CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
15th April 2016

CABINET
10th May 2016

REPORT AUTHOR: **County Councillor Wynne Jones**
Portfolio Holder for Finance

SUBJECT: **Treasury Management Qtr 4 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 March 2016.

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:

	Jun 16	**Sep 16**	**Dec 16**	**Mar 17**	**Jun 17**	**Sep 17**	**Dec 17**
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%
5yr PWLB	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.60%
10yr PWLB	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%
25yr PWLB	3.20%	3.30%	3.30%	3.50%	3.50%	3.60%	3.60%
50yr PWLB	3.00%	3.10%	3.10%	3.30%	3.30%	3.40%	3.40%

3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 5th March 2015 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 March 2016 is as shown below:-

Invested with:	**Principal £000's**	**Interest Rate**	**Start Date**	**Maturity Date**
Santander	6,610	0.40%	N/A	Deposit A/c
BOS	1,495	0.40%	N/A	Deposit A/c
HSBC	345	0.25%	N/A	Deposit A/c
Total	**8,450**	**0.40%**		
Lloyds TSB - LAMS	1,000	3.20%	13.08.12	14.08.17

4.3 There have been no relevant credit rating changes in the last few months in respect of the banks that the Authority utilises for deposits.

4.4 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.

4.5 **Glitnir:**
The winding up board of Glitnir made a distribution to creditors in a variety of currencies in March 2012. An element of the distribution was in Icelandic Kroner (ISK) which was placed in an escrow account in Iceland. 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.

Cabinet will be aware that this Authority did not take up a sale of escrow option but decided to retain the money in escrow until such time as there is further information forthcoming from the Icelandic government.

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
2016/17	0.60%
2017/18	1.25%
2018/19	1.75%

These are based on investments for up to three months duration.

5. Credit Rating Changes

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 March 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:

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 represents 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.

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.

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.

CFR Position:

	As at 31.03.15 Actual	2015/16 Original Estimate	2016/17 Original Estimate	2017/18 Original Estimate
	£M	£M	£M	£M
Capital Financing Requirement	224,482	227,799	319,727	329,533

6.3 The Authority had outstanding long-term external debt of £150.8M at 31st March 2015. In relation to the CFR figure for 31st March 2015, this equated to the Authority being under borrowed by £73.7M. 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.

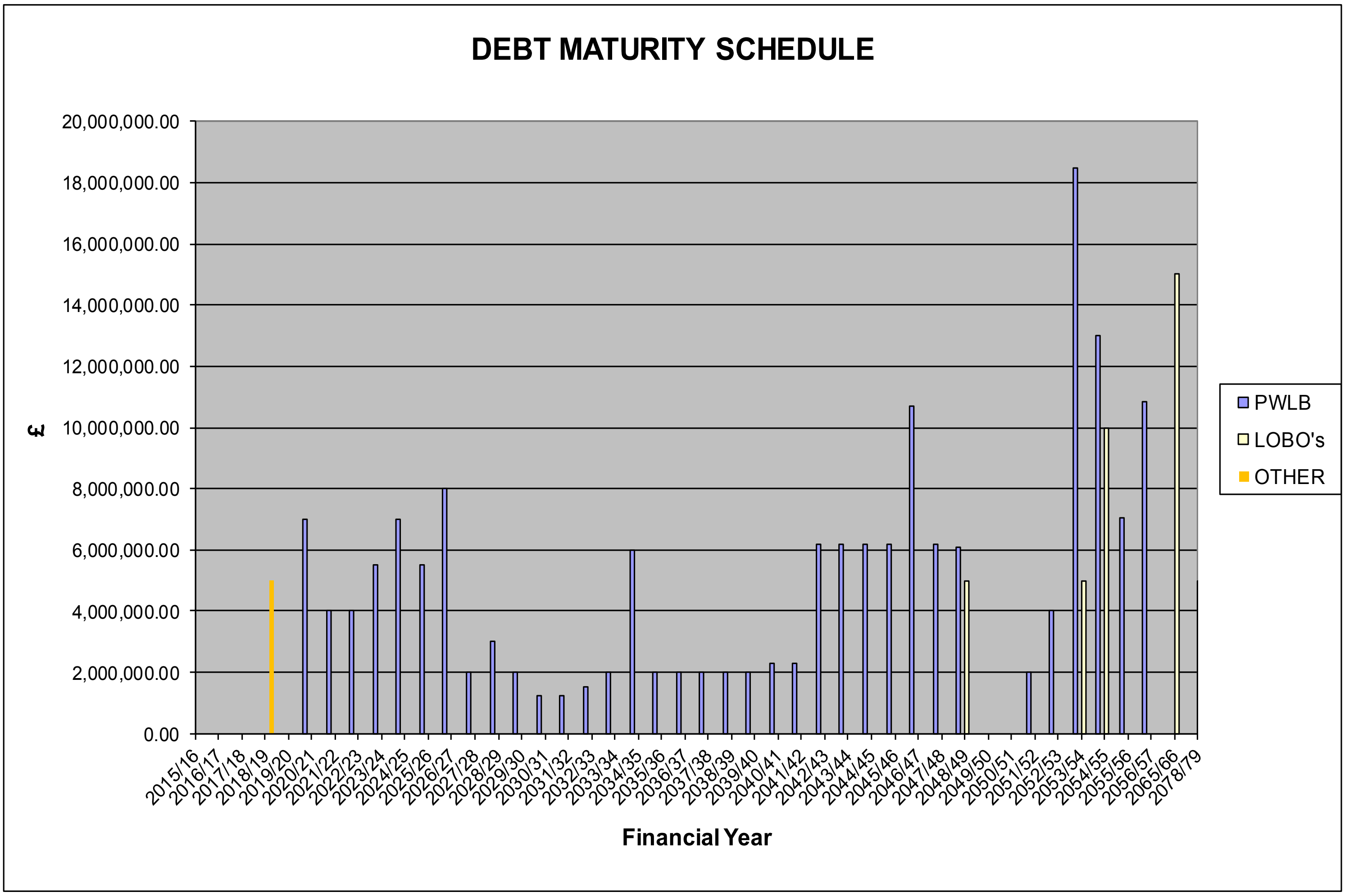
6.4 Capital Budget/Spend per efinancials:

