St Edmundsbury
BOROUGH COUNCIL

D67

Treasury Management Sub-Committee 23 July 2012

Annual Treasury Management Report 2011/12 and Investment Activity 1 April to 30 June 2012

1. Summary and Reasons for Recommendations

1.1 CIPFA's revised Code of Practice for Treasury Management (the Code) 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, including an annual treasury management and investment strategy (setting out its treasury management policies and strategies for the forthcoming year), a mid year treasury management review and an annual outturn report at the close of the financial year.

1.2 The purpose of this report is to:

a. present the Council's Annual Treasury Management Investment Report summarising the investment activities for the year 2011/12, and

b. provide a summary of investment activity for the first three months of the 2012/13 financial year.

2. Recommendations

2.1 The Sub-Committee is asked to:

a. scrutinise the content of this report, including details of treasury management performance for the first 3 months of the 2012/13 financial year, and

b. make recommendations as appropriate via the Performance and Audit Scrutiny Committee to Cabinet and Council regarding the approval of the attached Annual Treasury Management Report for 2011/12 (appendix 1 refers).

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3. Corporate Objectives

3.1 The recommendations meet the following, as contained within the Corporate Plan:-

(a) Working together for prosperous and environmentally-responsible communities; and

(c) Working together for an efficient Council.

4. Key Issues

Annual Report 2011/12

4.1 The Council's Treasury Management Annual Report for 2011/12 is attached at Appendix 1.

4.2 The total amount invested at 1 April 2011 was £32.4m and at 31 March 2012 £32.0m. The reduction in investment balances over this period was due primarily to the net effect of the Council's capital expenditure and asset disposals programmes. The average level of funds available for investment purposes during the year was £39.5m.

4.3 The budgeted income from investments in 2011/12 was £0.457m. Interest actually earned during the year totalled £0.582m; an overachievement of £0.125m against budget. The over achievement of interest on investments during this period was due primarily to higher than projected average cash holdings arising from differences between planned and actual capital expenditure and receipts cashflows. The average rate of interest achieved for the year was 1.48% against the target rate of 1.50%. This marginal underachievement in interest rates reflects the continued difficulties experienced during the year in finding attractive rates of interest with financial institutions that can deliver the required level of security.

4.4 Fluctuations in interest rates and in levels of planned cash flows (eg arising from the net effect of capital expenditure and receipts) can have a significant impact on the level of income from investments achieved in any given period, and thereby the Council's overall budget for the year. The establishment of the Interest Equalisation Reserve (as agreed by Council in February 2005) was designed to assist in smoothing out year-on-year variations in planned investment returns, the idea being that budgetary surpluses in investment returns in one year could be used to help fund budgetary deficits in another. As at 31 March 2012 the balance on this reserve was £0.727m. In view of the comparatively healthy position of this reserve, the budgetary surplus for the year has been credited to the Council's general reserves to be used to support future years' council tax levels.

4.5 A full list of investments held as at 31 March 2012 is shown at appendix 2.

Investment Activity: 1 April 2012 to 30 June 2012

4.6 The total amount invested at 1 April 2012 was £32.0m and at 30 June 2012 £34.7m. 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 (ie to Suffolk County Council, Suffolk Police and central government).

4.7 The 2012/13 Annual Treasury Management and Investment Strategy (report C294 refers) set out the Council's projections for the current financial year. The budget for investment income in 2012/13 is £0.569m which is based on a continuation of the previous year's 1.5% target rate of return on investments.

4.8 As at the end of June 2012 interest actually earned during the first quarter of the financial year amounted to £0.156m against a profiled budget for the period of £0.150m; a budgetary surplus of £0.006m. This modest budgetary surplus was due to the achievement of a higher than projected average rate of interest during the period (i.e. an average rate of return of 1.7% against a target rate for the period of 1.5%) which in turn is primarily due to preferential rates of interest currently being obtained on investments with Cater Allen (currently holding investments totalling £6m with rates of interest for investments up to 12 months duration ranging from 2% to 2.5%) and the Bank of Scotland (current investments totalling £11.75m with rates ranging from 0.75% for instant access to 3.1% for 12 month fixed duration investments). However in the current economic climate it is considered unlikely that these preferential rates will be available when current fixed term investments mature and that average returns will fall during the remainder of this year.

