CYNGOR SIR *POWYS* COUNTY COUNCIL.

AUDIT COMMITTEE
Via email

CABINET
13th September 2016

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

SUBJECT: **Treasury Management Qtr 1 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 30th June 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:

	Sep 16	Dec 16	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18
Bank rate	0.25%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
5yr PWLB	1.00%	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%
10yr PWLB	1.50%	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%
25yr PWLB	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%
50yr PWLB	2.10%	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%

3. Treasury Management Strategy

3.1 The Treasury Management Strategy approved by Full Council on 9th March 2016 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 June 2016 is as shown below:-

Invested with:	Principal £000's	Interest Rate	Start Date	Maturity Date
Santander	7,130	0.40%	N/A	Deposit A/c
BOS	11,020	0.40%	N/A	Deposit A/c
HSBC	50	0.25%	N/A	Deposit A/c
Total	**18,200**	**0.40%**		
Lloyds TSB - LAMS	1,000	3.20%	13.08.12	14.08.17

4.3 Due to the cut in bank rate which has since taken place in August, the Authority is expecting the deposit account rates above to decrease circa October/November.

4.4 There have been no credit rating changes in the last few months in respect of the banks that the Authority utilises for deposits. However, following the Brexit vote, there have been some changes to the Ratings Outlooks for these banks. This is due to the uncertainty around the Brexit process.

UK Sovereign Rating Action:
The following has taken place since the Brexit vote was announced:

<u>Fitch:</u>
- Sovereign rating downgraded by one notch, from AA+ to AA
- Outlook lowered to Negative, from Stable

Moody's:
- Sovereign rating affirmed, at Aa1 (equivalent to AA+ from Fitch / S&P)
- Outlook lowered to Negative, from Stable

Standard & Poor's (S&P):
- Sovereign rating downgraded by two notches, from AAA to AA
- Remains on Negative Outlook

4.5 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.

4.6 Glitnir:

The winding up board of Glitnir made a 100% 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 due to the currency controls that were in place. Cabinet on 30th August 2016 received an update report informing them that the Authority had taken part in the final Central Bank currency auction as a result of which the ISK had been sold at the best price available with settlement made to a Euro account held by the Authority with HSBC in the UK. This gives the Authority control over the timing of the currency exchange.

4.7 Redemption Penalties:
There are no current fixed investments to redeem.

4.8 Investment returns in future years:
Our advisors' current suggested earning rates for investments for budgeting purposes are as follows:-

	Suggested Rate
2016/17	0.25%
2017/18	0.25%
2018/19	0.50%

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

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 June 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 31.03.16 Actual	2016/17 Original Estimate	2017/18 Original Estimate	2018/19 Original Estimate
	£M	£M	£M	£M
Capital Financing Requirement	302,363	307,313	326,288	354,093

6.3 The Authority had outstanding long-term external debt of £226.4M at 31st March 2016. In relation to the CFR figure for 31st March 2016, this equated to the Authority being under borrowed by £76M. 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:

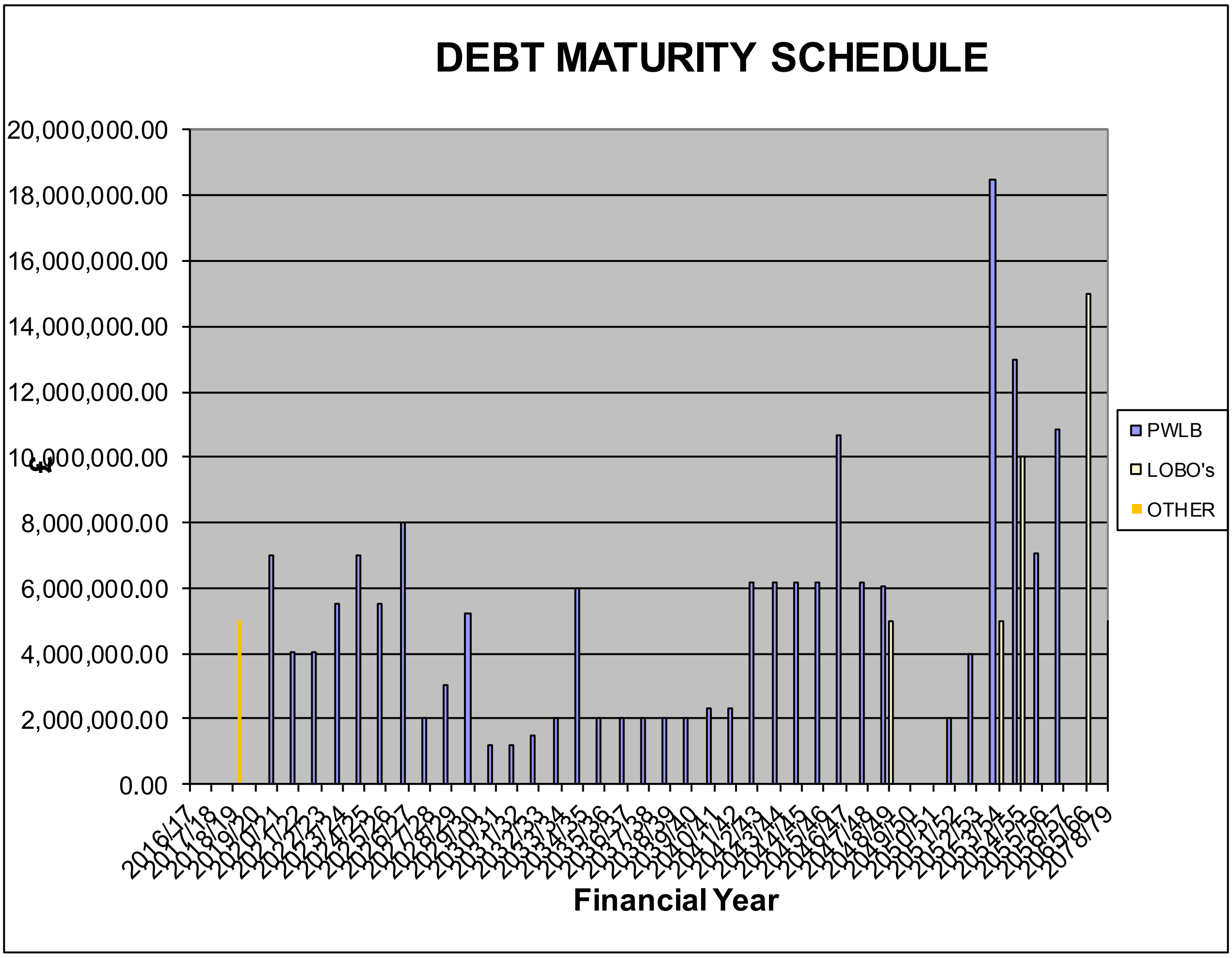
Capital:	**Approved Budget**	**Working budget**	**Actual Capital Spend (not including commitments)**	**%age spend**
	45,069,066			
June		52,381,477	3,087,768	5.89%

