CYNGOR SIR *POWYS* COUNTY COUNCIL

AUDIT COMMITTEE
26th September 2014

CABINET
30th September 2014

REPORT BY:	**Cllr. Dai Davies**
	Portfolio Holder for Finance
SUBJECT:	**Treasury Management Review 2013/14**

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. The Council's Overall Borrowing Need:

2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represent's the current year's unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

2.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through external borrowing or utilising temporary cash resources within the Council.

3. Strategy for 2013/14:

3.1 At the start of 2013/14 the Authority had an estimated Capital Financing Requirement of £217.7m, projected to rise by £17.6m during the course of the next three years to £235.3m. The Authority's external borrowing at 1st April 2013 stood at £145.8m. Analysis of the balance sheet at 31st March 2013 showed that the Authority was internally borrowed by £68.5M compared to £51M at 31st March 2012.

3.2 The expectation for interest rates within the strategy for 2013/14 anticipated low but rising Bank Rate (starting in Qtr 1 of 2015) and gradual rises in medium and longer term fixed borrowing rates during 2013/14. 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.

3.3 The Capital Programme for 2013/14 incorporated £10.5m 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 1.80% for 5 year borrowing, 2.90% for 10 year borrowing, 4.10% for 25 year borrowing and 4.20% for 50 year borrowing. This was revised several times during the year before ending at 2.60% for 5 year borrowing, 3.70% for 10 year borrowing 4.40% for 25 year borrowing and 4.40% for 50 year borrowing.

3.4 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.

4. Treasury Position:

4.1 The major issue for Treasury Management in 2013-14 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.

4.2 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 decreased by £1.929M in the year. This decrease arose as follows:

	£000s
Decrease in PWLB debt	(14)
Increase/Decrease in LOBO debt	Nil
Increase in Market debt	5,000
Decrease in Temporary Borrowing	(2,500)
Decrease in Investments	(4,415)
	(1,929)

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

	Balance 01-04-13	Borrowing	Investments	Repayments	Balance 31-03-14
	£000's	£000's	£000's	£000's	£000's
PWLB *	105,818	Nil	N/A	(14)	105,804
LOBOs *	40,000	Nil	N/A	Nil	40,000
Market Loans	Nil	5,000	N/A	Nil	5,000
Temporary Borrowing	2,500	5,200	N/A	(7,700)	Nil
Total	148,318	10,200	N/A	(7,714)	150,804
Temporary Investments	(6,185)	N/A	(285,320)	280,905	(10,600)
Long Term Investments	Nil	N/A	Nil	Nil	Nil
Net Borrowing	142,133	10,200	(285,320)	273,191	140,204

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

4.4 A summary of the economy for 2013/14 is at Appendix A.

5. Icelandic Banks:

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

5.2 **Landsbanki:**
Up to September 2013, distributions in respect of Landsbanki amounting to circa 53% had been received. A decision was made by the Council's Cabinet in October 2013 to take part in a competitive auction process in respect of its Landsbanki claims. This decision was made on the basis that the administration of the insolvent estate of Landsbanki is likely to continue for several years which creates a level of uncertainty around the timing of future recoveries. Future distributions could be made in a number of currencies including Icelandic Krona, which is less advantageous. The decision to sell was made alongside a number of other priority creditors including other local authorities.
The successful sale of the claims took place on 30th January 2014. Each creditor who participated in the sale achieved the same auction price. The price at which the claims were sold was based on a reserve price set by the Council on the basis of legal advice received, financial advice procured from the Local Government Association and the Council's own analysis of the financial position.

Glitnir Bank HF:
The winding up board of Glitnir made a distribution to creditors in a basket of currencies in March 2012. An element of the distribution was in Icelandic Kroner which was placed in an escrow account in Iceland and is earning interest of 4.2% as at 31/03/14. This element of the distribution has been retained in Iceland due to currency controls currently operating in Iceland and as a result is subject to exchange rate risk over which the Authority has no control. The distribution has

been made in full settlement, representing 100% of the claim.

