Shropshire Council

Committee and Date	Item
Cabinet 13 November 2013 12.30 pm *Audit Committee* *12 December 2013* *Council* *19 December 2013*	**11** Public

TREASURY STRATEGY 2013/14 – MID YEAR REVIEW

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1. Summary

1.1 This mid year Treasury Strategy report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management 2011 and covers the following:-

- An economic update for the first six months of 2013/14
- A review of the Treasury Strategy 2013/14 and Annual Investment Strategy
- A review of the Council's investment portfolio for 2013/14
- A review of the Council's borrowing strategy for 2013/14
- A review of any debt rescheduling undertaken
- A review of compliance with Treasury and Prudential limits for 2013/14

1.2 The key points to note are:-

- 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 £217,000 for the first six months of the year which is included within the Council's projected outturn position.

- In the first six months all treasury management activities have been in accordance with the approved limits and prudential indicators set out in the Council's Treasury Strategy.

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 six monthly performance is above benchmark and has delivered additional income of £217,000 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 the activities, and the pursuit of optimum performance consistent with those risks". The report informs Members of the treasury activities of the Council for the first six months of the financial year.

5.2 The CIPFA Code of Practice on Treasury Management 2011 was adopted by Council in February 2012 and the primary requirements of the Code were outlined in the Treasury Strategy 2012/13.

6. Economic update

6.1 **Global Economy** – Financial markets sold off sharply following comments from Ben Bernanke (the US Central Bank chairman) that suggested the US Central Bank may 'taper' its asset purchases earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK. Equity prices fell initially too, as US Central Bank purchasing of bonds has served to underpin investor moves into equities out of low yielding bonds. However, as the market moves to realign its expectations, bond yields and equities are likely to rise further in the expectation of a continuing economic recovery. In September the US Central Bank surprised financial markets by not starting tapering as it felt the run of economic data in recent months had been too weak to warrant taking early action. Bond yields fell sharply as a result, though it still only remains a matter of time until tapering does start. The tension in the US over passing a Federal budget for the new financial year starting on 1 October and raising the debt ceiling in mid-October also affected financial markets in the second quarter.

6.2 Tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a renewed flare-up. Economic survey data improved consistently over the first half of the year, pointing to a return to growth and ending six quarters of Eurozone recession.

6.3 The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis, the frail and unstable Italian political situation and the weak growth or recession in the UK's main trading partners (EU & US) make economic forecasting for the next six months very difficult with so many external influences weighing on the UK.

6.4 Geopolitical risks e.g. Syria, Iran, North Korea could also trigger safe haven flows from equities into bonds which would have an impact on UK gilt yields and PWLB rates over the next six months. .

6.5 **UK Economy** – During 2013/14 economic indicators suggested that the economy is recovering, albeit from a low level. After avoiding recession in the first quarter of 2013, with a 0.3% quarterly expansion the economy grew 0.7% in quarter 2. There have been signs of renewed vigour in household spending in the summer, with a further pick-up in retail sales, mortgages, house prices and new car registrations.

6.6 The Monetary Policy Committee (MPC) has kept the Bank Rate at its historically low level of 0.5% while quantitative easing remained at £375 billion. In August the MPC provided forward guidance that the Bank Rate is unlikely to change until unemployment first falls to 7%, which was not expected until mid-2016. However, 7% is only a point at which the MPC will review Bank Rate, not necessarily take action to change it. The 3 month average unemployment rate to July was 7.7% therefore investment returns will continue to be depressed.

6.7 Consumer Price Inflation (CPI) fell marginally from its peak of 2.9% in June to 2.7% in August. The Bank of England expects inflation to fall back to its target of 2% in 2015.

7 Economic Forecast

7.1 The Council receives its treasury advice from Capita Asset Services (formerly Sector Treasury Services). Their latest interest rate forecasts 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 believes the Bank Rate will remain at its current low level of 0.50% until September 2016 before rising to 1% in December 2016. This means investment returns will continue to be at historically low levels during this period. The Bank Rate is then expected to reach 1.25% by 31 March 2017.

7.3 Long term PWLB rates are expected to rise slightly to 4.50% in September 2014 before steadily increasing over time to reach 4.80% by 30 June 2015 due to high gilt issuance in the UK and the high volume of debt issuance in other major western countries.

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 Strategy update

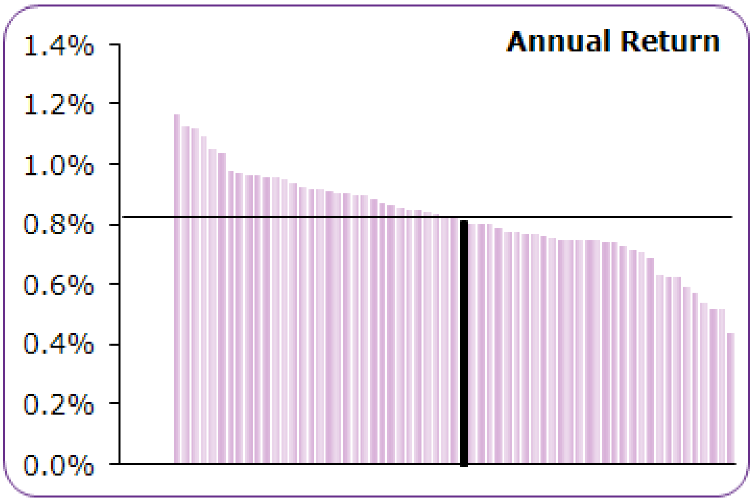
8.1 The Treasury Management Strategy (TMS) for 2013/14 was approved by Full Council on 28 February 2013. This Treasury Strategy does not require updating as there are no policy changes or any changes required to the prudential and treasury indicators previously approved.

