CYNGOR SIR *POWYS* COUNTY COUNCIL

AUDIT COMMITTEE
11th July 2013

CABINET
16th July 2013

REPORT BY:	**Cllr. Dai Davies** **Portfolio Holder for Finance**
SUBJECT:	**Treasury Management Review 2012/13**

REPORT FOR: **Approval**

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1. Introduction:

1.1 The Council's Treasury Management Policy as per the CIPFA Code of Practice requires an annual report on Treasury Management activity to be approved by Cabinet by 30th September each year.

1.2 Treasury Management in this context is defined as:
"The management of the authority's 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. Strategy for 2012/13

2.1 At the start of 2012/13 the Authority had an estimated Capital Financing Requirement of £188.7m, projected to rise by £38m during the course of the next three years to £226.7m. The Authority's external borrowing at 1st April 2012 stood at £145.8m. Analysis of the balance sheet at 31st March 2012 showed that the Authority was internally borrowed by £51M compared to £30M at 31st March 2011.

2.2 The expectation for interest rates within the strategy for 2012/13 anticipated low but rising Bank Rate (starting in Qtr 1 of 2014) with gradual rises in medium and longer term fixed borrowing rates over 2012/13. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued economic uncertainty promoted a cautious approach whereby investments would continue to be denominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

2.3 The Capital Programme for 2012/13 had £14m of prudential borrowing at start of year so there was the possibility the Authority may need to externally borrow during the year. The agreed strategy for this at the start of the year, based on interest rate forecasts and discussions with Sector (the Authority's advisors), was to set a benchmark of 2.30% for 5 year borrowing, 3.30% for 10 year borrowing, 4.20% for 25 year borrowing and 4.30% for 50 year borrowing. This was revised several times during the year before ending at 1.50% for 5 year borrowing, 2.50% for 10 year borrowing 3.80% for 25 year borrowing and 4.00% for 50 year borrowing.

2.4 In light of the continuing stress on the world banking system, enhanced priority was given to the security and liquidity of investments.

The strategy for investments therefore was:

a) to ensure the security of the Authority's funds
b) to ensure the Authority had sufficient liquidity to meet its cashflow requirements
c) to achieve the optimum yield after ensuring a) and b) above.

3. Treasury Position

3.1 The major issue for Treasury Management in 2012-13 was the continuing challenging environment of previous years i.e. low investment returns and continuing counterparty risk which meant giving heightened preference to security and liquidity of investments. This resulted in the investment portfolio being in investment instruments with lower rates of return but higher security and liquidity.

3.2 In order to balance the impact of the loss in investment income the Authority was mindful of the possibility of making premature repayments of debt if circumstances were conducive to this.

Net borrowing increased by £35.1M in the year. This increase arose as follows:

	£000s
Decrease in PWLB debt	(12)
Increase/Decrease in LOBO debt	Nil
Increase in Temporary Borrowing	2,500
Decrease in Investments	32,610
	35,098

3.3 The table below summarises the borrowing and investment transactions during the year:

	Balance 01-04-12	**Borrowing**	**Investments**	**Repayments**	**Balance 31-03-13**
	£000's	**£000's**	**£000's**	**£000's**	**£000's**
PWLB *	105,830	Nil	N/A	(12)	105,818
LOBOs *	40,000	Nil	N/A	Nil	40,000
Temporary Borrowing	Nil	2,500	N/A	Nil	2,500
Total	145,830	2,500	N/A	(12)	148,318
Temporary Investments	(38,795)	N/A	(293,620)	326,230	(6,185)
Long Term Investments	Nil	N/A	Nil	Nil	Nil
Net Borrowing	107,035	2,500	(293,620)	326,218	142,133

Note: * Public Works Loan Board / Lender's Option Borrower's Option

3.4 A summary of the economy for 2012/13 is at Appendix A.

4. Icelandic Banks

4.1 The investment figures above do not include deposits held in Iceland.

4.2 Following the Icelandic Supreme Court decision to grant UK local authorities priority status, the Landsbanki winding up board made second and third distributions in May and October 2012. The Icelandic Kroner element of the February 2012 distribution remained in an escrow account in Iceland earning interest. The Icelandic Kroner element of the Glitnir March 2012 distribution also remained in an escrow account earning interest. These elements were retained in Iceland due to currency controls operating in Iceland. Discussions regarding this took place during the year.

