St Edmundsbury
BOROUGH COUNCIL

C176

Treasury Management Sub-Committee 24 October 2011

Treasury Management Performance Report and Investment Activity: 1 April to 30 September 2011

1. Introduction

1.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA's) revised Code of Practice for Treasury Management, published in November 2009, was adopted by the Council on 23 February 2010. Given that Treasury Management activities involve the management of significant cashflows and investments, the Code requires that Members are provided with regular reports on the performance of the Council's treasury management function. This mid year report has been prepared in compliance with the CIPFA Code.

2. Purpose of this Report

2.1 The purpose of this report is to:-

(a) provide an update on Treasury Management activity and performance for the period 1 April to 30 September 2011;

(b) provide the Sub-Committee with an economic update for the first 6 months of 2011/2012, including revised interest rate forecasts; and

(c) advise the Sub-Committee of a joint procurement exercise currently being undertaken to appoint a Treasury Management Advisor for the Council with effect from 1 April 2012.

2.2 The Sub-Committee is asked to:-

(a) scrutinise the contents of this report, including details of treasury management performance for the first 6 months of the financial year; and

(b) make recommendations, as appropriate, via the Performance and Audit Scrutiny Committee to Cabinet and Council.

3. Investment Strategy 2011/2012

3.1 The Council's Annual Treasury Management and Investment Strategy was approved by Full Council on 1 March 2011 (Minute 90(B)(1) refers). The Strategy gives priority to the security and liquidity of investments, whilst at the same time seeking to achieve value for money in treasury management. They also seek to give maximum flexibility in terms of the usage of fixed and variable rate investments and allow for the balancing of certainty of income arising from fixed term investments with the need to retain a core balance that can be easily liquidated should the need arise.

3.2 In the current economic climate it is considered appropriate to keep investments short term, and only invest with a limited number of highly rated banks and building societies (using Sector Treasury Services Ltd (Sector), the Council's treasury management advisor, suggested creditworthiness approach) and non-rated building societies, subject to their meeting minimum financial criteria (based on asset base size, Dun and Bradstreet ratings, the Government's guarantee scheme for UK financial institutions and the review of published financial information). In addition, for counterparties based in countries outside the UK, our strategy is only to use organisations where the host country has a AAA sovereign rating.

4. Investment Activity: 1 April 2011 to 30 September 2011

4.1 The total amount invested at 1 April 2011 was £32.4m and at 30 September 2011 was £39.65m. The increase in balances over this period was due primarily to timing differences in respect of the collection of local taxes (Council Tax and Non Domestic Rates) and the payment of precepts (i.e. to Suffolk County Council, Suffolk Police and central Government). The average level of funds available for investment purposes in the first six months of 2011/2012 was £38.8m.

4.2 The 2011/2012 Annual Treasury Management and Investment Strategy set out the Council's projections for the current financial year. The budget for investment income in 2011/2012 is £457,000, equivalent to £11.97 for each Council Tax Band D property. This represented a target rate of return on investments of 1.50%.

4.3 As at the end of September 2011 interest actually earned during the first 6 months of the financial year amounted to £280,000 against the profiled budget for the period of £238,000, a budgetary surplus of £42,000. This modest budgetary surplus was due primarily to higher than projected average cash holdings during the period (arising mainly from timing differences in expected capital expenditure and receipts cashflows). The average rate of return on investments during the period was 1.44% against the target rate for the year of 1.5%, reflecting the continuation of historically low interest rates during the period and ongoing difficulties in finding attractive rates of interest with financial institutions that can deliver the required level of security.

4.4 If current interest rates continue to prevail, the budgeted income from investments for 2011/2012 may still not be achieved. In this situation, any shortfall in budgeted income will be met from the Interest Equalisation Reserve.

4.5 A full list of investments held as at 30 September 2011 is shown at Appendix 1 attached.

5. Economic Update and Interest rate Projections

5.1 The Council's treasury management advisor, Sector Treasury Services Ltd (Sector) has provided the following update on the performance of the economy and the potential impact upon future interest rates.