9. Annual Investment Strategy update

9.1 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. As outlined in paragraph 6 & 7 above there is still considerable uncertainty and volatility in the financial and banking market, both globally and in the UK. In this context it is considered that the Annual Investment Strategy approved on 28 February 2013 is still fit for purpose in the current economic climate.

9.2 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 Capita. 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.

10.3 In the first six months 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 £217,000 during the first six months which is included within the Council's projected outturn position. The black bar in the table below show's a comparison of Shropshire Council's investment performance compared to other Local Authorities for 2012/13. There is very little difference in percentage terms (0.35%) between the top performing Authority and Shropshire Council. The reason for the difference is because some Authorities permit investments for longer than 1 year which attracts a higher return but also increases risk. In the current economic environment and the continued risk of counterparty default, Shropshire Council takes a prudent approach and only invests for a maximum period of 1 year until market conditions stabilise further. The main priority continues to be the security of capital invested.



10.4 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 **<u>Appendix A</u>**. None of the approved limits within the Annual Investment Strategy were breached during the first six months of 2013/14 and have not been previously breached. 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.

10.5 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 six months of 2013/14 was £146.7 million.

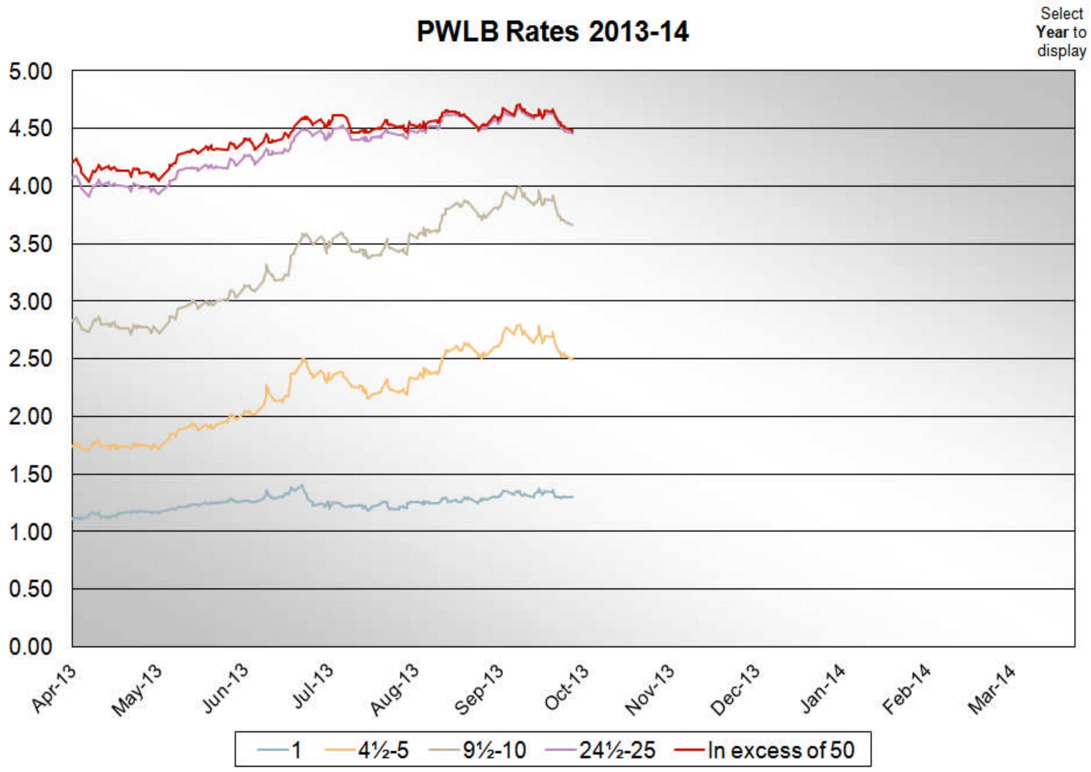
10.6 The Council's interest receivable/payable budgets are currently projecting a surplus of £1.2 million as reported in the monthly revenue monitoring reports due to no long term borrowing being undertaken and investment balances being higher than anticipated.

11. Borrowing

11.1 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.

11.2 Officers can confirm that the Prudential Indicators were not breached during the first six months of 2013/14 and have not been previously breached.

11.3 No new external borrowing is required in 2013/14 due to revisions to the capital programme. As outlined in the graph below, the general trend has been an increase in interest rates during the first six months of the year, across all bands, with the low points occurring in April. The high points were in late September.



11.4 During the first six months of the financial year there has been a lot of volatility in the financial markets and this has had an impact on the PWLB rates. Gilt yields remain vulnerable to pressures to rise, especially as they are powerfully influenced by US Treasury yields and American investors have been spooked by Chairman Bernanke's comments on tapering Quantitative easing. The Fed's reluctance to start tapering in September has potentially only delayed a trend for yields to rise.

12. Debt Rescheduling

12.1 Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. During the first six months of the year no debt rescheduling was undertaken.

13. Landsbanki Deposit Update

13.1 The latest position in relation to the £1 million deposit placed by Bridgnorth District Council with the Icelandic Bank, Landsbanki is that Shropshire Council has received four distributions amounting to around 55% of the total claim to date. The timing of any future distributions has still not been confirmed but the latest estimate is that the final payment may not be made until 2018.

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 30th September 2013 B. Prudential Limits C. Prudential Borrowing Schedule