CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
17th January 2014

CABINET
28th January 2014

REPORT AUTHOR: **County Councillor Tony Thomas**
Portfolio Holder for Finance

SUBJECT: **Treasury Management Quarterly Report**

REPORT FOR: **Information**

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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 31st December 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:

	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.5%	0.5%
5yr PWLB	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%
10yr PWLB	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%
25yr PWLB	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%
50yr PWLB	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%

Forecasts are currently not expecting a rise in Bank Rate until circa June 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 31st December 2013 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
RBS	18,400	0.86%	N/A	Deposit A/c
HSBC	285	0.25%	N/A	Deposit A/c
Total	**18,685**	**0.85%**		
Lloyds TSB - LAMS	1,000	3.20%	13.08.12	14.08.17

4.4 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.

4.6 As previously reported, the BOS deposit account rate of interest decreased from 0.75% to 0.40% with effect from 1st November 2013. Notification has been received from RBS that their rate will decrease from 0.86% to 0.50% with effect from 3rd January 2014. This is in line with expectations as the Authority has been fortunate to have received the previous levels of interest rates for as long as it has.

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 (WAO) opinion differed from this in that they suggested it should be treated as an investment. Unfortunately, despite meetings and extensive correspondence by Capita Treasury with the Welsh Government, Welsh Local Government Association and the Wales Audit Office, agreement on the accounting treatment for Welsh authorities has not been reached despite the provision of 3 separate legal opinions supporting the Capital Expenditure position. As such, Capita have said that they are not sure there is much more they can do in Wales. 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 distribution was in Icelandic Kroner which has been placed in an escrow account in Iceland. At present this is 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 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:
There are no current fixed investments to redeem.

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%	0.50%
2015/16	0.50%	0.50%

5. <u>Credit Rating Changes</u>

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

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

6. <u>Borrowing / Re-scheduling</u>

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 had outstanding external debt of £145.8M at 31st March 2013. In relation to the CFR figure for 31st March 2013, this equated to the Authority being under borrowed by £70.1M. This is a prudent and cost effective approach in the current economic climate. However, internal borrowing is only a temporary situation and, based on capital estimates, it will be necessary for the Authority to borrow at stages over the next few years. As such, the Authority needs to be mindful 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.

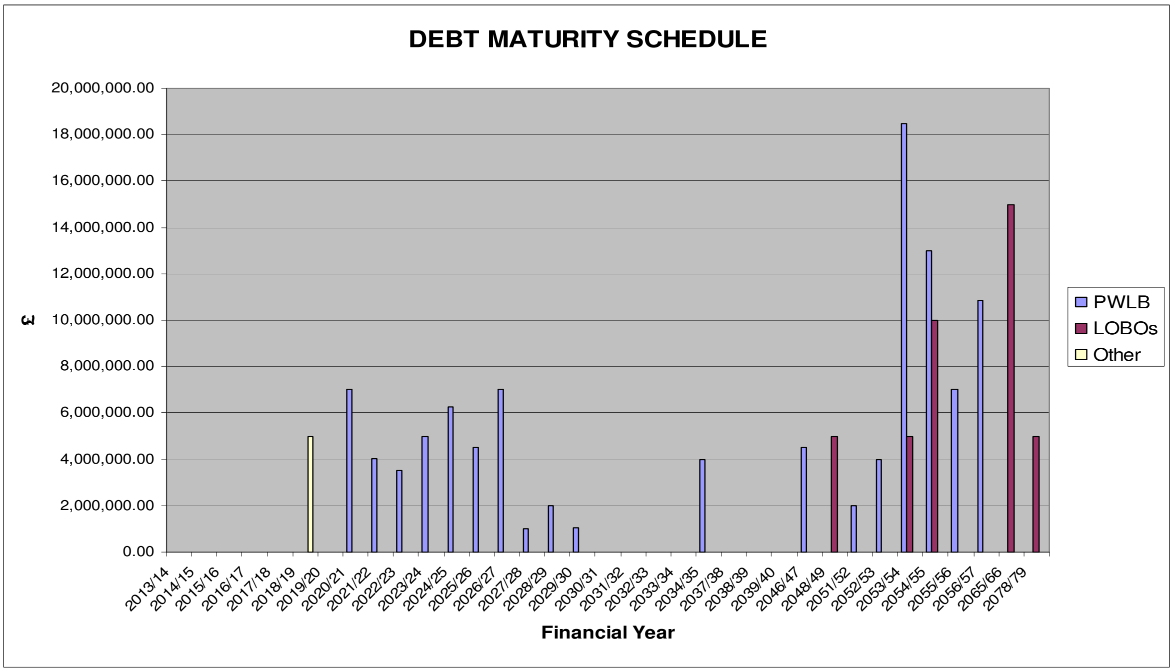
6.4 Capital Budget/Spend per efinancials:

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%
Oct		51,640,845	13,417,825	26.00%
Nov		51,665,278	16,170,586	31.30%
Dec		51,611,920	19,771,191	38.30%

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

6.5 *Debt Maturity Profile as at 31.12.13:*

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



6.6 Further to 6.3 above and due to an estimated decrease in cash available for cashflow purposes in the near future, the Authority borrowed £5M in early December from another local authority for a period of 5 years (as denoted in the graph above). This was at a rate of 2.3% which was below the PWLB rate available for the same period and taking into account the debt management charges.

