CYNGOR SIR *POWYS* COUNTY COUNCIL

AUDIT COMMITTEE
Via email

CABINET
13th Sept 2016

REPORT BY:	**Cllr. Wynne Jones** **Portfolio Holder for Finance**
SUBJECT:	**Treasury Management Review 2015/16**

REPORT FOR:	**Approval**

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 2015/16:

3.1 At the start of 2015/16 the Authority had an estimated Capital Financing Requirement of £227.8m, projected to rise by £25.4m during the course of the following four years to £253.2m. The Authority's external borrowing at 1st April 2015 stood at £150.8m. Analysis of the balance sheet at 31st March 2015 showed that the Authority was internally borrowed by £56.5M compared to £67.1M at 31st March 2014.

3.2 The expectation for interest rates within the strategy for 2015/16 anticipated low but rising Bank Rate (starting in Qtr 1 of 2016) and gradual rises in medium and longer term fixed borrowing rates during 2016/17. 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.
In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.
The actual movement in gilt yields meant that the general trend in PWLB rates during 2015/16 was an increase in rates during the first quarter followed by marked bouts of sharp volatility from July 2015 but with an overall trend for rates to fall to historically low levels by the end of the year.

3.3 The Capital Programme for 2015/16 incorporated £97.4m (£72.4M for the self-financing of the HRA on 2nd April) 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 Capita (the Authority's advisors), was to set a benchmark of 2.10% for 5 year borrowing, 2.70% for 10 year borrowing, 3.30% for 25 year borrowing and 3.30% for 50 year borrowing. This was revised several times during the year before ending at 1.17% for 5 year borrowing, 2.30% for 10 year borrowing, 3.20% for 25 year borrowing and 3.00% 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 2015-16, alongside reducing cash balances, 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 increased by £65.3M in the year. This increase arose as follows:

	£000s
Increase in PWLB debt	75,607
Increase/Decrease in LOBO debt	Nil
Increase/Decrease in Market debt	Nil
Decrease in Temporary Borrowing	(15,000)
Decrease in Investments	4,655
	65,262

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

	Balance 01-04-15	Borrowing	Investments	Repayments	Balance 31-03-16
	£000's	£000's	£000's	£000's	£000's
PWLB *	105,789	75,623	N/A	(16)	181,396
LOBOs *	40,000	Nil	N/A	Nil	40,000
Market Loans	5,000	Nil	N/A	Nil	5,000
Temporary Borrowing	15,000	655	N/A	(15,655)	Nil
Total	165,789	76,278	N/A	(15,671)	226,396
Temporary Investments	(14,105)	N/A	(254,825)	259,480	(9,450)
Long Term Investments	Nil	N/A	Nil	Nil	Nil
Net Borrowing	151,684	76,278	(254,825)	243,809	216,946

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

4.4 A summary of the economy for 2015/16 is at Appendix A.

5. Icelandic Banks:

5.1 **Landsbanki:**
Members will be aware that this situation was concluded in 2013/14.

5.2 **Glitnir Bank HF:**
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 was earning interest of 4.22% at 31/03/16. This element of the distribution was retained in Iceland due to currency controls operating in Iceland. The distribution has been made in full settlement, representing 100% of the claim.

Members will be aware that there has been a recent update report regarding the Glitnir situation.

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 2015/16 reveals that the Authority was under borrowed by £72.3M (23.9% of the CFR) at 31st March 2016 compared to £56.5M (25.2% of the CFR) at 31st March 2015. Internal investments in the balance sheet (showing that the Authority is internally borrowed) at 31st March 2016 were £51M compared to £44M at 31st March 2015.

7. Debt Rescheduling/Repayment:

7.1 At the start of 2015/16 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 2015/16 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 2015/16 was 4.46%. This compared with 4.32% in 2014/15. The increase was largely due to the borrowing for the self-financing of the HRA. However, 4.46% remains a very favourable average rate.

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 2015/16 the average rate on external investments achieved was 0.63% (0.53% in 2014/15) compared with the 3 month uncompounded LIBID rate of 0.456%.

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 2015/16.

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

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".

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:

Market expectations for the first increase in Bank Rate moved considerably during 2015/16, starting at quarter 3 2015 but soon moving back to quarter 1 2016. However, by the end of the year, market expectations had moved back radically to quarter 2 2018 due to many fears including concerns that China's economic growth could be heading towards a hard landing; the potential destabilisation of some emerging market countries particularly exposed to the Chinese economic slowdown; and the continuation of the collapse in oil prices during 2015 together with continuing Eurozone growth uncertainties.

These concerns caused sharp market volatility in equity prices during the year with corresponding impacts on bond prices and bond yields due to safe haven flows. Bank Rate, therefore, remained unchanged at 0.5% for the seventh successive year. Economic growth (GDP) in the UK surged strongly during both 2013/14 and 2014/15 to make the UK the top performing advanced economy in 2014. However, 2015 was disappointing with growth falling steadily from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4.

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 materially. These rates continued at very low levels during 2015/16.

The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back. In addition, a notable trend in the year was that several central banks introduced negative interest rates as a measure to stimulate the creation of credit and hence economic growth.

The European Central Bank had announced in January 2015 that it would undertake a full blown quantitative easing programme of purchases of Eurozone government and other bonds starting in March at €60bn per month. This put downward pressure on Eurozone bond yields. There was a further increase in this programme of QE in December 2015. The anti-austerity government in Greece, elected in January 2015, eventually agreed to implement an acceptable programme of cuts to meet EU demands after causing major fears of a breakup of the Eurozone. Nevertheless, there are continuing concerns that a Greek exit has only been delayed.

As for America, the economy continued to grow healthily on the back of resilient consumer demand. The first increase in the central rate occurred in December 2015 since when there has been a return to caution as to the speed of further increases due to concerns around the risks to world growth.

On the international scene, concerns increased about the slowing of the Chinese economy and also its potential vulnerability to both the bursting of a property bubble and major exposure of its banking system to bad debts. The Japanese economy also suffered disappointing growth in this financial year despite a huge programme of quantitative easing, while two of the major emerging market economies, Russia and Brazil, are in recession. The situations in Ukraine, and in the Middle East with ISIS, have also contributed to volatility.

The UK elected a majority Conservative Government in May 2015, removing one potential concern but introducing another due to the promise of a referendum on the UK remaining part of the EU. The government maintained its tight fiscal policy stance but the more recent downturn in expectations for economic growth made it more difficult to return the public sector net borrowing to a balanced annual position within the period of this parliament.

Appendix B:

Statement of Accounts
Treasury Management

		2015/16	2015/16	2014/15
		Actual	Budget	Actual
		£	**£**	**£**
Employees		160,103	160,000	158,395
Transport	*1	1,253,283	3,250,000	2,382,149
Supplies & Services		165,704	190,000	184,289
Interest Paid	*2	10,060,890	7,050,000	7,031,129
Debt Management Expenses		25,992	6,000	113
Gross Expenditure		**11,665,972**	**10,656,000**	**9,756,075**
Interest Received	*3	123,228	0	95,127
Gross Income		**123,228**	**0**	**95,127**
Net Expenditure		**11,542,744**	**10,656,000**	**9,660,948**

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 over the original budget due to the HRA self-financing. This was budgeted for in the HRA Business Plan.

Note 3: Supplies & Services was under budget due to a reduction in bank charges partly due to the outsourcing of leisure.

Note 4: Debt management expenses were over budget due to the cost of the borrowing undertaken for HRA self-financing. The HRA was charged with this cost.

Note 5: A surplus of £123k 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 2016/17.