



<u>Committee and Date</u>
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9
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TREASURY MANAGEMENT UPDATE – QUARTER 2 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 Council's Treasury Advisor, Capita Asset Services. It also updates Members on the internal treasury team's performance.
- 1.2. During the second 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 £101,925 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 £101,925 which will be reflected in the Period 6 Revenue Monitor.
- 4.3. The Council currently has £135m held in investments as detailed in Appendix A and borrowing of £338m 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 2014 and 30 September 2014.

6. Economic Background

- 6.1. After strong UK Gross Domestic Product (GDP) growth of 0.8%, 0.7% and 0.7% in the last three quarters and 0.9% in the first quarter of 2014, it appears very likely that strong growth will continue into 2014 as forward looking indicators are looking encouraging. This strong growth has resulted in unemployment falling much faster through the threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate.
- 6.2. Also encouraging has been the sharp fall in Inflationary pressures. Consumer Price Inflation (CPI) fell to 1.5% in July, its lowest rate since 2009. Recent developments, including falls in producer price inflation and very weak wages growth, suggest that CPI is likely to fall further in 2014 to possibly 1%.
- 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 September meeting with the majority citing reasons such as declines in manufacturing, exports and housing activity, in conjunction with the weaknesses within the Eurozone for holding rates at their historic low. The MPC minutes further reiterated the split in their decision though with two policymakers voting to raise rates to 0.75% for the second successive month.
- 6.4. In September, the Federal Reserve continued with its monthly \$10 billion reductions in asset purchases. Asset purchases have now fallen from \$85

billion to \$15 billion and are expected to cease completely in October 2014 providing strong economic growth continues in the US this year.

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

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:

	Dec-14	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%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.25%	2.50%
5yr PWLB rate	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%	3.50%	3.50%
10yr PWLB rate	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.20%	4.30%	4.30%
25yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%
50yr PWLB rate	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	5.00%

7.2. Capita undertook a review of its interest rate forecasts in mid-August following the issue of the latest Bank of England Inflation Report. By the beginning of September, a further rise in geopolitical concerns, principally over the Ukraine but also over the Middle East, has caused a further flight into safe havens like gilts and depressed PWLB rates further. Their latest forecast which was updated on the 24 October 2014 now includes a first increase in Bank Rate to be in June 2015 instead of March 2015 as previously reported as a result of the latest MPC minutes which revealed an increase in caution over UK growth prospects and an increase in concern that we could be heading into an era of subdued inflation with a greater risk that the Eurozone could be heading into deflation.

7.3. Long term PWLB rates are expected to rise to 4.50% in March 2016 before steadily increasing over time to reach 5% 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. Negative developments on the geo-political front as well as any fresh issues regarding the Eurozone related sovereign debt crisis could significantly impact safe-haven flows of investor money into UK, US and German bonds and produce shorter term movements away from Capita's central interest rate forecasts.

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 second 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 £101,925 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 £102 million during the quarter and £93 million was repaid during the quarter.
- 8.4. A full list of investments held as at 30 September 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 second 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 second quarter of 2014/15 was £151 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 second quarter of 2014/15 fell from 4.40% to 4.0% in mid-August. 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 generally 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	1.28%	2.48%	3.16%	3.74%	3.72%
Date	08/09/2014	28/08/2014	28/08/2014	01/09/2014	29/08/2014
High	1.49%	2.87%	3.66%	4.24%	4.20%
Date	16/07/2014	03/07/2014	03/07/2014	04/07/2014	07/07/2014
Average	1.40%	2.66%	3.39%	3.98%	3.96%

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
Council, 27 February 2014, Treasury Strategy 2014/15.

Cabinet Member:

Mike Owen, Portfolio Holder

Local Member

N/A

Appendices

- A. Investment Report as at 30 September 2014
- B. Prudential Limits
- C. Prudential Borrowing Schedule