CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
11th October 2013

CABINET
22nd October 2013

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

SUBJECT: **Treasury Management Quarterly Report**

REPORT FOR: **Information**

1. Summary

1.1 CIPFA's Treasury Management Bulletin issued in March 2009 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 CIPFA Code of Practice on Treasury Management emphasises 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 In line with the above this report is providing information on the activities for the quarter ending 30th September 2013.

2. Economic Background and Forecasts

2.1 The economic background is attached at Appendix B.

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

	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.5%
5yr PWLB	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%
10yr PWLB	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%
25yr PWLB	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%
50yr PWLB	4.4%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%

Forecasts are currently not expecting a rise in Bank Rate until circa September 2016.

3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 21st Feb 2013 is at Appendix A.

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.

4.2 The Authority's investment position as at 30th Sept 2013 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
RBS	17,305	0.86%	N/A	Deposit A/c
BOS	Nil	0.75%	N/A	Deposit A/c
HSBC	50	0.25%	N/A	Deposit A/c
Total	**17,355**	**0.86%**		
Lloyds TSB - LAMS	1,000	3.20%	13.08.12	14.08.17

4.4 Members will note that the Authority's investments have decreased in the last quarter from £21M to £17M.

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. The Authority continues to not make any fixed term investments with any bank other than Lloyds TSB. Barclays Bank had certain credit ratings downgraded during this quarter but this had no effect on this Authority.

4.6 As anticipated in previous reports, the Authority has now received notification from BOS that the deposit account rate of interest will decrease to 0.40% with effect from 1st November 2013.

4.7 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.

4.8 The table above excludes investments still held in Iceland. The Icelandic court granted preferential creditor status for this type of investment 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 four distributions to creditors to date equating to circa 55%. The latest of these was in mid September. An element of the first and fourth distributions was in Icelandic Kroner which has been placed in an escrow account in Iceland. At present this is earning interest of 4.17%. These elements of the distributions have 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 present this is 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
2014/15	0.50%	0.60%
2015/16	0.50%	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 September 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.

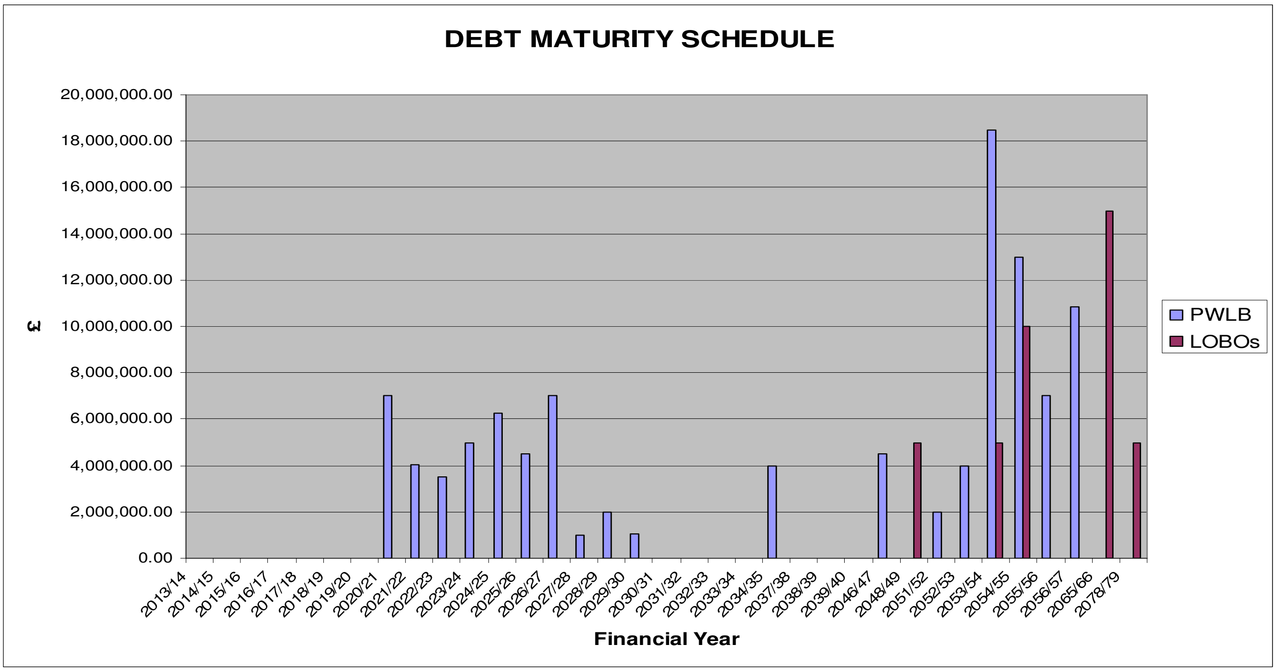
6.4 Capital Budget/Spend per efinancials:

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%
July		51,240,059	4,821,991	9.40%
August		51,127,676	7,548,379	14.80%
Sept		51,598,530	10,674,620	20.70%

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

6.5 *Debt Maturity Profile as at 30.09.13:*

(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, it is likely 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 30.09.13	Target borrowing rate now	Target borrowing rate previous
5 year	2.65%	2.50%	2.20%
10 year	3.73%	3.70%	3.30%
25 year	4.46%	4.40%	4.20%
50 year	4.48%	4.40%	4.30%

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 discount continues to be available in 2013/14 and the Authority has registered its interest in this preferred rate option.

