Shropshire Council

Committee and Date	Item
Council 13 December 2012	**8** Public

TREASURY STRATEGY 2012/13 – MID YEAR REVIEW

Responsible Officer Rachel Musson
e-mail: rachel.musson@shropshire.gov.uk Tel: (01743) 252007 Fax (01743) 252390

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 2012/13
- A review of the Treasury Strategy 2012/13 and Annual Investment Strategy
- A review of the Council's investment portfolio for 2012/13
- A review of the Council's borrowing strategy for 2012/13
- A review of any debt rescheduling undertaken
- A review of compliance with Treasury and Prudential limits for 2012/13

1.2 The key points to note are:-

- The internal treasury team achieved a return of 0.98% on the Council's cash balances outperforming the benchmark by 0.69%. This amounts to additional income of £396,991 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 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 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 revised 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** – Investor confidence remains weak in the Eurozone because successive rescue packages have first raised, and then disappointed, market expectations. The uncertainty created by the continuing Eurozone debt crisis is having a major effect in undermining business and consumer confidence not only in Europe and the UK, but also in America and the Far East/China.

6.2 Eurozone growth is expected to remain weak as austerity programmes in various countries curtail economic recovery. A crunch situation is rapidly developing in Greece as it failed yet again to achieve deficit reduction targets and so may require yet another (third) bail out. There is a distinct possibility that some of the northern European countries could push for the ejection of Greece from the Eurozone unless its financial prospects improve.

6.3 A financial crisis was also rapidly escalating over the situation in Spain. However, in early September the European Central Bank (ECB) announced that it would purchase unlimited amounts of shorter term bonds of Eurozone countries which have formally agreed the terms for a bailout. Importantly, this support would be subject to conditions and include supervision from the International Monetary Fund. This resulted in a surge of confidence that the Eurozone has at last put in place the framework for adequate defences to protect the Euro. However, it remains to be seen whether Spain and Italy will accept such a loss of sovereignty in the light of the verdicts that voters have delivered to the politicians in other peripheral countries which have accepted such supervision and austerity programmes. The Eurozone crisis is therefore far from being resolved yet.

6.4 The risks in economic forecasts continue unabated from the previous treasury strategy. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while America is in political deadlock which prevents a positive approach to countering weak growth. Whether the presidential election in November will remedy this deadlock is debatable but urgent action will be required in early 2013 to address the US debt position. In September the US Federal Reserve announced an aggressive stimulus programme for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, they also announced that it was unlikely there would be any increase in interest rates until at least 2015.

6.5 **UK Economy** – Economic sentiment, in respect of the prospects for the UK economy to recover swiftly from recession, suffered a major blow in August when the Bank of England substantially lowered its expectations for the speed of recovery and the rate of growth over the coming months and materially amended its forecasts for 2012 and 2013. The UK economy is heavily influenced by worldwide economic developments, particularly in the Eurozone, and the on-going negative sentiment in that area would inevitable permeate into the UK's economic performance. Consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on real incomes from high inflation and low pay rises, all taking its toll. Whilst inflation has fallen considerably, UK GDP fell by 0.5% in the quarter to 30 June the third quarterly fall in succession meaning the UK's recovery from the initial 2008 recession has been the worst and slowest from any of the five previous recessions since 1930.

6.6 The Monetary Policy Committee (MPC) has kept the Bank Rate at its historically low level of 0.5% while quantitative easing was increased by £50 billion to £375 billion in July. Low growth is expected to continue in the UK, with the Bank Rate unlikely to rise in the next 2 years, coupled with a possible further extension of quantitative easing will continue to keep investment returns depressed.

7 Economic Forecast

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

	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%
5yr PWLB rate	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.30%
10yr PWLB rate	2.50%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.20%	3.30%
25yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%
50yr PWLB rate	3.90%	3.90%	3.90%	4.00%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%

7.2 Sector believes the Bank Rate will remain at its current low level of 0.50% until September 2014 before rising to 0.75% in December 2014. This means investment returns will continue to be at historically low levels during this period. The Bank Rate is then expected to reach 1.00% by 31 March 2015.

7.3 Taking account of the introduction of the PWLB certainty rate in November 2012 which will reduce PWLB borrowing rates by 0.20% for most local authorities, long term PWLB rates are expected to fall slightly to 3.90% in December 2012 before steadily increasing over time to reach 4.50% by 31 March 2015 due to high gilt issuance in the UK and the high volume of debt issuance in other major western countries. However, the current safe haven status of the UK may continue for some time, postponing any increases in yield.

7.4 There is considerable uncertainty in all forecasts due to the speed of economic recovery in the UK, 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 and the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy.