Capital:	**Approved Budget**	**Working budget**	**Actual Capital Spend (not including commitments)**	**%age spend**
	128,931,594			
June		136,989,764	75,576,339	55.17%
Sept		141,157,883	83,517,819	59.20%
Dec		126,548,605	93,174,660	73.63%
March (latest figures as at time of writing report)		109,072,636	100,008,762	91.70%

The figures above include the figures for the self-financing of the HRA.
The financing of the approved capital budget included £97.4M of Prudential borrowing in total. £72.4M was borrowed on 2nd April in respect of the self-financing of the HRA.
The exact structure of loans arranged for the HRA purpose reflected the requirements of the HRA business plan, the overall requirements of the Council and certain limitations (e.g. the minimum average duration of any borrowing) put in place by the Welsh Government. The loans were, therefore, arranged at a set of bespoke, higher PWLB interest rates that applied only to Welsh HRA self-financing authorities and may make these loans less flexible, from a restructuring point of view, than would normally be the case.

6.5 *Debt Maturity Profile as at 31.03.16:*

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



6.6 Target rates:

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

Period	Borrowing rate at 31.03.16	Target borrowing rate now
5 year	1.89%	1.70%
10 year	2.56%	2.30%
25 year	3.33%	3.20%
50 year	3.14%	3.00%

6.7 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

6.8 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.

7. Prudential Indicators

7.1 All TM Prudential Indicators were complied with in the quarter ending 31st March 2016.

Proposal

It is proposed that the Treasury Management quarterly report is received.

Statutory Officers

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".

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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 2015/16:

7.5 "High" credit quality:

7.5.1 It is proposed that the Authority continue with the following in respect of defining a "high" credit quality. If a rating is not available from any of the rating agencies then the available ratings will be used. Members will note that this proposal excludes investments with some banks off the advisors' suggested list:-

Long Term Ratings (in respect of long-term investments):

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 (in respect of short-term investments):

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
F1+	N/A	A-1+
F1	P-1	A-1

7.6 Country limits:

7.6.1 It is proposed that the Authority will use approved counterparties from the UK and approved counterparties from other countries with the following sovereign credit ratings:-

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
AAA	Aaa	AAA

Country	Maximum Investment per Country	Credit Rating/Other Assessment of Risk
AAA countries (listed at Appendix D)	£20M (held in call accounts)	As per rating list
UK	No Maximum Investment	As per rating list