6. Balance Sheet Review:

6.1 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.

6.2 The review for 2013/14 revealed that the Authority was under borrowed by £67.1M (31% of the CFR) at 31st March 2014 compared to £68.5M (31% of the CFR) at 31st March 2013. Internal investments in the balance sheet (showing that the Authority is internally borrowed) at 31st March 2014 were £53M compared to £55M at 31st March 2013.

7. Debt Rescheduling/Repayment:

7.1 At the start of 2013/14 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.

7.2 However, the Authority was already heavily internally borrowed and short term savings by avoiding new long term external borrowing in 2013/14 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.

7.3 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.

8. Performance Measurement:

8.1 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 2013/14 was 4.52%. This compared with 4.66% in 2012/13.

8.2 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.

8.3 In 2013/14 the average rate on external investments achieved was 0.91% (1.38% in 2012/13) compared with the 3 month uncompounded LIBID rate of 0.39719.

9. Summary Statement of Accounts

9.1 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).

10. Prudential/Treasury Indicators

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

11. Member Training

11.1 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 2013/14.

12. Treasury Management Policy Statement

12.1 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

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 the procurement of a replacement income management/ cash receipting system, live implementation of which is due in October 2014.

Proposal

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

Statutory Officers

Chief Finance Officer's comment:
The Strategic Director Resources (S151 Officer) notes the report's contents and that by receiving the report before 30th September the Cabinet has met the Council's responsibility under the code of practice.

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:**
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:

The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it only to start gently rising from quarter 1 2015. This forecast rise has now been pushed back to a start in quarter 3 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during 2013/14. Consequently, there was no additional quantitative easing during 2013/14 and Bank Rate ended the year unchanged at 0.5% for the fifth successive year.

While CPI inflation had remained stubbornly high and substantially above the 2% target during 2012, by January 2014 it had, at last, fallen below the target rate to 1.9% and then fell further to 1.7% in February. It is also expected to remain slightly below the target rate for most of the two years ahead.

Gilt yields were on a sharply rising trend during 2013 but volatility returned in the first quarter of 2014 as various fears sparked a flight to quality. The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing into 2013/14. That part of the Scheme, which supported the provision of credit for mortgages, was terminated in the first quarter of 2014 as concerns rose over resurging house prices.

The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth has led to a cumulative (in the 2013 Autumn Statement and the March 2014 Budget) reduction in the forecasts for total borrowing of £97bn over the next five years, culminating in a £5bn surplus in 2018-19.

The EU sovereign debt crisis subsided during the year and confidence in the ability of the Eurozone to remain intact increased substantially. Perceptions of counterparty risk improved after the ECB statement in July 2012 that it would do “whatever it takes” to support struggling Eurozone countries; this led to a return of confidence in its banking system which continued into 2013/14 and led to a move away from only very short term investing. However, this is not to say that the problems of the Eurozone, or its banks, have ended as the zone faces the likelihood of weak growth over the next few years at a time when the total size of government debt for some nations is likely to continue rising. Upcoming stress tests of Eurozone banks could also reveal some areas of concern.

Appendix B

Statement of Accounts
Treasury Management

		2013/14	2013/14	2012/13
		Actual	Budget	Actual
		£	**£**	**£**
Employees		172,234	175,693	181,795
Transport	*1	3,107,782	3,496,790	3,854,678
Supplies & Services		187,620	197,590	210,840
Interest Paid	*2	6,919,005	7,579,588	6,850,479
Debt Management Expenses		28	6,000	32
Gross Expenditure		**10,386,669**	**11,455,661**	**11,097,824**
Interest Received	*3	242,145	0	500,753
Gross Income		**242,145**	**0**	**553,862**
Net Expenditure		**10,144,524**	**11,455,661**	**10,597,071**

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 2013/14 which did not take place.

Note 3: A surplus of £242k on interest received was achieved as 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 2014/15. In respect of these cash balances, the Authority benefitted for longer than expected from good deposit account rates that it had thought would be withdrawn.