

**Committee and Date**

Cabinet
15th February 2011

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Item

11

Public

TREASURY MANAGEMENT UPDATE – QUARTER 3 2010/11

**Responsible
Officers**

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Summary

The report outlines the treasury management activities of the Council in the last quarter. It highlights the economic environment in which treasury management decisions have been made and the interest rate forecasts of the Council's Treasury Advisor, Sector Treasury Services. It also updates Members on the internal treasury team's performance. The key points to note are:-

- In the last quarter all treasury management activities have been in accordance with the approved limits and prudential indicators set out in the Council's Treasury Strategy.
- During the third quarter of 2010/11 the internal treasury team achieved a return of 0.74% on the Council's cash balances outperforming the benchmark by 0.40%. This amounts to additional income of £115,000 during the quarter which is included within the Council's projected outturn position in the monthly revenue monitor. However, compared to the original estimate there is still a shortfall of £437,000 on investment income for 2010/11 per paragraph 16 of this report.
- Following the Chancellor's announcement on the Spending Review on 20 October 2010, HM Treasury has instructed the Public Works Loan Board (PWLB) to increase the average interest rate on all new loans to an average of 1% above the Government's cost of borrowing which took effect immediately. This means all the Council's future PWLB borrowing will be increased by up to 1%.

Recommendations

Members are asked to note the report.

REPORT

Introduction

1. The Council defines its treasury management activities as "the management of the authority's investments and 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". The report informs Members of the treasury activities of the Council between 1st October 2010 and 31st December 2010.

Economic Background

2. Sector's view is that public finances appeared to deteriorate during the quarter ending 31 December 2010. The economic figures therefore cast doubt on whether the Government will be able to meet its borrowing forecast of £149 billion this year.
3. Activity surveys suggested that the recovery still has a reasonable amount of momentum. The surveys suggested that the recovery weakened in the construction sector, but strengthened in the larger manufacturing sector. Gross Domestic Product (GDP) expanded by 0.7% in the third quarter of 2010. Further doubt has been cast on the sustainability of the recovery in the labour market though as unemployment rose by 35,000 in the three months to October. However, latest figures released on 25th January 2011 show GDP reduce to -0.5% for the last quarter.
4. The Monetary Policy Committee (MPC) voted to keep official interest rates on hold at 0.5% during the quarter and to not increase its programme of asset purchases under the Bank's quantitative easing (QE) programme. The Bank of England's quarterly inflation report suggested that most members thought that there was an increased risk that CPI inflation would overshoot the 2% target at the two year horizon.
5. The UK's trade deficit widened further during the quarter and the overall deficit also grew. The balance of trade in goods deficit rose from £8.4 billion to £8.5 billion in October.
6. Inflationary pressures continued to rise during the quarter. Consumer Price Inflation (CPI) edged up from 3.1% to 3.2% in October and then to 3.3% in November. House prices have also continued to fall during the quarter.

Economic Forecast

7. The Council receives its treasury advice from Sector Treasury Services. Their latest interest rate forecasts are shown below:

	Mar 2011 %	June 2011 %	Sept 2011 %	Dec 2011 %	Mar 2012 %	June 2012 %	Sept 2012 %	Dec 2012 %	Mar 2013 %
Bank Rate	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.75	2.25
5yr PWLB rate	3.30	3.30	3.40	3.50	3.60	3.80	3.90	4.10	4.30
10yr PWLB rate	4.40	4.40	4.40	4.50	4.70	4.80	4.90	5.00	5.10
25yr PWLB rate	5.20	5.20	5.20	5.30	5.30	5.40	5.40	5.40	5.50
50yr PWLB rate	5.20	5.20	5.20	5.30	5.30	5.40	5.40	5.40	5.50

8. Sector believes the Bank Rate will remain at its current low level of 0.50% before rising to 0.75% in December 2011. The Bank Rate is then expected to gradually increase to reach 2.25% by the end of March 2013.
9. Long term PWLB rates are expected to steadily increase over time to reach 5.50% by March 2013 due to high gilt issuance in the UK and the high volume of debt issuance in other major western countries.
10. There is considerable uncertainty in all forecasts due to the speed of economic recovery in the US and EU, the degree to which government austerity programmes will dampen economic growth, the potential for more quantitative easing and the timing of this in both the UK and US, the potential for a major EU sovereign debt crisis and the speed of recovery of banks profitability and balance sheet position.