Global economy

5.2 The Eurozone sovereign debt crisis continued with Spain, and particularly Italy, being the focus of renewed market concerns that they may soon join with Greece, Ireland and Portugal in needing assistance. The lack of a co-ordinated or credible Eurozone response left commentators concerned over the increasing risks of sovereign default and the resulting effect on the Eurozone banking sector.

5.3 There was simultaneously a major crisis in the US caused by intense political difficulties over the urgent need to increase the ceiling on total US sovereign debt and also plans to reduce the budget deficit. The ceiling was no sooner raised than it was followed by the shock loss of the AAA credit rating from Standard and Poors.

5.4 These twin crises severely dented business and consumer confidence in the developed world and contributed to a slow down in GDP growth to the point that there has been a major resurgence of fears of a double dip recession in many countries. These crises also damaged investor confidence so that world stock markets fell sharply.

UK economy

5.5 Following zero growth in the final half of 2010/11 the UK economy grew by a weaker than expected 0.2% in the first quarter of 2011/12. This then dented future growth prospects. These are currently very subdued as UK consumer sentiment has been negatively impacted by falling disposable income due to high inflation and an increase in the level of VAT, excessive levels of debt, and concerns over security of employment. In addition, hopes for an export led recovery have been dimmed by the downturn of growth in our major international markets, especially the EU and the US.

5.6 Inflation remains stubbornly high, although the expectation of future falls, the external nature of the price increases (energy, oil, food etc.), and the negative impact a rate rise would have on the UK consumer and the economy, is likely to stop the Monetary Policy Committee from raising the Bank Rate for some considerable time to come. The MPC have also started to debate additional monetary easing e.g. a further round of quantitative easing in order to stimulate growth.

5.7 International investors continue to view UK government gilts as being a safe haven from EU sovereign debt. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and sent PWLB borrowing rates to remarkably low levels.

Outlook for the next six months of 2011/12

5.8 There remain huge uncertainties in economic forecasts due to the following major difficulties:

- *the speed of economic recovery in the UK, US and EU;*
- *the potential for a major EU sovereign debt crisis which could have a devastating impact on financial markets and the global and UK economy*
- *the degree to which government austerity programmes will dampen economic growth in the western world;*
- *the potential for more quantitative easing, and the timing of this in both the UK and US*
- *the speed of recovery of banks' profitability and balance sheet imbalances.*

Sector's interest rate forecast – September 2011

Sector's Interest Rate View	Now	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.25%	2.50%
3 Month LIBID	0.75%	0.70%	0.70%	0.70%	0.70%	0.70%	0.90%	1.10%	1.30%	1.60%	1.90%	2.40%	2.70%
6 Month LIBID	1.04%	1.00%	1.00%	1.00%	1.20%	1.30%	1.50%	1.70%	1.90%	2.10%	2.40%	2.70%	3.00%
12 Month LIBID	1.51%	1.50%	1.50%	1.50%	1.60%	1.80%	2.00%	2.25%	2.50%	2.75%	3.00%	3.40%	3.70%
5yr PWLB Rate	2.50%	2.50%	2.70%	2.90%	3.00%	3.10%	3.20%	3.40%	3.60%	3.80%	4.00%	4.10%	4.20%
10yr PWLB Rate	3.71%	3.80%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%
25yr PWLB Rate	4.76%	5.00%	5.00%	5.10%	5.10%	5.10%	5.20%	5.20%	5.30%	5.40%	5.40%	5.50%	5.50%
50yr PWLB Rate	4.81%	5.00%	5.00%	5.10%	5.10%	5.10%	5.20%	5.20%	5.30%	5.40%	5.40%	5.50%	5.50%

***Note** – **LIBID** = London Interbank BID rate (average rate at which the London banks are borrowing from each other) - **PWLB** = Public Works Loan Board (statutory body providing loan finance to local authorities for capital expenditure purposes).*

5.9 On the basis of the above analysis, Sector has recently revised its interest rate forecasts. Sector was previously projecting that the Bank of England's Monetary Policy Committee would hold bank base rates at 0.5% through to December 2011, when a 0.25% increase was predicted, with a further 0.25% increase predicted for March 2012 (i.e. a base rate of 1%). These projections were used to inform the setting of the Council's target rate of return for the year of 1.5%. Sector's most recent projections are for the current historic low bank rate to continue for at least a further 12 months, rising to 0.75% by December 2012 and 1% by March 2013. Sector advise that this will have the effect of subduing investment returns.

