Shropshire Council

Committee and Date	Item
Cabinet 16 November 2011 12.30 pm	**10** Public

TREASURY MANAGEMENT UPDATE – QUARTER 2 2011/12

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1. Summary

1.1. 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.

1.2. During the second quarter of 2011/12 the internal treasury team achieved a return of 0.98% on the Council's cash balances outperforming the benchmark by 0.59%. This amounts to additional income of £141,600 during the quarter which is included within the Council's projected outturn position in the monthly revenue monitor.

2. Recommendations

2.1. Members are asked to accept the position as set out in the report.

REPORT

3. Risk Assessment and Opportunities Appraisal

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

3.2. There are no direct environmental, equalities or climate change consequences arising from this report.

3.3. 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 the rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4. Financial Implications

4.1. There are no direct financial implications arising from this report.

5. Background

5.1. 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 1 July 2011 and 30 September 2011.

6. Economic Background

6.1. Sector's view is that the economic recovery in the UK has ground to a halt during the quarter. Indicators suggest that the economy has at best stagnated. Conditions on the high street have deteriorated further and the levels of employment have fallen again. The pace of job losses across the whole economy looks unlikely to ease off in the coming months. In the US and the eurozone, economic recovery has also lost a significant amount of momentum.

6.2. Conditions in the housing market have also continued to deteriorate. Whilst the number of mortgage approvals for new house purchases rose during the quarter this has not prevented renewed falls in house prices.

6.3. Inflationary pressures continued to rise during the quarter. Consumer Price Inflation (CPI) rose from 4.2% in June to 4.4% in July and 4.5% in August. A series of rises in electricity and gas prices also took effect in late August and September which, together with a rise in food inflation, could push inflation close to 5% in September.

6.4. 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. However, since the end of the quarter the MPC decided to increase its QE programme by a further £75 billion, this clearly underlines how concerned the MPC now is about the prospects for growth of the UK economy. Most MPC members still think that the rise in inflation will only be temporary and that inflation will fall back sharply next year. So despite the worsening near term inflation outlook, the weakness of the activity data has pushed members further away from an interest rate rise.

6.5. Financial market sentiment deteriorated sharply in the second quarter, reflecting declining prospects for economic growth and renewed risk aversion as a result of the eurozone sovereign debt crisis. The FTSE 100 index finished the quarter 14% lower than its level at the end of the first quarter.

7. Economic Forecast

7.1. The Council receives its treasury advice from Sector Treasury Services.

Sector has recently undertaken a review of their interest rate forecasts as a result of two major events. The decision by the MPC to expand quantitative easing over the next four months by a further £75 billion had an immediate effect of reducing long term borrowing rates and the marked deterioration of growth prospects in the US, EU and UK, especially as concerns have further increased over Greece and the potential fall out from their debt situation also depressed PWLB rates to even lower levels. Their latest interest rate forecasts to 31 March 2015 are shown below:

Sector's Interest Rate View	Now	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
5yr PWLB Rate	2.41%	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
10yr PWLB Rate	3.46%	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
25yr PWLB Rate	4.31%	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
50yr PWLB Rate	4.42%	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%

7.2. Sector believes the Bank Rate will remain at its current low level of 0.50% until September 2013 when it is expected to rise to 0.75%. The Bank Rate is then expected to gradually increase to reach 1.25% by 31 March 2014 and 2.5% by 31 March 2015.

7.3. Long term PWLB rates are expected to fall slightly to 4.30% in December 2011 before steadily increasing over time to reach 5.30% by 31 March 2015 due to high gilt issuance in the UK and the high volume of debt issuance in other major western countries.

7.4. 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.

8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2011/12 was approved by Full Council on 24 February 2011. 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.

8.2. 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. This approach has been endorsed by our external advisors, Sector.

8.3. In the second quarter of 2011/12 the internal treasury team outperformed its benchmark by 0.59%. The investment return was 0.98% compared to the benchmark of 0.39%. This amounts to additional income of £141,600 during the quarter which is included in the Council's projected outturn position in the monthly revenue monitor.

8.4. A full list of investments held as at 30 September 2011, 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 second quarter of 2011/12. 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.

8.5. 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 second quarter of 2011/12 was £96 million.

8.6. The Council's interest receivable/payable budgets are currently projecting a surplus of £163,000 due to no long term borrowing being undertaken to date.

9. Borrowing

9.1. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy. 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.

9.2. The Prudential Indicators were not breached during the second quarter of 2011/12 and have not been previously breached. The Internal Treasury team made loans totalling £94 million during the quarter and £99 million was repaid during the quarter.

