bn with the aim of avoiding a technical default and to shore up a faltering economy.

The Bank of England published their Quarterly Inflation Report which reiterated their view of sluggish growth in the short term and that the Euro zone crisis poses the biggest threat to our economy. It also raised its inflation forecast for two years time to around 1.8%. These projections are likely to dampen the expectations for further Quantitative Easing in May.

February's public finances figures will have come as a relief to the Chancellor, after Moody's rating agency warned that Britain would lose its triple A rating in the next 18 months. The data, driven by a drop in local government borrowing and a modest rise in tax receipts, showed their biggest monthly surplus in four years. Nevertheless, the faltering growth will give little room to reduce borrowing further.

CPI fell from 4.25% in December to 3.6% in January and 3.4% in February and was in line with the Bank of England's forecasts for inflation to average just over 3.4% in the first quarter of 2012. The fall in CPI was largely down to the VAT increase falling out of the calculation.

Despite the doom and gloom there was a string of positive date in February which brought confidence to consumers and investors alike. The Manufacturing sector grew in February, albeit at a slower pace than in previous months. The Purchasing Managers Index for the Service sector expanded at its fastest pace in 10 months in January to 56.0 from 54.0. Positive data resulting from the surveys has helped dampen fears of a further recession.

Retail sales rose by 0.9% in Jan on the back of shops offering discounts on household goods and furniture. Weak consumption was a major reason for Britain's disappointing growth last year but encouraging economic news suggested that consumers were spending again. However, retail sales in February dropped by 0.8%, a bigger than anticipated drop, so this will dampen previous encouraging news. Consumers have seen the tightest squeeze on their budgets for more than three decades as inflation outpaced wages. Figures show that real disposable income fell 1.2% in 2011, the biggest drop since 1977 when the then Labour government sought to cap incomes growth in an attempt to bring down inflation.

The jobless rate remained unchanged at 8.4% in February. This will provide relief for the government who are relying on private firms to create enough jobs to make up for the cuts in the public sector.

Nationwide showed house prices increasing by 0.6% in Feb, the biggest rise since April 2010. Given the challenging economic backdrop, the housing market may have been boosted temporarily by relief for first-time buyers from stamp duty tax, which expired on 24th March.

The Chancellor delivered his budget on 21st March and, within this, used measures to spur businesses to invest and hire by cutting taxes for companies and high earners. With the government constrained by its pledge to rid the UK of the bulk of its deficit by 2017, it is counting on exports and investment to drive the recovery. The Chancellor claimed vindication for his budget after GlaxoSmithKline announced plans to create more than 1,000 jobs in Britain and EnQuest, a North Sea oil company, said it will invest more in the UK after the Chancellor promised to guarantee tax breaks for dismantling platforms and developing new fields.

The Treasury's fiscal watchdog predicts the economy will expand just 0.8% in 2012 with growth stalling in the second quarter due to the extra bank holiday. Risks to the outlook were highlighted when Bank of England Governor, Mervyn King, told lawmakers the financial crisis in the Euro zone, where two-fifths of British exports are sold, has not gone away.

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