CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
26th September 2013

CABINET
1st October 2013

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 28th June 2013.

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 13	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%
5yr PWLB	1.80%	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.40%
10yr PWLB	2.90%	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%	3.50%
25yr PWLB	4.10%	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%	4.60%
50yr PWLB	4.20%	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%	4.70%

3. Treasury Management Strategy

3.1 Full Council on 21st Feb 2013 approved the Investment Strategy for 2013/14 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

Further to the ratings above the Strategy includes using UK nationalized or part nationalized institutions based on the following explanation:

"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. These institutions, however, are recipients of an F1+ short term rating as they have 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.

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 28th June 2013 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
RBS	20,000	0.86%	N/A	Deposit A/c
BOS	1,665	0.75%	N/A	Deposit A/c
HSBC	100	0.25%	N/A	Deposit A/c
Total	**21,765**	**0.85%**		
Lloyds TSB - LAMS	1,000	3.20%	13.08.12	14.08.17

4.4 Members will note that the Authority's investments have increased in the last quarter from £6M to £21M. This is usual in the first quarter of the financial year as income is received in advance of spend.

4.5 There have been no relevant credit rating changes in the last few months in respect of the banks that the Authority utilises for deposits. 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. Barclays and Co-op banks both had certain credit ratings downgraded during this quarter but this had no effect on this Authority.

4.6 Local Authority Mortgage Scheme:

In August 2012, following a Cabinet report, the Authority entered the Local Authority Mortgage Scheme with an allocation to Lloyds TSB of £1M. Under the scheme this was deemed as Capital Expenditure. However, the Wales Audit Office opinion differs from this in that they suggest it should be treated as an investment. Various discussions/representations in respect of this are ongoing. However, until such time as there is any update, this Authority has concurred with WAO's requirement to treat this as an investment and, as such, the amount is included in the table above and is being accounted for as an investment. Council approved this investment following a retrospective report on 16th May 2013

4.7 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 has made three distributions to creditors to date equating to circa 48%. An element of the first distribution was in Icelandic Kroner which has been placed in an escrow account in Iceland. At 31st March this was earning interest of 4.17%. This element of the distribution has been retained in Iceland due to current Icelandic currency controls.

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. At 31st March this was earning interest of 4.20%. This element of the distribution has been retained in Iceland due to current Icelandic currency controls.

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 £38,745.99.

4.6 Redemption Penalties:
The fixed investment listed in the table above is 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
2013/14	0.50%	0.50%
2014/15	0.60%	0.60%
2015/16	1.50%	1.50%

5. Credit Rating Changes

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

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

6. Borrowing / Re-scheduling

6.1 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.

6.2 The Authority's Capital Position:

	As at 31.03.13 Actual	2013/14 Original Estimate	2014/15 Original Estimate	2015/16 Original Estimate
	£M	£M	£M	£M
Capital Financing Requirement	215,894	225,144	232,675	237,837

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.

6.3 The Authority currently has outstanding external debt of £145.8M. In relation to the CFR figure for 31st March 2013, this means the Authority was under borrowed at 31st March by £70.1M.

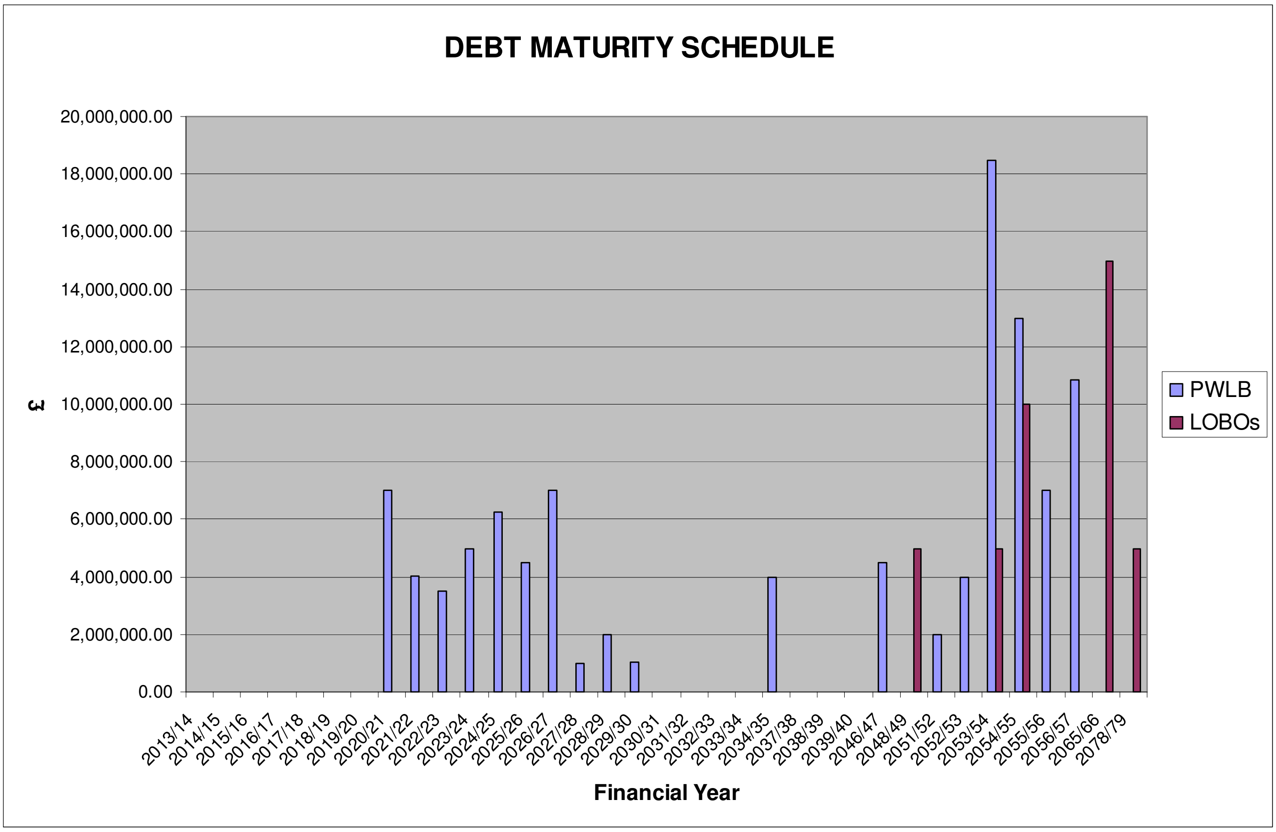
6.4 Capital Budget/Spend per efinancials:

