Shropshire Council	**Committee and Date** Cabinet 11 February 2015 12.30 pm	**Item** **13** Public

TREASURY MANAGEMENT UPDATE – QUARTER 3 2014/15

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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 Councils Treasury Advisor, Capita Asset Services. It also updates Members on the internal treasury team's performance.

1.2. During the third quarter of 2014/15 the internal treasury team achieved a return of 0.57% on the Council's cash balances outperforming the benchmark by 0.27%. This amounts to additional income of £94,500 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 3 performance is above benchmark and has delivered additional income of £94,500 which will be reflected in the Period 9 Revenue Monitor.

4.3. The Council currently has £116 million held in investments as detailed in Appendix A and borrowing of £338 million 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 October 2014 and 31 December 2014.

6. Economic Background

6.1. After strong UK Gross Domestic Product (GDP) growth in 2013 at an annual rate of 2.7% and strong growth in the first two quarters of 2014, growth has eased back slightly during the third quarter. This has resulted in a downward revision of growth forecasts for 2015 and 2016, albeit growth will still remain strong for UK standards.

6.2. Also encouraging has been the sharp fall in Inflationary pressures. Consumer Price Inflation (CPI) fell to 1.0% in November, its lowest rate since September 2002 before falling even further to 0.5% in December due to the fall in the price of oil and food prices. Forward indications are that inflation is likely to remain below 1% for the best part of the year.

6.3. The Monetary Policy Committee (MPC) voted to keep official interest rates on hold at 0.5% during the quarter and voted not to increase its programme of asset purchases under the Bank's quantitative easing (QE) programme at its December meeting. The MPC minutes showed a consolidation of support for holding off on increasing the Bank Rate due to the fall in inflation.

6.4. As expected, the U.S. Federal Reserve ended its monthly asset purchases in October 2014 following strong economic growth over the last year which looks likely to continue going forward. It is therefore confidently predicted that the first increase in US interest rates will occur by the middle of 2015.

6.5. Meanwhile, the Eurozone is facing an increasing threat from deflation. In

November the inflation rate fell further to reach 0.3%. However, this is an average for all Eurozone countries and includes some countries with negative rates of inflation. Accordingly, the European Central Bank (ECB) did take some rather limited action in June and September to loosen monetary policy in order to promote growth and is currently expected to embark on quantitative easing early in 2015 to counter this threat of deflation and to stimulate growth.

7. Economic Forecast

7.1. The Council receives its treasury advice from Capita Asset Services. Their latest interest rate forecasts to 31 March 2018 are shown below:

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
5yr PWLB rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%

7.2. Capita undertook a review of its interest rate forecasts on 5 January 2015 after a proliferation of fears in financial markets around the plunge in the price of oil which caused a flight to quality from equities into bonds. These flows were compounded by further fears that Greece could be heading towards an exit from the Euro after the general election and financial flows generated by the increasing likelihood that the European Central Bank would soon be starting on full blown quantitative easing purchases of Eurozone government debt. The result of the combination of the above factors is that we have seen bond yields plunging to phenomenally low levels, especially in long term yields. These falls are unsustainable in the longer term but how quickly these falls will unwind is hard to predict. Their latest forecast now includes a first increase in Bank Rate to be in December 2015 instead of June 2015 as previously reported as a result of the sharp fall in inflation. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in the Bank Rate will be slow and gradual.

7.3. Long term PWLB rates are expected to rise from their current low levels to 4% in March 2016 before steadily increasing over time to reach 4.8% by 31 March 2018 due to the high volume of gilt issuance in the UK, and the bond issuance in other major western countries.

7.4. As the threat of potential risks from a number of sources still remains, caution must be exercised in respect of all interest rate forecasts at the current time. We are experiencing exceptional levels of volatility which are highly correlated to geo-political and sovereign debt crisis developments meaning PWLB rates and bond yields are so unpredictable at present.

8. Treasury Management Strategy

8.1. The Treasury Management Strategy (TMS) for 2014/15 was approved by Full Council on 27 February 2014. 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 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.

8.3. In the third quarter of 2014/15 the internal treasury team outperformed its benchmark by 0.27%. The investment return was 0.57% compared to the benchmark of 0.30%. This amounts to additional income of £94,500 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 £45 million during the quarter and £66 million was repaid during the quarter.

8.4. A full list of investments held as at 31 December 2014, 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 third quarter of 2014/15. 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 third quarter of 2014/15 was £140 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 2014/15 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 third quarter of 2014/15 fell from 4.1% to 3.9% in late October. No new external borrowing is currently required in 2014/15 although work is continuing to develop a new capital programme but the business cases for a number of proposed schemes are still in development and dependant on external decisions before the Council can make a commitment to them. Once this programme is finalised it will be presented to Council for consideration and the prudential borrowing implications updated in the Treasury Strategy. As outlined below, borrowing rates fell during the quarter. The low and high points during the quarter can be seen in the table below.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.12%	1.94%	2.54%	3.24%	3.22%
Date	31/12/2014	16/12/2014	16/12/2014	16/12/2014	16/12/2014
High	1.38%	2.56%	3.24%	3.85%	3.84%
Date	01/10/2014	01/10/2014	01/10/2014	01/10/2014	01/10/2014
Average	1.24%	2.23%	2.91%	3.60%	3.60%

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)
Cabinet, 30 July 2014, Treasury Management Update Quarter 1 2014/15
Cabinet, 10 December 2014, Treasury Management Update Quarter 2 2014/15
Council, 27 February 2014, Treasury Strategy 2014/15.

Cabinet Member:
Mike Owen, Portfolio Holder

Local Member
N/A

Appendices
A. Investment Report as at 31 December 2014
B. Prudential Limits
C. Prudential Borrowing Schedule