9.3. Sector's target rate for new long term borrowing (25 years) for the second quarter of 2011/12 started at 5.40% and ended at 5.10%. Due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new external borrowing of £8 million (excluding HRA) is required in 2011/12, however no long term borrowing has been undertaken to date. As outlined below, borrowing rates have fallen during the quarter across all bands. The low points during the quarter were seen in the latter part of September. The high points were seen on the 1 July 2011.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.42%	2.18%	3.31%	4.41%	4.54%
Date	23/09/11	13/09/11	13/09/11	23/09/11	23/09/11
High	1.64%	3.17%	4.50%	5.28%	5.25%
Date	01/07/11	01/07/11	01/07/11	01/07/11	01/07/11
Average	1.50%	2.59%	3.82%	4.84%	4.88%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) Cabinet 03 August 2011, Treasury Management Update Quarter 1 2011/12. Council, 24 February 2011, Treasury Strategy 2011/12.
Cabinet Member: Keith Barrow, Leader of the Council
Local Member N/A
Appendices A. Investment Report as at 30 September 2011 B. Prudential Limits C. Prudential Borrowing Schedule

Appendix A

SECTOR

Appendix A

Shropshire Council

Monthly Investment Analysis Review

September 2011

Monthly Economic Summary

General Economy

UK manufacturing shrank at its fastest pace in over two years in August. The PMI Manufacturing Index fell from an upwardly revised 49.4 (July) to 49 (August), its weakest level since June 2009. More concerning was the data for the dominant service sector, slowing at its fastest pace for a decade. The PMI Services Index fell from 55.4 (July) to 51.1 (August). The Bank of England unsurprisingly maintained interest rates at 0.5%, which they have continued to do since March 2009. The Monetary Policy Committee decisively voted 9-0 in favour of no rate change and hinted at reintroducing Quantitative Easing, possibly as soon as October, to provide a boost to the stalling economy. Consumer Price Index (CPI) rose by 0.1% in August, with the annual rate at 4.5%. The main drivers behind the increase were record annual increases in clothing, footwear, furniture and the biggest rise in household bills in 2 years. Retail sales remained flat, with a 0.2% fall in August. High inflation and suppressed wage growth continues to force consumers to reduce spending. However, the Office of National Statistics stated the effects of the widespread riots in August, which caused some store closures, were difficult to quantify. Public Sector Net Borrowing (PSNB) hit a high for the month of August, £15.934bn, driven by higher government spending. However, previous month's borrowing was revised down, which meant borrowing for the year to date currently stands at £51.482bn. The International Monetary Fund (IMF) cut the UK growth forecast from 1.5% to 1.1%. The IMF stated the global economy is entering a new dangerous phrase and recovery has considerably weakened, requiring strong polices to improve the outlook and reduce risk. The GfK Consumer Confidence Index increased for the first time in four months, rising to -30 from -31, as Britons become more optimistic about the economic outlook.

Housing Market

According to Halifax, house prices fell by 1.2% in August and were 2.6% lower in the three months to August compared to a year-ago. Halifax housing economist, Martin Ellis, said that low interest rates continue to support the market, but a gloomy economic outlook and pressures on household finances will constrain demand. However, he expects broad stability in both prices and activity over the coming months. Nationwide said that house prices rose just 0.1% in September, with prices down 0.3% compared to a year ago. Nationwide's chief economist, Robert Gardner, stated he expects the market to be relatively flat for the rest of the year, although downside risks have increased. The number of mortgages granted to homebuyers rose to 35,226 in August from the revised 33,734 in July, according to the British Bankers' Association. Figures from the Bank of England also showed that mortgage approvals had risen, hitting their highest level since December 2009 (52,410 in August, up from an upwardly revised 49,664 in July).

Currency

Sterling began the month at \$1.6184 against the pound and continued on a downward trend for most of the month until it reached a low of \$1.5345 (22/09/11), ending the month at \$1.562. The drivers behind the movement in the £/\$ was Quantitative Easing expectations intensifying and growing concerns about the European debt crisis leading to increased demand for the dollar (flight to safety). Sterling had a volatile month against the euro, rising from €1.1351 at that start of the month, to end the month at €1.1549, whilst peaking at €1.1628 (09/09/11). The European debt crisis and concerns about the UK's economy were the primary forces behind the fluctuations.

