

**Committee and Date**

Cabinet
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Item

10

Public

TREASURY MANAGEMENT UPDATE – QUARTER 2 2013/14

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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, Capita Asset Services (formerly Sector Treasury Services). It also updates Members on the internal treasury team's performance.
- 1.2. During the second quarter of 2013/14 the internal treasury team achieved a return of 0.55% on the Council's cash balances outperforming the benchmark by 0.29%. This amounts to additional income of £106,000 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. The Council makes assumptions about the levels of borrowing and investment income over the financial year. Reduced borrowing as a result of capital receipt generation, or delays in delivery of the capital programme will both have a positive impact of the council's cash position. Similarly, higher than benchmarked returns on available cash will also help the Council's financial position. For monitoring purposes, assumptions are made early in year about borrowing and returns based on the strategies agreed by Council in the preceding February. Performance outside of these assumptions result in increased or reduced income for the Council.
- 4.2. The Quarter 2 performance is above benchmark and has delivered additional income of £106,000 which will be reflected in the Period 6 Revenue Monitor.
- 4.3. The Council currently has £125.8m held in investments as detailed in Appendix A and borrowing of £353m at fixed interest rates.

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 2013 and 30 September 2013.

6. Economic Background

- 6.1. After strong growth of 0.7% in the previous quarter the UK economy looks likely to grow even more strongly in the second quarter. The pick-up in economic growth appears to have supported the labour market, with employment rising by 80,000 in the 3 months to July.
- 6.2. The big news in financial markets was that the US Federal Reserve unexpectedly decided not to taper its asset purchases in September. In announcing its decision to maintain monthly purchases of \$85 billion, the Fed explained that it wanted to await more evidence that the economic recovery will be sustained before adjusting the pace of its purchases. This came despite previous hints of tapering from the Fed and the fall in the unemployment rate in July and August.
- 6.3. Inflationary pressures eased during the quarter. Consumer Price Inflation (CPI) fell from a 2013 peak of 2.9% in June to 2.7% in August, driven by a drop in the contribution from energy prices.
- 6.4. The new Governor of the Bank of England, Mark Carney, took office in July. Alongside the August Quarterly Inflation Report, the Bank introduced its new policy of forward guidance in which the Monetary Policy Committee (MPC) pledged not to raise official interest rates, or reduce the size of the asset purchase facility, until the unemployment rate falls to 7%. On current forecasts this is most likely to reach this level in late 2016.

6.5. Meanwhile, Eurozone business surveys suggested that the economy continued to grow in the second quarter, albeit at a moderate pace. There was a general election in Germany in which the incumbent Chancellor, Angela Merkel, performed better than expected by winning 41.5% of the vote. She is now likely to form a coalition, but it remains to be seen what form this will take.

7. Economic Forecast

7.1. The Council receives its treasury advice from Capita Asset Services (formerly Sector Treasury Services). Their latest interest rate forecasts to 30 June 2015 are shown below:

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%
5yr PWLB rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%
10yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%
25yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%
50yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%

7.2. Capita undertook a review of its interest rate forecasts in late September as a result of an increase in confidence in economic recovery, mainly in the US, but more recently, also in the UK and the Eurozone. The latest forecast now includes a first increase in Bank Rate in quarter 3 of 2016 therefore it will remain at its current low level of 0.50% for the foreseeable future.

7.3. Long term PWLB rates are expected to rise to 4.50% in September 2014 before steadily increasing over time to reach 4.80% by 30 June 2015 due to the marked recovery in confidence in equity markets, anticipating stronger economic recovery in America, supported by growth in the Far East.

7.4. Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely during the remainder of 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds. The overall balance of risks to economic recovery in the UK is currently weighted to the upside after five months of robust good news on the economy. However, only time will tell just how long this period of strong economic growth will last. The above estimates are conservative and also reflect a prolonged, but successful management of the Eurozone crisis.

8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2013/14 was approved by Full Council on 28 February 2013. 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 Capita'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, Capita Asset Services.
- 8.3. In the second quarter of 2013/14 the internal treasury team outperformed its benchmark by 0.29%. The investment return was 0.55% compared to the benchmark of 0.26%. This amounts to additional income of £106,000 during the quarter which is included in the Council's projected outturn position in the monthly revenue monitor. The Internal Treasury team made loans totalling £228 million during the quarter and £235 million was repaid during the quarter.
- 8.4. A full list of investments held as at 30 September 2013, compared to Capita'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 2013/14. 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 first quarter of 2013/14 was £146.7 million.

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 Prudential Indicators were not breached during the second quarter of 2013/14 and have not been previously breached. The schedule at Appendix C details the Prudential Borrowing approved and utilised to date.
- 9.2. Capita's target rate for new long term borrowing (25 years) for the second quarter of 2013/14 rose from 4.10% to 4.40%. As outlined below, borrowing rates rose during the quarter. The low points during the quarter were seen during July. The high points were seen in September 2013. No new external borrowing is required in 2013/14 due to a review of the Capital Programme.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.98%	1.95%	3.17%	4.19%	4.27%
Date	18/07/2013	18/07/2013	18/07/2013	18/07/2013	18/07/2013
High	1.17%	2.6%	3.79%	4.48%	4.51%
Date	18/09/2013	11/09/2013	11/09/2013	11/09/2013	11/09/2013
Average	1.07%	2.27%	3.47%	4.32%	4.37%

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

Council, 28 February 2013, Treasury Strategy 2013/14.

Cabinet, 24 July 2013, Treasury Management Update Quarter 1 2013/14

Cabinet Member:

Keith Barrow, Leader of the Council

Local Member

N/A

Appendices

A. Investment Report as at 30 September 2013

B. Prudential Limits

C. Prudential Borrowing Schedule