8. Treasury Strategy update

8.1 The Treasury Management Strategy (TMS) for 2012/13 was approved by Full Council on 23 February 2012. 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 23 February 2012 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 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.

10.3 In the first six months of 2012/13 the internal treasury team outperformed its benchmark by 0.69%. The investment return was 0.98% compared to the benchmark of 0.29%. This amounts to additional income of £396,991 during the first six months which is included within the Council's projected outturn position.

10.4 A full list of investments held as at 30 September 2012, 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 first six months of 2012/13 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 2012/13 was £115 million.

10.6 The Council's interest receivable/payable budgets are currently projecting a surplus of £1,244,000 as reported in the monthly revenue monitoring reports due to no long term borrowing being undertaken to date and investment balances being higher than anticipated.

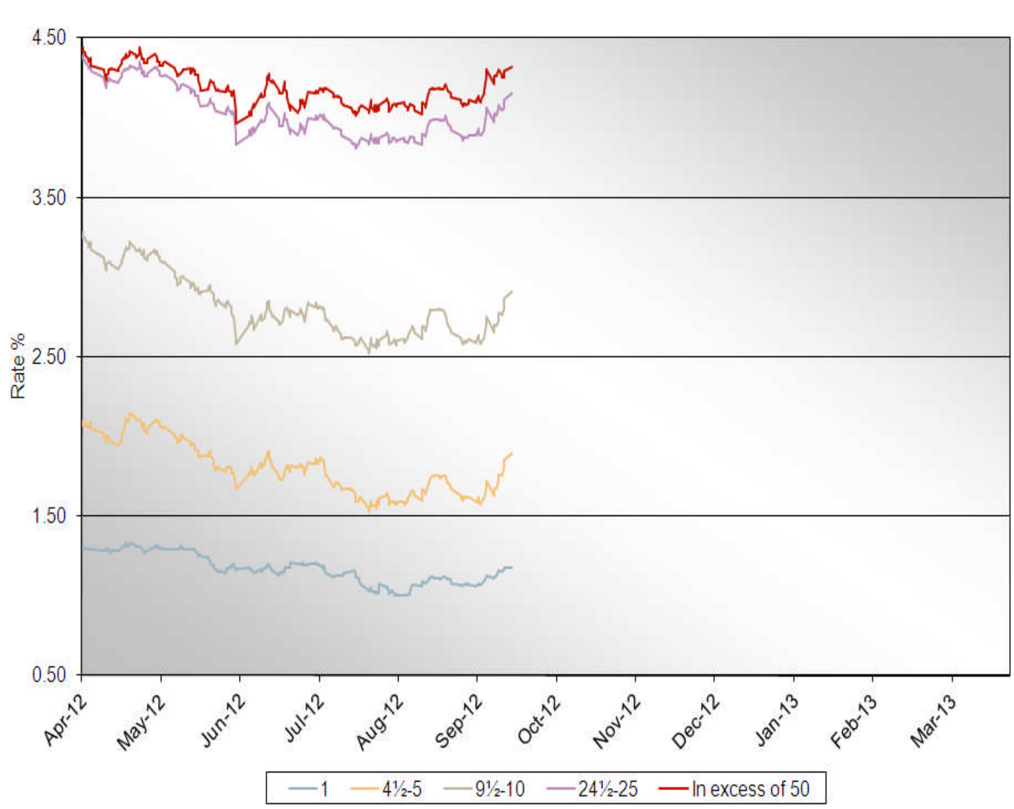
11. Borrowing

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 2012/13 and have not been previously breached.

11.3 Due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new non-HRA external borrowing of £12.7 million is required in 2012/13. This figure is as at 30 September 2012. No borrowing has currently been undertaken to date. As outlined in the graph below, the general trend has been a reduction in interest rates during the first six months of the year, across all bands, with the low points occurring in the middle of July and the start of August. The high points were in early to mid April.

PWLB Rates 2012-13



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. The coalition government's aim to accelerate the speed of reduction in the public sector deficit, the MPC announcement to increase quantitative easing and the marked deterioration of growth prospects in the US, EU and UK has meant that UK gilts have taken a safe haven status for international investors which have caused a major fall in bond yields which, in turn, have dragged down PWLB rates.

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 is expected to receive 100% back of the principal sum invested, the first two distributions amounting to around 40% of the total claim were received in June 2012. The third distribution of around 6% was received in October 2012. 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 December 2019.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) Council, 23 February 2012, Treasury Strategy 2012/13 Cabinet, 01 August 2012, Treasury Management Update Quarter 1 2012/13.
Cabinet Member: Keith Barrow, Leader of the Council
Local Member N/A
Appendices A. Investment Report as at 30th September 2012 B. Prudential Limits C. Prudential Borrowing Schedule