7.7 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 to be held in fixed term investments)	Up to 364 days	As per Capita's matrices and the Authority's definition of a high credit rating
Foreign Banks	5	Up to 364 days	As per Capita'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 Capita's matrices and the Authority's definition of a high credit rating
Lloyds Bank (as a mortgage lender in the LAMS scheme)	5	Up to 5 years	N/A
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

January proved a horrendous start to 2016 for the financial markets as share prices declined amidst concerns about a potential "hard landing" in China. The UK economy, however, appears to have gathered some momentum, with the PMIs indicating at least 0.5% q/q growth, while consumer confidence picked up despite all of the turmoil. Furthermore, oil prices and a weaker sterling should help the UK economy; although the EU referendum (June 2016) could add to uncertainty.

US headline inflation is set to remain low for much of 2016 as the joint impact of a strong dollar and soft commodity prices persist. The 2% target rate is not expected to be reached until 2017, with the dollar's appreciation by 20% since mid-2014 keeping core goods price inflation suppressed. The external deflationary influences will probably last longer than had been initially thought but will fade as the year progresses, when increasing domestic price pressures will take over and push core prices to the target level.

Data suggests that EZ growth has maintained the 0.3% q/q expansion seen in Q3, which would be slower than surveys indicate. With the composite PMI and EC Economic Sentiment Indicator having dipped in January, there is the prospect that growth has probably slowed at the start of 2016.

UK

Q4 GDP is likely to have accelerated a touch from Q3, at around 0.5% q/q, but the economy does not appear to have great impetus and remains below trend growth at 1.9% annualised. 2.2% over 2015 as a whole is a sharp deceleration from 2.9% in 2014. Growth is being driven almost solely by the services sector, with industrial production and construction output both declining on the quarter. Nevertheless, the latest manufacturing PMI did pick up to leave the composite consistent with further improvement in GDP growth. The preface to the EU referendum will add to the uncertain mix that has dogged early 2016. In addition, the decline in manufacturing investment intentions may, partially, be a consequence, but the service sector intentions are undented. Retail sales volumes fell in December but grew strongly over Q4.

The recovery continues to be underpinned by consumer spending and real household spending, with big ticket items, such as cars, having been strong. While vehicle sales have slowed more recently, other durable goods sales should remain strong. With house prices heading up and quantity rising, mortgage approval values have jumped 26% y/y, but with RICS reporting a narrowing between buyer and seller enquiries house price growth may become more restrained.

The trade deficit narrowing in October was down to the goods balance, whereby export volumes increased and imports declined. However, trade is not set to support recovery just yet! The deficit will widen over Q4 unless there is a marked narrowing in December, and will be a drag on growth, though less than in Q3. On-going deterioration of EU trade is being offset by improvement in the non-EU deficit. Survey measures point to subdued demand from the EU, leaving export orders at historically low levels.

The labour market remains robust with employment rising 267,000 in the three months to November, leaving the unemployment rate at 5.1%. Yet even with evidence of labour shortages and high employment, wage growth remains subdued, with headline pay growth easing to 1.9% y/y. Remaining slack in the economy should ensure that wage growth does not rise sharply during 2016, with the percentage of part time workers looking for longer working hours still double that seen prior to the crisis and job-to-job movement also lower than pre-2008.

CPI inflation edged higher in December, as fuel price deflation softened and airfares rose, though these impacts were offset by falling food and alcohol price inflation. Petrol prices fell but not as fast as they had the previous year, and even oil prices remaining at sub-$33 per barrel will not prevent the drag from fuel prices dissipating over the year, on base effects.

Food producer price deflation is easing which should reduce the drag they exert as well. With the effect of stronger sterling waning, the downside impact from import prices should diminish. Analysts project inflation to rise to around 1% by the middle of this year, but rises should be gradual. Wholesale gas and electricity prices have tracked oil lower and will remain a drag on inflation as utility companies tend to buy wholesale energy two years in advance.

The indirect impact of lower oil prices will restrain inflation for some time, but the lower household medium-term inflation expectations do not suggest that near zero inflation is likely to become embedded. Nevertheless, growing inflationary pressures are not evident in the economy, thus inflation should remain below the 2% target, possibly for a couple more years.