7. Prudential Indicators

7.1 All TM Prudential Indicators were complied with in the quarter ending 30th Sept 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 Septmeber 2013 the contract has been awarded with implementation meetings planned for October. Full live use of the system is planned by 1st April 2014. 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, Leisure and the Debt Recovery Unit.

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**	
Contact Officer Name:	Tel:	Fax:	Email:
Ann Owen	01597 826327	01597 826290	ann.owen@powys.gov.uk

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:

Approved Treasury Management Strategy 2013/14:

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.			

Appendix B

Economic Background

General Economy:

During 2013/14 economic indicators suggest that the economy is recovering, albeit from a low level. After avoiding recession in the first quarter of 2013, with a 0.3% quarterly expansion, the economy grew 0.7% in Q2. There have been signs of renewed vigour in household spending in the summer, with a further pick-up in retail sales, mortgages, house prices and new car registrations.

The strengthening in economic growth appears to have supported the labour market, with employment rising at a modest pace and strong enough to reduce the level of unemployment further. Pay growth also rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the top rate of income tax. Excluding bonuses, earnings rose by just 1.0% y/y, well below the rate of inflation at 2.7% in August, causing continuing pressure on household's disposable income.

The Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding, particularly to small and medium size enterprises. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with mortgage interest rates falling further to new lows. Together with the Government's Help to Buy scheme, which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. Mortgage approvals by high street banks have risen as have house prices, although they are still well down from the boom years pre 2008.

Turning to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in Q2 started to come down, but only slowly, as Government expenditure cuts took effect and economic growth started to show through in a small increase in tax receipts. The 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan and monetary policy was unchanged in advance of the new Bank of England Governor, Mark Carney, arriving. Bank Rate remained at 0.5% and quantitative easing also stayed at £375bn. In August, the Monetary Policy Committee (MPC) provided forward guidance that Bank Rate is unlikely to change until unemployment first falls to 7%. This is not expected until mid 2016. However, 7% is only a point at which the MPC will review Bank Rate, not necessarily take action to change it. The three month to July average rate was 7.7%.

CPI inflation (MPC target of 2.0%), fell marginally from a peak of 2.9% in June to 2.7% in August. The Bank of England expects inflation to fall back to 2.0% in 2015.

Financial markets sold off sharply following comments from Ben Bernanke (the US Fed chairman) in June that suggested the Fed. may 'taper' its asset purchases earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK. Equity prices fell initially too, as Fed. purchasing of bonds has served to underpin investor moves into equities out of low yielding bonds. However, as the market moves to realign its expectations, bond yields and equities are likely to rise further in expectation of a continuing economic recovery. Increases in payroll figures have shown further improvement, helping to pull the unemployment rate down from a high of 8.1% to 7.3%, and continuing house price rises have helped more households to escape from negative equity. In September, the Fed. surprised financial markets by not starting tapering as it felt the run of economic data in recent months had been too weak to warrant taking early action. Bond yields fell sharply as a result, though it still only remains a matter of time until tapering does start.

Tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a renewed flare-up. Economic survey data improved consistently over the first half of the year, pointing to a return to growth in Q2, so ending six quarters of Eurozone recession.

Outlook for the next six months of 2013/14:

Economic forecasting remains difficult with so many external influences weighing on the UK. Volatility in bond yields is likely during 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds. Downside risks to UK gilt yields and PWLB rates include:

- A return to weak economic growth in the US, UK and China causing major disappointment to investor and market expectations
- The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- The Italian political situation is frail and unstable: the coalition government fell on 29 September.
- Problems in other Eurozone heavily indebted countries (e.g. Cyprus and Portugal) which could also generate safe haven flows into UK gilts.
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- Weak growth or recession in the UK's main trading partners - the EU and US, depressing economic recovery in the UK.
- Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds

Upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.
- Increased investor confidence that sustainable robust world economic growth is firmly expected, together with a reduction or end of QE operations in the US, causing a further flow of funds out of bonds into equities.
- A reversal of Sterling's safe-haven status on a sustainable improvement in financial stresses in the Eurozone.
- In the longer term - a reversal of QE in the UK; this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held.
- Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt, consequent upon repeated failure to achieve fiscal correction targets and sustained recovery of economic growth, causing the ratio of total Government debt to GDP to rise to levels that provoke major concern.

The overall balance of risks to economic recovery in the UK is now weighted to the upside after five months of robust good news on the economy. However, only time will tell just how long this period of strong economic growth will last and it remains exposed to vulnerabilities in a number of key areas. The longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Near-term, there is some residual risk of further QE if there is a dip in strong growth or if the MPC were to decide to take action to combat the market's expectations of an early first increase in Bank Rate. If the MPC does takes action to do more QE in order to reverse the rapid increase in market rates, especially in gilt yields and interest rates up to 10 years, such action could cause gilt yields and PWLB rates over the next year or two to significantly undershoot the forecasts in the table below. The tension in the US over passing a Federal budget for the new financial year starting on 1 October and raising the debt ceiling in mid October could also see bond yields temporarily dip until agreement is reached between the opposing Republican and Democrat sides. Conversely, the eventual start of tapering by the Fed will cause bond yields to rise.