Treasury Management Strategy

11. The Treasury Management Strategy (TMS) for 2010/11 was approved by Full Council in February 2010. The Council's Annual Investment Strategy, which is incorporated in the TMS, outlines the Council's investment priorities as the security and liquidity of its capital.
12. The Council aims to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (up to 1 year), and only invest with highly credit rated financial institutions using the Sector's suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information provided by Sector. The Treasury Team continue to take a prudent approach keeping investments short term and with the most highly credit rated organisations.
13. In the third quarter of 2010/11 the internal treasury team outperformed its benchmark by 0.40%. The investment return was 0.74% compared to the benchmark of 0.34%. This amounts to additional income of £115,000 during the quarter which is included in the Council's projected outturn position in the monthly revenue monitor.
14. A full list of investments held as at 31 December 2010, compared to Sector's counterparty list, and changes to Fitch, Moody's and Standard & Poor's credit ratings are shown in Appendix A. None of the approved limits within the Annual Investment Strategy were breached during the third quarter of 2010/11. Officers continue to monitor the credit ratings of institutions on a daily basis. Delegated authority has been put in place to make any amendments to the approved lending list.
15. As illustrated in the economic background section above, investment rates available in the market are at an historical low point. The average level of funds available for investment purposes in the third quarter of 2010/11 was £115 million which is consistent with other local authority's investment balances.
16. The Council's budgeted investment income for 2010/11 is £1.09 million. The interest receivable on cash balances is currently projecting to under achieve against the budget by £437,000 due to the historically low interest rates currently available. This position does however assume that the Council will undertake all borrowing required for the capital programme during the year. The expenditure on the capital programme continues to be monitored closely and any borrowing required will be taken as late as possible to reduce interest costs.

Borrowing

17. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Prudential Indicators (affordability limits) are outlined in the TMS. A list of the approved limits is shown in Appendix B. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.
18. Officers can confirm that the Prudential Indicators were not breached during the third quarter of 2010/11. Although net borrowing was slightly higher than anticipated it was still well below the Capital Financing Requirement and within the Authorised borrowing limit of the Council. The Internal Treasury team made loans totalling £200m during the quarter and £215m was repaid during the quarter.
19. Sector's target rate for new long term borrowing (25 years) for the third quarter of 2010/11 started at 4.20% and ended at 5%. Due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new external borrowing of £15.2 million is required in 2010/11. No borrowing has currently been undertaken to date. As outlined below, interest rates have gradually increased during the quarter across all bands. This was due to the PWLB policy change following the spending review on 20th October where the interest rates on all new loans was increased to an average of 1% above Government's cost of borrowing, this means all the Council's future PWLB borrowing will be increased by up to 1%. The high points were seen in late December.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.61%	1.81%	3.07%	3.98%	4.04%
Date	20/10/10	12/10/10	12/10/10	04/10/10	04/10/10
High	1.77%	3.45%	4.75%	5.46%	5.43%
Date	29/12/10	16/12/10	16/12/10	15/12/10	15/12/10
Average	1.41%	2.82%	4.13%	4.98%	4.99%

20. The economic assumptions and interest rate forecasts included within this report will be used to inform the budget strategy for 2011/12 and Medium Term Financial Plan.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

Council, 25 February 2010, Treasury Strategy 2010/11
 Strategic Overview & Scrutiny, 8th September 2010, Treasury Management Update Quarter 1 2010/11.
 Cabinet, 15th September 2010, Treasury Management Update Quarter 1 2010/11.
 Cabinet, 10th November 2010, Treasury Management Update Quarter 2 2010/11.

Human Rights Act Appraisal

The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998

Environmental Appraisal

N/A

Community / Consultations Appraisal

N/A

Risk Management Appraisal

Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with comprehensive and rigorous internal controls will enable

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the Council to manage the risk associated with Treasury Management activities and the potentials for financial loss.

Cabinet Member:

Mike Owen, Portfolio Holder

Local Member

N/A

Appendices

A. Investment Report as at 31 December 2010

B. Prudential Limits

C. Prudential Borrowing Schedule