Shropshire Council

Committee and Date	Item
Audit Committee 27 November 2014 Cabinet 10 December 2014 Council 18 December 2014	**8** Public

TREASURY STRATEGY 2014/15 – MID YEAR REVIEW

Responsible Officer James Walton
e-mail: james.walton@shropshire.gov.uk Tel: (01743) 255011 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 2014/15
- A review of the Treasury Strategy 2014/15 and Annual Investment Strategy
- A review of the Council's investment portfolio for 2014/15
- A review of the Council's borrowing strategy for 2014/15
- A review of any debt rescheduling undertaken
- A review of compliance with Treasury and Prudential limits for 2014/15

1.2 The key points to note are:-

- 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 £209,925 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.

2.2 Members note that any capital schemes brought forward that would impact on the current strategy would need to be approved by Council.

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 £209,925 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 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 –** In September, the US 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 stop in October 2014, providing strong economic growth continues. First quarter growth figures for the US were depressed by exceptionally bad winter weather, but growth rebounded very strongly in the second quarter to an annualised rate of 4.6%. The US faces similar debt problems to those of the UK, but due to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although the weak labour force participation rate remains a matter of key concern for the US Federal Reserve when considering the amount of slack in the economy and monetary policy decisions.

6.2 The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, the inflation rate fell further to reach a low of 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) took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to a negative rate of 0.2% and to start a programme of purchases of corporate debt although it has not embarked yet on full quantitative easing which is the purchase of sovereign debt.

6.3 Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international competitiveness and the need for overdue reforms of the economy. It is therefore possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but have only been postponed.

6.4 By the beginning of September, a further rise in geopolitical risks principally over the Ukraine but also over the Middle East has caused a further flight into safe haven flows from equities into bonds which has depressed PWLB rates further.

6.5 **UK Economy** – After strong economic growth in the UK of 2.7% in 2013, and strong quarterly growth of 0.7% and 0.9% in the first two quarters of 2014, it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance.

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. The overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the MPC last August, before it said it would consider any increases in Bank Rate. The MPC has therefore subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in the Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is not expected until the second quarter of 2015.

6.7 There has been a sharp fall in Consumer Price Inflation (CPI) reaching 1.5% in May and July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1%.

7 Economic Forecast

7.1 The Council receives its treasury advice from Capita Asset Services. Their latest interest rate forecasts 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 believes the Bank Rate will remain at its current low level of 0.50% until June 2015 when it is expected to rise to 0.75% before rising to 1% in December 2015. This means investment returns will continue to be at historically low levels during this period. The Bank Rate is then expected to reach 1.5% by 31 June 2017 and 2.50% by 31 March 2018.

7.3 Long term PWLB rates are expected to rise to 4.50% in March 2016 before steadily increasing over time to reach 5.00% by 31 March 2018 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. As there are significant potential risks from the Eurozone and from financial flows from emerging markets in particular, caution must be exercised in respect of all interest rate forecasts at the current time. The general expectation for an eventual trend of gently rising gilt yields and PWLB rates is expected to remain unchanged as market fundamentals will focus on the sheer volume of UK gilt issuance and the price of those new debt issues. Negative (or positive) developments in the Eurozone 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 central forecasts. 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 2014/15 was approved by Full Council on 27 February 2014. 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. It is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. In this context it is considered that the Annual Investment Strategy approved on 27 February 2014 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.

9.3 In the first six months 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 £209,925 during the first six months which is included within the Council's projected outturn position.

9.4 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 first six months of 2014/15 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.

9.5 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 2014/15 was £148 million.

9.6 The Council's interest receivable/payable budgets are currently projecting a surplus of £0.843 million as reported in the monthly revenue monitoring reports due to no long term borrowing being undertaken and investment balances being higher than anticipated.

10. Borrowing

10.1 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.

10.2 Officers can confirm that the Prudential Indicators were not breached during the first six months of 2014/15 and have not been previously breached.

10.3 No new external borrowing is 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. The schemes being considered are already within the current authorised borrowing limits in place. As outlined in the table below, the general trend has been a decrease in interest rates during the first six months of the year, across longer dated maturity bands, but a rise in the shorter maturities, reflecting in part the expected rise in the Bank Rate. The dates of the low points and high points across different maturity bands are shown in the table below.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.20%	2.48%	3.16%	3.75%	3.73%
Date	10/04/2014	28/08/2014	28/08/2014	29/08/2014	29/08/2014
High	1.48%	2.86%	3.66%	4.29%	4.26%
Date	15/07/2014	04/07/2014	20/06/2014	02/04/2014	01/04/2014
Average	1.34%	2.65%	3.67%	4.10%	4.17%

10.4 During the first six months of the financial year there has been a lot of volatility in the financial markets which are highly correlated to geopolitical and sovereign debt crisis developments and this has had an impact on the PWLB rates. The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

11. Debt Rescheduling

11.1 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.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) Council, 27 February 2014, Treasury Strategy 2014/15
Cabinet Member: Keith Barrow, Leader of the Council
Local Member N/A
Appendices A. Investment Report as at 30th September 2014 B. Prudential Limits C. Prudential Borrowing Schedule