Forecast

Sector maintained its bank rate forecast, expecting a 0.25% increase in Q4 of 2012, followed by a further three consecutive 0.25% increases. Expecting the bank rate to be 1.5% in Q3 of 2013. UBS revised their forecast, expecting the base rate to remain at 0.5% throughout 2012. Capital Economics kept its forecast, believing the bank rate will remain unchanged to at least 2013.

Bank Rate	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
Sector	0.50%	0.50%	0.50%	0.50%	0.75%
UBS	0.50%	0.50%	0.50%	0.50%	0.50%
Capital Economics	0.50%	0.50%	0.50%	0.50%	0.50%

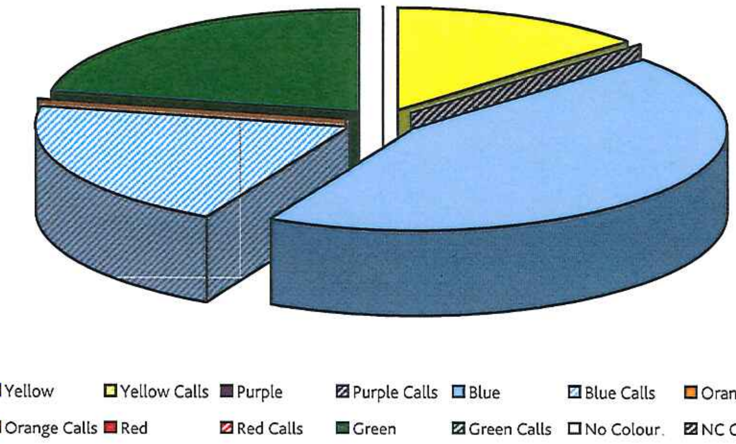
Shropshire Council

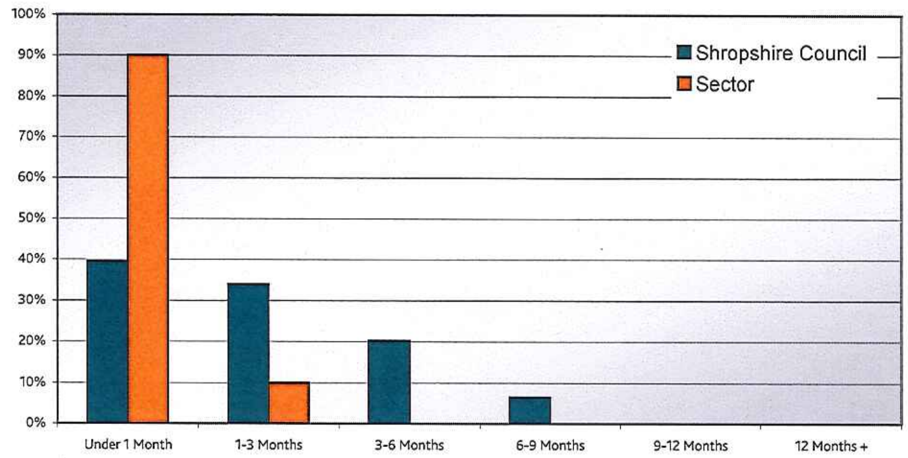
Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date
NatWest	16,250,000	1.00%		Call
Clydesdale Bank	2,520,000	0.50%	05/09/2011	05/10/2011
Southampton City Council	2,000,000	0.40%	06/09/2011	14/10/2011
Southampton City Council	2,000,000	0.40%	06/09/2011	20/10/2011
Birmingham City Council	5,000,000	0.40%	07/09/2011	20/10/2011
Barclays	2,080,000	0.63%	07/09/2011	31/10/2011
Lloyds TSB	4,320,000	1.25%	03/08/2011	04/11/2011
Clydesdale Bank	4,110,000	0.73%	04/08/2011	04/11/2011
Lloyds TSB	1,520,000	1.25%	08/08/2011	08/11/2011
Nationwide BS	5,960,000	0.76%	10/08/2011	11/11/2011
Lloyds TSB	5,000,000	2.00%	15/12/2010	14/12/2011
Nationwide BS	2,540,000	0.83%	15/09/2011	14/12/2011
Lloyds TSB	3,260,000	1.25%	21/09/2011	20/12/2011
Lloyds TSB	5,900,000	1.46%	14/07/2011	20/01/2012
RBS	5,000,000	1.00%	06/07/2011	31/01/2012
Lloyds TSB	5,000,000	2.00%	04/02/2011	03/02/2012
Lloyds TSB	5,000,000	2.08%	02/06/2011	31/05/2012
Blaenau Gwent BC	1,200,000	0.45%	26/09/2011	03/11/2011
Total Investments	**£78,660,000**	**1.12%**		