5.10 In views of the heightened uncertainty in the financial markets, and in particular concerns that the Eurozone crisis may spread (i.e. from Countries such as Greece, Ireland and Portugal to include Spain and Italy), Sector are currently recommending that clients keep future investments relatively short dated and with highly rated institutions. Unless there is a significant improvement in market conditions within the next few months, this strategy will further impact upon investment returns.

6. Appointment of Treasury Management Advisors

6.1 The Council uses Sector as its external treasury management adviser. The CIPFA Treasury Management Code states that relationships with advisors should be subject to regular review to ensure that value for money is being obtained. The existing contract with Sector is due to end on 31 March 2012. The Council is currently engaged in a joint procurement exercise with East Cambridgeshire District Council and Forest Heath District Council for the appointment of a treasury management adviser with effect from 1 April 2012. The outcome of this exercise will be reported to the next Treasury Management Sub-Committee meeting on 23 January 2012.

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APPENDIX 1

INVESTMENTS AS AT 30/09/2011

Principal	Counterparty	Start Date	Maturity Date	Interest Rate (%)
£0	Santander UK Business Reserve Account	Inst/Acc	Inst/Acc	0.6500
£3,150,000	Bank of Scotland Call A/C	Inst/Acc	Inst/Acc	0.7500
£0	Bank of Scotland BasePLUS Account	Inst/Acc	Inst/Acc	0.5000
£500,000	Barclays Reserve Account	Inst/Acc	Inst/Acc	0.7000
£3,000,000	Clydesdale 30 Day Notice Account	30 day	30 day	0.8500
£1,000,000	Nottingham Building Society	01/04/2011	03/10/2011	1.2000
£1,500,000	Skipton Building Society	03/05/2011	17/10/2011	1.0600
£1,500,000	Principality Building Society	03/05/2011	19/10/2011	1.0800
£1,000,000	Nottingham Building Society	01/06/2011	15/11/2011	1.2000
£1,000,000	Newcastle Building Society	15/06/2011	15/11/2011	1.1200
£1,000,000	Cater Allen	17/11/2010	17/11/2011	2.5000
£1,000,000	Progressive Building Society	01/06/2011	22/11/2011	1.2000
£500,000	Progressive Building Society	01/06/2011	23/11/2011	1.2000
£500,000	Principality Building Society	01/06/2011	23/11/2011	1.0700
£1,000,000	Cater Allen	01/12/2010	01/12/2011	2.5000
£500,000	Norwich & Peterborough Building Society	01/06/2011	01/12/2011	1.2500
£2,000,000	Cater Allen	15/12/2010	14/12/2011	2.5000
£1,000,000	West Bromwich Building Society	01/07/2011	15/12/2011	1.1500
£1,500,000	Skipton Building Society	01/07/2011	22/12/2011	1.1000
£500,000	Newcastle Building Society	01/07/2011	23/12/2011	1.2000
£1,500,000	Leeds Building Society	01/07/2011	04/01/2012	0.9100
£1,000,000	West Bromwich Building Society	04/07/2011	04/01/2012	1.2500
£1,500,000	Norwich & Peterborough Building Society	01/08/2011	16/01/2012	1.2000
£1,000,000	Principality Building Society	01/08/2011	19/01/2012	1.1500
£1,000,000	Norwich & Peterborough Building Society	01/08/2011	23/01/2012	1.3000
£1,000,000	Newcastle Building Society	01/09/2011	15/02/2012	1.2800
£1,000,000	Nottingham Building Society	05/09/2011	15/02/2012	1.2500
£1,500,000	Bank of Scotland	07/03/2011	07/03/2012	2.0500
£2,000,000	Cater Allen	05/07/2011	03/07/2012	2.5000
£2,000,000	Bank of Scotland	01/06/2011	27/07/2012	2.6500
£2,000,000	Bank of Scotland	02/08/2011	31/07/2012	2.0500
£2,000,000	Cater Allen	29/09/2011	28/09/2012	2.5000
£39,650,000	**TOTAL**			

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