Sept				
Dec				
March				

The financing of the approved capital budget included £20.4M of Prudential borrowing in total.

6.5 *Debt Maturity Profile as at 30.06.16:*

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



6.6 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

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 30th June 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".

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**	
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 2016/17:

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	£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

In the lead up to the EU referendum, UK economic growth performed surprisingly strongly (0.6%q/q). Industrial production fell in May but had a very strong month in April. Services output also gained in April.

In the US, underlying retail sales growth hit a two year high in May but industrial activity and business investment remained weak. Accordingly, the Federal Bank may be deterred from increasing interest rates while payroll growth goes through this lull and the uncertainty surrounding Brexit will add to the central bank's caution. Nevertheless, analysts continue to point to the risks of a rising inflation backdrop that could force the Fed to raise rates at a faster pace than currently indicated by the futures curve.

Q2 EZ growth was expected to have slowed from that in Q1 with the June composite PMI consistent with just 0.3% q/q growth. Industrial production and retail sales saw only modest gains falling short of Q1 performance, and economists suggested that a slow-down may be the feature of the remainder of the year as rising inflation impacts on households' real income growth. The UK decision to leave the EU is likely to add to downside pressures on sentiment.

Chinese growth figures continued to be treated with scepticism in some quarters.

UK

Output indicators suggested an economic slowdown post the EU referendum Leave vote. However, the GfK consumer confidence survey was one of the few surveys to point to a more positive story. Industrial production contracted in May but expanded strongly in April, so even further contraction in June would probably leave it healthily stronger over Q2. The index of services showed solid growth in April. Post-Brexit data will be awaited but analysts expect stagnation in the second half of the year with a potential pick up in 2017. However, the outlook is highly uncertain.

Accordingly, recovery remains in the hands of household spending which did not seem overly held back by the referendum uncertainty, with retail sales volumes increasing in both April and May to indicate a strong quarter's contribution to Q2 GDP growth. The June CBI reported sales balance, however, fell suggesting a slowing of sales. Though consumer confidence eased it did so from extremely high levels, reflecting solid spending growth. The Bank of England agents' measure of consumer services was also healthy, but the housing market may be less supportive of spending going forward with new buyer enquiries dipping and suggesting sharp house price growth slowing.

Employment levels improved in the run up to the referendum pushing it to a record high and unemployment down to 5%, an eleven year low. Employment intentions remained upbeat but whether this will remain post-Brexit is unknown. Annual average earnings rose strongly in April but were more subdued over the three month average. Surveys pointed to an acceleration of wage growth, reflecting previous take up of labour market slack. However, the EU vote and ongoing underemployment are likely to restrain the upside potential.

Timing of Easter apart, CPI held fairly steady at 0.3%, with core inflation at 1.2%. Fuel's impact increased in May to offset weaker clothing/food inflation. That contribution is likely to increase as the value of the £ falls and base effects lift the annual rate. Wholesale energy prices remained below 2014 levels and with utility firms purchasing wholesale energy two years in advance the drag from retail energy will continue on inflation. Import prices will increase on the back of Sterling's Brexit weakening, which will have both direct and indirect impacts on inflation, though that effect generally has a two year time lag. The effect may, though, be softened if the economy weakens as expected. Inflation forecasts have seen the 2% target being hit earlier, in Q2 next year, while looser monetary policy will soften mortgage payments and narrow the gap between CPI and RPI measures.

Financial markets were initially rocked by the Brexit decision and the Bank of England was not slow to indicate that it would take action to support the economy in the aftermath of the vote and the uncertainty ahead. An interest rate cut in Q3 was expected and the interest rate expectations curve had shifted lower. Gilt yields crumbled, with the benchmark ten year yield hitting a record low. Sterling fell to a thirty five year low on the back of the move in the relative interest rate expectations. The UK's sovereign rating had also been downgraded. On the upside, the FTSE 100 rallied strongly, as member companies' earnings are more international, though the more domestic focussed 250 struggled.