CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
12th October 2012

CABINET
23rd October 2012

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

SUBJECT: **Treasury Management Quarterly Report**

REPORT FOR: **Information**

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1. Summary

1.1 The Treasury Management Scrutiny Review in 2008/09 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 30th September 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:

	Dec 12	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
10yr PWLB	2.50%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%
25yr PWLB	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%
50yr PWLB	3.90%	3.90%	3.90%	4.00%	4.00%	4.10%	4.20%	4.30%

3. Treasury Management Strategy

3.1 Full Council on 1st March 2012 approved the Investment Strategy for 2012/13 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)	£5M	As per rating list
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	20 (a maximum £10M of this to be held in fixed term investments)	Up to 364 days	As per Sector's matrices and the Authority's definition of a high credit rating
Foreign Banks	5	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 (£2m 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 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.			

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 30th September 2012 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
Lloyds TSB	5,000	3.00%	12.06.12	04.06.13
Lloyds TSB	3,000	1.65%	06.08.12	06.02.13
RBS	14,550	0.86%	N/A	Deposit A/c
HSBC	155	0.25%	N/A	Deposit A/c
Lloyds TSB	5,000	0.75%	N/A	Deposit A/c
Total	**27,705**			

4.3 Members will note that the Authority's investments have decreased significantly in the last quarter from £39M to £27M indicating that available cash balances do appear to be dwindling as has been predicted in TM reports over the last couple of years. Officers will monitor this for possible borrowing requirements although no actual borrowing will be undertaken before the introduction of the PWLB's new certainty rate on 1st November 2012.

4.4 There have been no relevant credit rating changes in the last few months. However, due to the continued uncertainty in the Euro zone, the Authority is currently not making any fixed term investments with any bank other than Lloyds TSB.

4.5 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 2011 with 100% Glitnir and 100% Landsbanki monies expected back.

Landsbanki:
The winding up board of Landsbanki made a first distribution to creditors in a basket of currencies in February 2012. An element of this distribution was in Icelandic Kroner which has been placed in an escrow account in Iceland and is earning interest of 3.35%. This element of the distribution has been retained in Iceland due to currency controls currently operating in Iceland. A further distribution in GBP was made in May 2012.

Glitnir:
The winding up board of Glitnir made a full distribution to creditors in a basket of currencies in March 2012. An element of this distribution was in Icelandic Kroner which has been placed in an escrow account in Iceland and is earning interest of 3.4%. This element of the distribution has been retained in Iceland due to currency controls currently operating in Iceland.

The payment of the funds held in escrow 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.

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

4.7 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	0.50%	0.70%
2013/14	0.60%	1.00%
2014/15	1.30%	1.60%
2015/16	2.50%	3.30%

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

6.2 The credit rating list for end of September 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 31.03.12	2012/13 Estimate	2013/14 Estimate
	£M	£M	£M
Capital Finance Requirement	196,696	223,378	234,686

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 figure for 31st March 2012, this means the Authority was under borrowed at 31st March by £50.9M.

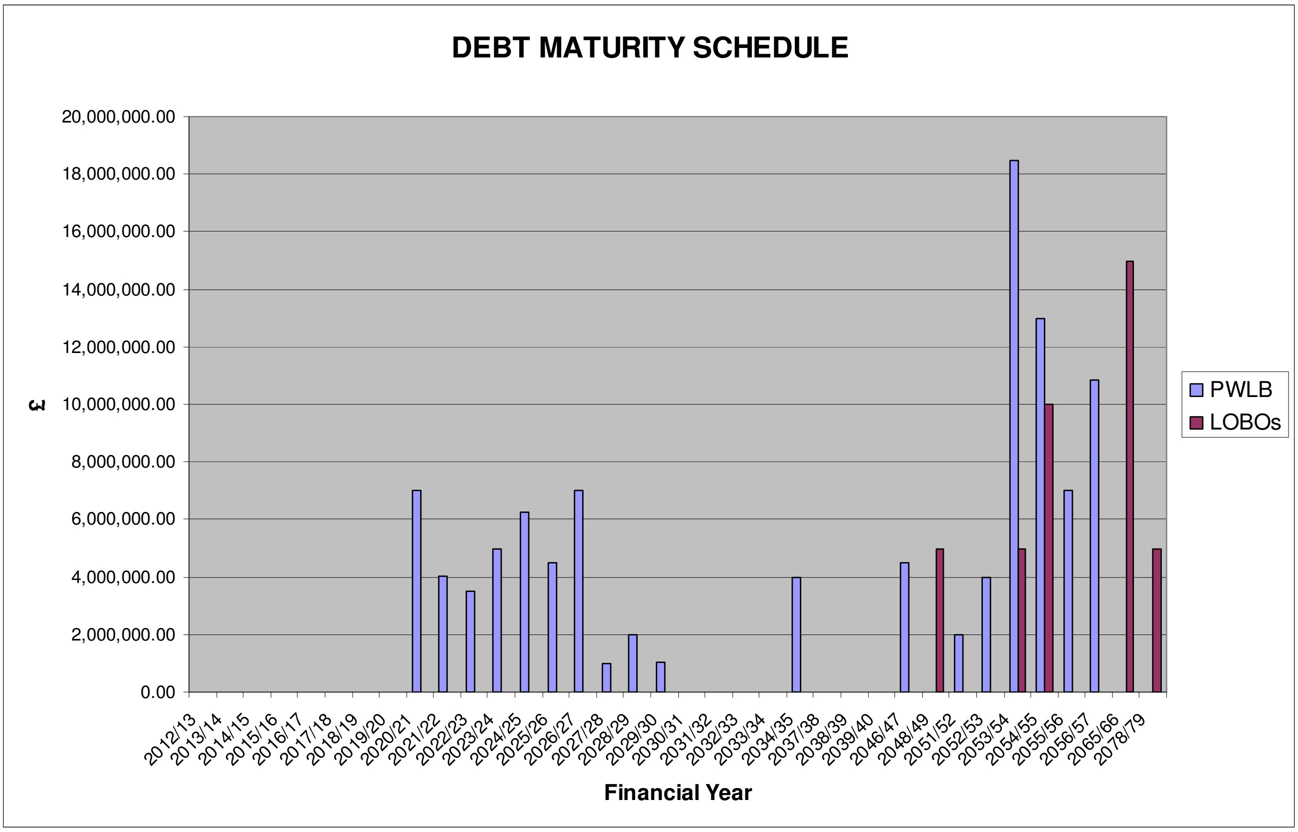
7.4 Capital Budget/Spend:

Capital:	Approved Budget	Working budget	Capital Spend	%age spend
April	62,849,763	69,447,726	33,300	0.05%
May		70,376,248	2,575,130	3.70%
June		70,871,413	5,824,922	9.20%
July		71,609,254	10,791,779	15.07%
Aug		71,370,919	14,530,307	20.36%
Sept		71,194,874	18,239,889	25.62%

The financing of the approved capital budget included £14M of Prudential borrowing.

7.5 *Debt Maturity Profile as at 30.09.12:*

(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

7. 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 and the decrease in available cash balances, 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 30.09.12	Target borrowing rate now	Target borrowing rate previous
5 year	1.77%	2.00%	2.30%
10 year	2.72%	3.00%	3.30%
25 year	4.00%	4.20%	4.20%
50 year	4.14%	4.30%	4.30%

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.

7.10 PWLB Certainty Rate:

In the March 2012 budget report the Government announced that it would 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 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 further reduced rate, to authorities demonstrating best quality and value for money.
This Authority has registered its interest in this preferred rate option. A PWLB circular setting out the details of the certainty rate is due out in October. Borrowing under this scheme will be available from 1st November 2012 until 31st October 2013.

8. <u>Prudential Indicators</u>

8.1 All Prudential Indicators were complied with in the quarter ending 30th September 2012.

9. Projects Update

9.1 Income Management System:
As reported in the TM Review Report for 2011/12, TM is taking the lead role in the acquirement of a replacement income management/cash receipting system. This is due to support being withdrawn for the current system at the end of March 2013. Members will appreciate that this is a vital corporate system.

9.2 The project has an appointed Project Manager and Business Analyst from ICT and a project group made up of relevant key officers from the stakeholder areas has been formed and has met. Mapping of the current system is almost complete and a scoping document for the new system will be drawn up shortly. Members will continue to be updated as the project progresses.

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:

With dwindling GDP figures & a widening public finance deficit, it appeared apparent that long term economic stability would continue to find itself near the top of the government's agenda. The month of August began with data showing Britain's manufacturing sector shrinking at its fastest rate in more than three years. This was largely attributed to further government spending cuts, Euro zone turmoil and an extra public holiday in June. The UK's dominant service sector also took a heavy hit with the PMI index falling to a 19 month low of 51.0 in June. Confirming the bleak picture painted by the goods and services markets, Britain's trade deficit hit a record high in June rising to £4.3bn compared to £2.3bn in May. The deficit may take some of the credit for the unexpected rise in inflation to 2.6% in July from 2.4% in June. As demand for domestic goods gradually sank, retailers reined in seasonal sales causing a small price surge. A sudden rise in airfares through July also provided more fuel.

Pressure on the government continued to rise throughout July on the reception of the UK Public Finances report. Public sector finances, excluding financial sector interventions, showed a deficit of £557m compared to a £2.8bn surplus in July 2011. Britain's public finances are highly seasonal and July typically shows a surplus due to inflows of income tax & corporation tax payments but this year the North Sea oil & gas output has been unusually low, going some way to explain the deficit.

Despite signs of growing economic weakness the MPC has left the Bank rate unchanged at 0.5% and made no change to its programme of quantitative easing. Comments from some policy makers suggested that these decisions were finely balanced and a good case for more bond purchases could be made. Following the August MPC decision the Bank sharply cut its forecast for medium-term growth in Britain's economy due to worries that the financial crisis may be more long-lasting than first thought. In its quarterly inflation report the BOE said that growth in two years time was likely to be around 2% a year, down sharply from the forecast of 2.67% just three months ago.

In the face of a contracting economy the labour market continued to remain surprisingly resilient. Also adding to positive economic news, British retailers reported an unexpected rise in sales in July with June's data also being revised higher. These positive consumption levels may not, however, have seeped into August as a CBI report issued near the end of the month showed that British retailers experienced an unexpected drop in sales.

Economic data released during September however has been better than expected. GDP, which the Office for National Statistics had said had contracted at 0.7%, had contracted by 0.4%. The British Chambers of Commerce reported that the UK economy grew in the three months from July to September by 0.5% and said that it did not agree with the ONS that the economy had been contracting for the previous nine months. However, it did say that fixing the UK's finances would take longer than previously hoped.

The ONS is due to release its first estimate of economic growth for the third quarter on 25th October. It is widely expected to show a return to growth, partly due to a boost from the Olympics.

Appendix B:

MARKET RATES AVAILABLE

Banks:

Duration	%
Overnight	0.56 – 0.48
1 Week	0.75 – 0.55
2 Week	0.75 – 0.55
1 Month	0.65 – 0.55
2 Month	0.95 – 0.85
3 Month	0.93 – 0.87
4 Month	1.30 – 1.05
5 Month	1.35 – 1.10
6 Month	1.15 – 1.15
9 Month	1.50 – 1.40
10 Month	1.65 – 1.50
11 Month	1.70 – 1.55
12 Month	1.72 – 1.60