6.7 Target rates:

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

Period	Borrowing rate at 31.12.13	Target borrowing rate now	Target borrowing rate previous
5 year	2.92%	2.50%	2.50%
10 year	3.94%	3.60%	3.70%
25 year	4.44%	4.40%	4.40%
50 year	4.39%	4.40%	4.40%

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 locallydetermined 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. <u>Prudential Indicators</u>

7.1 All TM Prudential Indicators were complied with in the quarter ending 31st December 2013.

8. <u>Projects Update</u>

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. Implementation meetings are due to start in January with full live use of the system planned by 1^{st} June 2014. Members will continue to be updated as the project progresses.

8.2 Corporate Direct Debits:
Successful implementation of this was achieved in the Debt Recovery Unit in October/November. This allows aged debt to be collected from customers in instalments with no requirement for manual receipting.

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

<u>Proposal</u>

It is proposed that the Treasury Management Quarterly Report is received.

<u>Statutory Officers</u>

The Strategic Director – Resources (s151 officer) notes the content of the report and supports the recommendation. It is important that Cabinet continues to be informed about this key activity.

The Solicitor to the Council (Monitoring Officer) has made the following comment: “I have nothing to add to the report”.

<u>Future Status of the Report</u>

Not applicable

Recommendation:		**Reason for Recommendation:**	
That the Treasury Management Quarterly Report be received		**To ensure Cabinet remains informed about current Treasury Management performance**	
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:

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

Overview

The better economic news does seem to be spreading. In the UK that has, naturally, done little to dissuade the markets that the Bank of England will have to raise rates earlier than it had hoped, whilst in the Eurozone the improvement reflects a degree of stabilisation rather than anything more promising. In response to growing concern that the broader economy is not improving quickly enough, the European Central Bank took action by implementing a rate cut of 0.25%. Meanwhile, the US economy, despite the more upbeat nature of data releases, continues to suffer uncertainty with the Federal Reserve dithering over when it will commence its tapering of asset purchases, whilst there remains the prospect of a renewed battle on Capitol Hill over the Budget and debt ceiling.

UK

Data releases continue to point to an economy in recovery, and one that does not show any great signs of faltering at present.

The first revision of Q3 GDP growth still estimates expansion at 0.8% but there are only mixed indications that the recovery is becoming more balanced. Growth was almost entirely down to household spending and companies building up stock levels. Investment posted a 1.4% quarter on quarter increase, which was the strongest since Q1 2012, with business investment also rising by that level. However, the combination of declining exports and rising imports meant that net trade was a negative contributor to growth.

The business surveys continue to be positive and indicate that growth is likely to accelerate in Q4, and though this month's composite PMI activity balance slipped, the level remains strong. It is a similar story to that coming from the industrial surveys which remain upbeat.

Consumer spending rose by 0.8% in Q3, which is the best performance since Q2 2010 and further narrows the differential with pre-crisis spending levels. However, recent evidence does indicate that the pace of spending growth has eased in the early part of Q4, with October retail sales falling by 0.7% and wiping out the gains posted since June. The fall occurred across all sectors, with food volumes falling for a third month. As noted, spending in November was fairly subdued with the CBI reported sales balance sharply lower on the levels posted earlier in the year, whilst consumer confidence has also wobbled this month with the composite PMI balance easing slightly from -11 to -12.

The imbalance between domestic and overseas demand remains a troubling issue. Net trade proved a hefty drag on GDP as the deficit widened after imports rose by 0.9% q/q and exports fell by 2.4% q/q. The manufacturing PMI export orders balance, nevertheless, continues to be strong, and the BoE Agents' measure was unchanged and indicative of exporters being little affected by the increasing strength of sterling.

Employment has benefited from the improvement in the economy with 176,000 jobs created in Q3, while the workforce only grew by 129,000. An increase of 157,000 full time positions is another sign of firms' growing confidence in the recovery. The improvement in employment saw the ILO rate of unemployment fall from 7.7% to 7.6%, whilst the ONS's experimental monthly measure came in at 7.1% and the claimant count fell from 4% to 3.9%. A large amount of slack remains in the labour market and real incomes continue to fall as pay growth of 0.8% is still considerably lower than the rate of inflation.

Inflation pressures, meanwhile, do not seem to have been affected by the economic recovery, with headline CPI falling from 2.7% to 2.2%, the lowest level since November 2009. Core inflation also weakened from 2.2% to 1.7%, also a four year low. The fall in CPI was helped by a 3% m/m decline in petrol prices, with lower education costs also snipping 0.2% off inflation, as the proportionate rise in average fees was lower than in 2012. Economists indicate that the signs are that inflation will continue to ease as petrol prices are lower again in November. The food element should also start to feel the impact of falls in global agricultural commodity prices and domestic food producer prices, seen over the last six months. These should filter into the inflation equation soon whist sterling strength will help to cut the cost of consumer goods imports. Producers' pricing intentions have shown some firming and there is a potential for output price inflation to pick up from the present four year low, but the impact could take as long as a year to affect prices in the shops, which have yet to reflect the fall in last year's output price inflation. Household inflation expectations have become more subdued, falling from 3.2% to 2.7% in a year's time, which reversed the pick up seen in October. Overall, analysts believe that CPI inflation will decline to below the BoE's 2% target level in 2014.

The markets are pricing in the first interest rate hike for mid-2015 and, given the mismatch with moves projected in the US, that has led to a strengthening of the £/$ exchange rate to a twenty seven month high.