Shropshire Council

Portfolio Breakdown by Sector's Suggested Lending Criteria





Y	P	B	O	R	G	N/C
1	2	3	4	5	6	7
Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 3mths	No Colour

Portfolios weighted average risk number = 3.4

WARoR = Weighted Average Rate of Return
WAM = Weighted Average Time to Maturity

	% of Portfolio	Amount	% of Colour in Calls	Amount of Colour in Calls	% of Call in Portfolio	WARoR	WAM	WAM at Execution	Excluding Calls/MMFs WAM	Excluding Calls/MMFs WAM at Execution
Yellow	12.97%	£10,200,000	0.00%	£0	0.00%	0.41%	16	37	16	37
Purple	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Blue	65.15%	£51,250,000	31.71%	£16,250,000	20.66%	1.40%	78	165	114	242
Orange	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Red	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Green	21.88%	£17,210,000	0.00%	£0	0.00%	0.71%	38	78	38	78
No Colour	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
	100.00%	£78,660,000	20.66%	£16,250,000	20.66%	1.12%	61	130	77	163

Shropshire Council

Monthly Credit Rating Changes
FITCH

Date	Update Number	Institution	Country	Rating Action
16/09/2011	957	UBS AG	Switzerland	Individual and Viability Ratings placed on 'Negative Watch'
28/09/2011	964	Intesa Sanpaolo	Italy	LT Outlook changed to 'Negative' from 'Stable'
28/09/2011	964	Banca IMI SpA	Italy	LT Outlook changed to 'Negative' from 'Stable'
30/09/2011	966	Clydesdale Bank	U.K	LT Rating downgraded to 'A+' from 'AA-', ST Rating downgraded to 'F1' from 'F1+', Viability Rating downgraded to 'bbb' from 'bbb+'

Monthly Credit Rating Changes

MOODY'S

Date	Update Number	Institution	Country	Rating Action
14/09/2011	953	Societe Generale	France	LT Rating downgraded to 'Aa3' from 'Aa2' and removed from 'Under Review for Possible Downgrade' to 'Negative Outlook'
14/09/2011	954	Credit Agricole SA	France	LT Rating downgraded to 'Aa2' from 'Aa1', FSR downgraded to 'C' from 'C+'
15/09/2011	955	Calyon Corporate and Investment Bank	France	LT Rating Remain Under Review but Direction Uncertain
16/09/2011	956	UBS AG	Switzerland	LT placed 'Under Review for Possible Downgrade' from 'Negative Outlook', FSR placed 'Under Review for Possible Downgrade' from 'Negative Outlook'
16/09/2011	956	USB Limited	U.K	LT placed 'Under Review for Possible Downgrade' from 'Negative Outlook'
21/09/2011	960	Fortis Bank	Belgium	LT Rating placed 'Under Review for Possible Downgrade', FSR Outlook changed to 'Positive' from 'Negative'
22/09/2011	961	Bank of America NA	USA	LT Rating downgraded to 'A2' from 'Aa3' and Outlook changed to 'Negative' from 'Under Review for Possible Downgrade'
22/09/2011	961	Wells Fargo Bank NA	USA	LT Rating downgraded to 'Aa3' from 'Aa2' and Outlook changed to 'Negative' from 'Under Review for Possible Downgrade'
22/09/2011	963	Citibank NA	USA	LT Rating removed from 'Under Review for Possible Downgrade' and assigned 'Negative Outlook'
28/09/2011	965	Clydesdale Bank	U.K	LT Rating downgraded to 'A2' from 'A1' and remains 'Under Review for Possible Downgrade', ST Rating placed 'Under Review for Possible Downgrade'

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Monthly Credit Rating Changes

S&P

Date	Update Number	Institution	Country	Rating Action
16/09/2011	958	UBS AG	Switzerland	LT Rating placed on Negative Watch
16/09/2011	958	UBS Limited	U.K	LT Rating placed on Negative Watch
20/09/2011	959	Italy Sovereign Rating	Italy	Sovereign Rating downgraded to 'A' from 'A+'
22/09/2011	962	Intesa Sanpaolo	Italy	LT Rating downgraded to 'A' from 'A+'
22/09/2011	962	Banca IMI SpA	Italy	LT Rating downgraded to 'A' from 'A+'