5. Balance Sheet Review

5.1 The Authority's advisors carry out an annual balance sheet review following closure of the accounts. This provides, amongst other things, information as to the internal/external borrowing position of the Authority and hence, its future need to borrow.

5.2 The review for 2012/13 is currently being undertaken, the results of which will be reported to members when available. The review for 2011/12 revealed that the Authority was under borrowed at 31st March 2012 by £51.5M (26% of the Capital Financing Requirement). Internal investments in the balance sheet (showing that the Authority is internally borrowed) at 31st March 2012 were £31.3M.

6. Debt Rescheduling/Repayment

6.1 At the start of 2012/13 the expectation was that investment rates were expected to continue to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

6.2 However, the Authority was already heavily internally borrowed and short term savings by avoiding new long term external borrowing in 2012/13 would need to be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.

6.3 The Authority continued to monitor the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions but PWLB interest rates throughout the year with an average of 1% differential between new borrowing rates and premature repayment rates were not conducive to this.

7. Performance Measurement

7.1 Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide.

In this context, the overall average rate of interest paid on all debt in 2012/13 was 4.66%. This compared with 4.71% in 2011/12.

7.2 The Treasury Management Policy stipulates that the Average Rate on External Investments should be compared with the 3-month uncompounded LIBID rate. This is in preference to the 7-day uncompounded LIBID rate and is in line with Sector's advice. It reflects a more realistic neutral investment position for core investments with a medium-term horizon and a rate which is more stable with less fluctuations caused by market liquidity. Historically, the 3-month rate has been slightly higher than the 7-day rate and is, therefore, more challenging for the cash manager.

7.3 In 2012/13 the average rate on external investments achieved was 1.38% compared with the 3 month uncompounded LIBID rate of 0.56376.

8. Summary Statement of Accounts

8.1 The Treasury Management Policy Statement stipulates that a summary Statement of Accounts for Treasury Management be produced at the year end and reported as part of the annual review (see Appendix B).

9. Prudential/Treasury Indicators

9.1 During the year the Authority operated the treasury limits as approved by Council.

10. Member Training

10.1 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. As such, the Authority provided one members' briefing session for treasury management in 2012/13.

11. Treasury Management Policy Statement

11.1 Any major changes to the Treasury Management Policy Statement are reported to Cabinet whilst any minor changes are circulated to members via the members' portal. The Statement is available on the Intranet at:

http://intranet.powys.gov.uk/index.php?id=4585

12. Treasury Management – Banking

12.1 The Treasury Management section manages the Authority's corporate bank accounts. In 2012/13 all bank account reconciliations were completed on a timely basis.

13. Projects

13.1 The Treasury Management section led on several projects throughout the year including the further roll out of e-returns (electronic paying-in slips) to establishments and schools and the successful introduction of barcoding of invoices to enable payment at Post Offices. Treasury Management also took the lead role in the acquirement of a replacement income management/ cash receipting system, implementation of which is due to start in June 2013.

Proposal

It is proposed that the Treasury Management Review Report is approved.

Statutory Officers

Chief Finance Officer's comment:

"The CFO supports the recommendation of the report".

The Solicitor to the Council (Monitoring Officer) has made the following comment:

Future Status of the Report

Not applicable

Recommendation:		**Reason for Recommendation:**	
The contents of this report are approved.		Statutory requirement	
Person(s) To Action Decision			
Date By When Decision To Be Actioned:			
Relevant Policy (ies):	Financial Regulations, Treasury Management Policy		
Within Policy:	**Y**	**Within Budget:**	**N/A**
Contact Officer Name:	**Tel:**	**Fax:**	**Email:**
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Background Papers used to prepare Report:

Treasury Management Policy Statement
CIPFA Code of Practice on Treasury Management and Cross Sectoral Guidance Notes
Advisor's Papers

Appendix A:

Economy 2012/13:

Sovereign debt crisis: The EU sovereign debt crisis was an ongoing saga during the year. However, the European Central Bank statement in July that it would do "whatever it takes" to support struggling Eurozone countries provided a major boost in confidence that the Eurozone was (at last) beginning to get on top of its problems. This was followed by the establishment of the Outright Monetary Transactions scheme in September. During the summer a €100bn package of support was given to Spanish banks. The crisis over Greece blew up again as it became apparent that the first bailout package was insufficient. An eventual very protracted agreement of a second bailout for Greece in December was then followed by a second major crisis, this time over Cyprus, towards the end of the year. In addition, the Italian general election in February resulted in the new Five Star anti-austerity party gaining a 25% blocking vote; this ahs the potential to make Italy almost ungovernable if the grand coalition formed in April proves unable to agree on individual policies. This could then cause a second general election but one which could yield an equally unsatisfactory result. This result emphasises the dangers of a Eurozone approach heavily focussed on imposing austerity rather than promoting economic growth, reducing unemployment and addressing the need to win voter support in democracies subject to periodic general elections. This weakness leaves continuing concerns that this approach has merely postponed the ultimate debt crisis rather than provide a conclusive solution. These problems will, in turn, also affect the financial strength of many already weakened EU banks during the expected economic downturn in the EU. There are also major questions as to whether the Greek Government will be able to deliver on its promise of cuts in expenditure and increasing tax collection rates, given the hostility of much of the population.

The UK Coalition Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Moodys followed up this warning by actually downgrading the rating to AA+ in February 2013 and Fitch then placed their rating on negative watch after the Budget statement in March. Key to retaining the AAA rating from Fitch and S&P will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level within a reasonable timeframe.

UK growth: 2012/13 started the first quarter with negative growth of -0.4%. This was followed by an Olympics boosted +0.9% in the next quarter, then by a return to negative growth of -0.3% in the third quarter and finally a positive figure of +0.3% in the last quarter. This weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing (QE) by £50bn in July to a total of £375bn on concerns of a downturn in growth and a forecast for inflation to fall below the 2% target. QE was targeted at further gilt purchases. In the March 2013 Budget, the Office of Budget Responsibility yet again slashed its previously over optimistic growth forecasts for both calendar years 2013 and 2014 to 0.6% and1.8% respectively.

UK CPI inflation has remained stubbornly high and above the 2% target, starting the year at 3.0% and still being at 2.8% in March. However, it is forecast to fall to 2% in three years time. The MPC has continued its stance of looking through temporary spikes in inflation by placing more importance on the need to promote economic growth.

Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB rates depressed for much of the year at historically low levels.

Bank Rate was unchanged at 0.5% throughout the year while expectations of when the first increase would occur were pushed back to Quarter 1 2015 at the earliest.

Deposit rates: The Funding for Lending Scheme, announced in July, resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling sharply in the second half of the year. However, perceptions of counterparty risk have improved after the ECB statement in July that stated it would do "whatever it takes" to support struggling Eurozone countries. This has resulted in some return of confidence to move away from only very short term investing.

Appendix B

Statement of Accounts
Treasury Management

		2012/13	2012/13	2011/12
		Actual	Budget	Actual
		£	**£**	**£**
Employees		181,795	176,732	187,829
Transport	*1	3,854,678	3,882,040	71,005
Supplies & Services		210,840	231,149	181,411
Interest Paid	*2	6,850,479	7,213,550	6,873,804
Debt Management Expenses		32	6,000	0
Gross Expenditure		**11,097,824**	**11,509,471**	**7,314,049**
Interest Received	*3	500,753	150,000	553,862
Gross Income		**500,753**	**150,000**	**553,862**
Net Expenditure		**10,597,071**	**11,359,471**	**6,760,187**

Note 1: Transport relates to the cost of leasing across the Authority and is included in the Treasury Management Statement of Accounts as leasing is classed as a Treasury Management activity.

Note 2: Interest paid was under budget as the budget included calculations for Prudential borrowing in 2012/13 which did not take place. Actual interest paid on existing loans was a slight underspend of £14k.

Note 3: A surplus of £351k on interest received was achieved as interest rates for short-term fixed investments were higher than expected and the Authority continued to benefit from good deposit account rates that it had thought would be withdrawn. Also, the Authority carried higher cash balances than expected during the year due to a significant proportion of the Capital programme spend not taking place until late in the financial year or being rolled forward to 2013/14.