Capital:	Approved Budget	Working budget	Capital Spend	%age spend
April	43,263,425	47,805,260	-463,381	-3.17%
May		49,019,588	1,022,805	2.09%
June		49,058,945	2,115,278	4.31%

The financing of the approved capital budget included £11.4M of Prudential borrowing.

6.5 *Debt Maturity Profile as at 28.06.13:*

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



6.6 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 6.3 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 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.

6.7 Target rates:

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

Period	Borrowing rate at 28.06.13	Target borrowing rate now	Target borrowing rate previous
5 year	2.49%	1.80%	1.50%
10 year	3.57%	2.90%	2.50%
25 year	4.45%	4.10%	3.70%
50 year	4.54%	4.20%	3.90%

6.8 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

6.9 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. However, PWLB interest rates have not been conducive towards rescheduling.

6.10 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. This Authority has registered its interest in this preferred rate option.

7. Prudential Indicators

7.1 All Prudential Indicators were complied with in the quarter ending 28th June 2013.

8. Projects Update

8.1 Income Management System:
As reported previously, TM is taking the lead role in the acquirement of a replacement income management/cash receipting system. Replacement was necessary due to support being withdrawn for the current system. Members will appreciate that this is a vital corporate system. At the end of June 2013 the project was in evaluation stage with implementation timetabled to start from August onwards. Members will continue to be updated as the project progresses.

8.2 TM continues to work with other service areas on projects/improvements. This currently includes Income and Awards, Customer Services and Leisure.

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".

The Solicitor to the Council (Monitoring Officer) has made the following comment:
"I have nothing to add to 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 circulars

Appendix A:

Economic Background

General Economy:

With the economy still in need of a revival and the Monetary Policy Committee (MPC) seemingly stuck in a state of limbo over key stimulus decisions, Mark Carney has his work cut out when he joins the Bank of England in July. The latest GDP revisions released at the end of the month show the UK has further to go in attaining pre-crisis levels of output than initially thought. Whilst the 0.3% quarterly rise in GDP remained unrevised, the year-on-year was unexpectedly halved to 0.3%.
Public finance data confirmed that years of further austerity lay ahead and this was further underlined in the Spending Review. Public Sector Net Borrowing came in at £8.8bn which was only a fraction of the £15.5bn seen in May 2012. Despite the figure outwardly appearing positive, the figure was flattered by a £3.9bn transfer of income from the Bank of England's quantitative easing fund, as well as a temporary boost to receipts from the recent UK-Swiss tax agreement.
A sharp rise in May's CIPS/Markit report on services joined improvements in the manufacturing and construction surveys in providing evidence that an economic recovery may be taking root. Figures at the beginning of the month showed service activity reaching a 12 month high of 54.9 from 52.9 previously. With manufacturing PMI reaching 51.3 and the construction survey indicating the sector returned to growth (50.8), the overall improvement in the surveys suggests economic growth is gaining momentum in the second quarter.
The recovery in the wider economy already appears to be filtering through to the labour market which has proved resilient recently, aided by the willingness of workers to accept below inflation wage growth. Growth in employment helped unemployment figures to edge down slightly on both the ILO and claimant measures this month, although the falls were fairly modest. Based on the wider ILO measure, unemployment fell by 5,000 in the three months through to April to 2.51 million, causing the jobless rate to hold steady at 7.8%. Nevertheless, the overall picture may not be as bright below the surface – employment activity is still looking weaker than a few months ago and real pay continues to fall sharply, squeezing further on consumers' already tight budgets.
Despite disposable income levels being reduced, the underlying retail picture appeared to strengthen somewhat in June with sales volumes rising 2.1%, easily reversing the cold weather-related drops seen in both March and April. Indeed, the average level of sales for April and May was 0.3% above the level seen in the first quarter of the year indicating that retail sales may provide a modest boost to growth in Q2. The positive economic data releases in June were largely the basis for the MPC keeping Quantitative Easing on hold again. June's MPC minutes confirmed that the outgoing Governor Mervyn King was outvoted at his final meeting and that appetite on the majority of the Committee for more policy stimulus remains muted.
Although the inflation outlook is becoming a little more favourable, continual upside pressure may prevent Mr Carney from introducing more policy response in terms of further asset purchases. Indeed, the headline CPI rate rose from 2.4% to 2.7%, reversing most of April's fall and confirmed that it was primarily the result of some temporary factors, as well as Easter timing effects. Despite the general improvement seen in data releases over the month of June, the economy's near term-prospects remain fairly bleak. These prospects are expected to encourage Mr Carney to take action to ensure the recovery gains traction over the medium term.