Appendix B

Prudential Indicators – Quarter 1 to 4 2011/12

Prudential Indicator	2011/12 Indicator £m	Quarter 1 – Actual £m	Quarter 2 – Actual £m	Quarter 3 – Actual £m	Quarter 4 – Actual £m
Capital Financing Requirement (CFR)	299	283*	286*		
Gross borrowing	298	278	278		
Investments	90	85	79		
Net borrowing	208	193	199		
Authorised limit for external debt	453	278	278		
Operational boundary for external debt	383	278	278		
Limit of fixed interest rates (borrowing)	348	278	278		
Limit of variable interest rates (borrowing)	174	0	0		
Principal sums invested > 364 days	40	0	0		
Maturity structure of borrowing limits	%	%	%		
Under 12 months	15	0	0		
12 months to 2 years	15	3	3		
2 years to 5 years	45	9	9		
5 years to 10 years	75	9	9		
10 years and above	100	79	79		

* Based on period 6 Capital Monitoring report (excluding PFI)

Reconciliation of Prudential Borrowing approvals and years applied/schemes applied to

APPENDIX C

Appendix C

Prudential Borrowing Approvals	Date Approved	Amount Approved £	Applied (Spent) 2006/07 £	Applied (Spent) 2007/08 £	Applied Outturn 08/09 2008/09 £	Applied Outturn 09/10 2009/10 £	Applied Outurn 10/11 2010/11 £	Budgeted Period 6 11/12 2011/12 £	Budgeted Period 6 11/12 2012/13 £	Budgeted Period 6 11/12 2013/14 £	Budgeted Period 6 11/12 2014/15 £	First year MRP Charged	Asset Life	Final year MRP Charged
Monkmoor Campus	24/02/2006	3,580,000												
Capital Receipts Shortfall -Cashflow	24/02/2006	5,000,000												
Applied:														
Monkmoor Campus			3,000,000		0							2007/08	25	2031/32
William Brooks					0		3,580,000					2011/12	25	2035/36
Tern Valley					2,000,000							2010/11	35	2044/45
		8,580,000	**3,000,000**	**0**	**2,000,000**	**0**	**3,580,000**	**0**	**0**	**0**	**0**			
Highways	24/02/2006	2,000,000	2,000,000									2007/08	20	2026/27
Accommodation Changes	24/02/2006	650,000	410,200	39,800								2007/08	6	2012/13
Accommodation Changes - Saving	31/03/2007	(200,000)												
		450,000	**410,200**	**39,800**	**0**	**0**	**0**	**0**	**0**	**0**	**0**			
Waste Management Site - Oswestry	29/06/2007	712,500												
Waste Management Site - Oswestry	20/06/2008	(712,500)												
		0	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**			
William Brooks	18/07/2008	0					-					2011/12	25	2035/36
Primary School Capital Programme	19/12/2008	0					-	-				2012/13	25	2036/37
The Ptarmigan Building	05/11/2009	3,744,000				3,744,000						2010/11	25	2034/35
The Mount McKinley Building	05/11/2009	2,782,000				2,782,000						2011/12	25	2035/36
The Mount McKinley Building	05/11/2009	0					-					2011/12	5	2015/16
Capital Strategy Schemes - Capital Receipts shortfall	25/02/2010	9,283,042					-	-	6,407,442	2,688,000	-		25	
- Desktop Virtualisation						187,600	-					2010/11	5	2014/15
Carbon Efficiency Schemes/Self Financing	25/02/2010	5,799,348					115,656	2,908,692	1,725,000	550,000	500,000		5	
New School Amalgamations - Self Financing	25/02/2010	9,000,000							3,000,000	3,000,000	3,000,000			
Renewables - Biomass - Self Financing	14/09/2011	2,662,230						95,000	2,567,230			2013/14	25	2037/38
Solar PV Council Buildings - Self Financing	11/05/2011	5,200,000						100,000	3,272,000	1,828,000		2013/14	25	2038/39
Previous NSDC Borrowing		955,595			821,138	134,457	-	-				2009/10	5/25	
		50,456,215	**5,410,200**	**39,800**	**2,821,138**	**6,848,057**	**3,695,656**	**3,103,692**	**16,971,672**	**8,066,000**	**3,500,000**			
MRP Charged			0.00	(288,367.00)	(296,326.67)	(339,361.72)	(589,162.85)	(860,518.50)	(1,442,256.50)	(2,328,597.04)	(2,726,500.13)			
Prudential Borrowing CFR				**5,161,632.52**	**7,686,443.86**	**14,195,138.94**	**17,301,632.44**	**19,544,805.59**	**35,074,221.09**	**40,811,624.05**	**41,585,123.92**			