4.9 Most market analysts are predicting that current bank base rates will be held at 0.5% for the remainder of the financial year, with Sector (the Council's treasury management advisers) now projecting that the base rate will remain unchanged until the first quarter of 2014 when a 0.25% increase is predicted. This has already been factored into the calculation of the target rate for the year. As such, assuming that the target rate can continue to be met and that estimated cash flows for the year are reasonably accurate, the budgeted investment income for 2011/12 should still be achievable. In the event that there is a shortfall in budgeted income, this will be met from the interest equalisation reserve. Treasury management performance will continue to be closely monitored with further quarterly performance reports being brought to this sub committee for scrutiny.

4.10 A full list of investments held as at 30 June 2012 is shown at appendix 2.

5. Other Options Considered

5.1 Options for the management of Council investments are formally considered within the annual treasury management and investment strategy. This includes key strategies in respect of the maintenance of the Council's debt free status, the continuation of in-house management of funds, and the approach to be adopted in establishing the credit worthiness of potential counterparties. The changing nature of the economic climate requires that these key areas are subject to on-going review.

6. Community Impact

6.1 **Crime and Disorder Impact** *(including Section 17 of the Crime and Disorder Act 1998)*
None

6.2 **Diversity and Equality Impact** *(including the findings of the Equality Impact Assessment)*
None

6.3 **Sustainability Impact** *(including completing a Sustainability Impact Assessment)*
None

7. Consultation *(refer to the Consultation and Community Engagement Strategy)*

7.1 Treasury management activities are undertaken in consultation with Sector (the Council's appointed Treasury Management advisers) and also takes into account information obtained from investment brokers and other economic commentators. This committee provides for the scrutiny of treasury management strategies and performance, with changes in strategies and policies subject to approval by Cabinet and full Council.

8. Resource implications *(including asset management implications)*

8.1 The total interest earned in 2011/12 from the Council's investments amounted to £0.582m representing income per Council Tax Band D equivalent property of £14.02.

9. Risk/Opportunity Assessment *(potential hazards or opportunities affecting corporate, service or project objectives)*

9.1

Risk area	**Inherent level of Risk** (before controls)	**Controls**	**Residual Risk** (after controls)
	High/Medium/Low		High/Medium/Low
Fluctuations in interest rates or in projected cashflows having significant impact on budgeted investment income.	High	Spread of investments for periods of up to two years. Budget monitoring and quarterly performance reports. Use of interest equalisation reserve to smooth out year-on-year fluctuations.	Medium
Bank / building society failure resulting in loss of Council funds.	High	Use of Sector advice on counterparty credit ratings (based on Fitch and Moody ratings) and the setting of lending limits. Use of non-rated building societies based on asset base and additional credit checks.	Medium

10. Legal or policy implications

10.1 The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2011/12. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

Ward(s) affected	All
Background Papers	Treasury Management Performance and Annual Treasury Management and Investment Strategy – 2011/12 (B410) and 2012/13 (C294)

Document1

Annual Treasury Management Report 2011/2012

1 Introduction

1.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 (the Code) was adopted by Council on 23 February 2010.

1.2 The primary requirements of the Code are as follows:

a. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
b. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
c. Receipt by Council of an Annual Treasury Management Strategy Report for the year ahead, a mid year review report (as a minimum) and an annual review report of the previous year.
d. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
e. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Treasury Management Sub-Committee.

1.3 Treasury management in this context is defined as:

'The management of the local authority's 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.'

1.4 The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2011/12.

2 The Council's Debt Free Status

2.1 The Council became debt free in 1992 and since then has refrained from any borrowing apart from the temporary use of overdraft facilities. This was continued in 2011/12 with the result that the Council had no Prudential Code indicators so far as borrowing was concerned in the year. During the financial year all the Council's investments were managed by in-house staff.

3 Investment Strategy for 2011/12

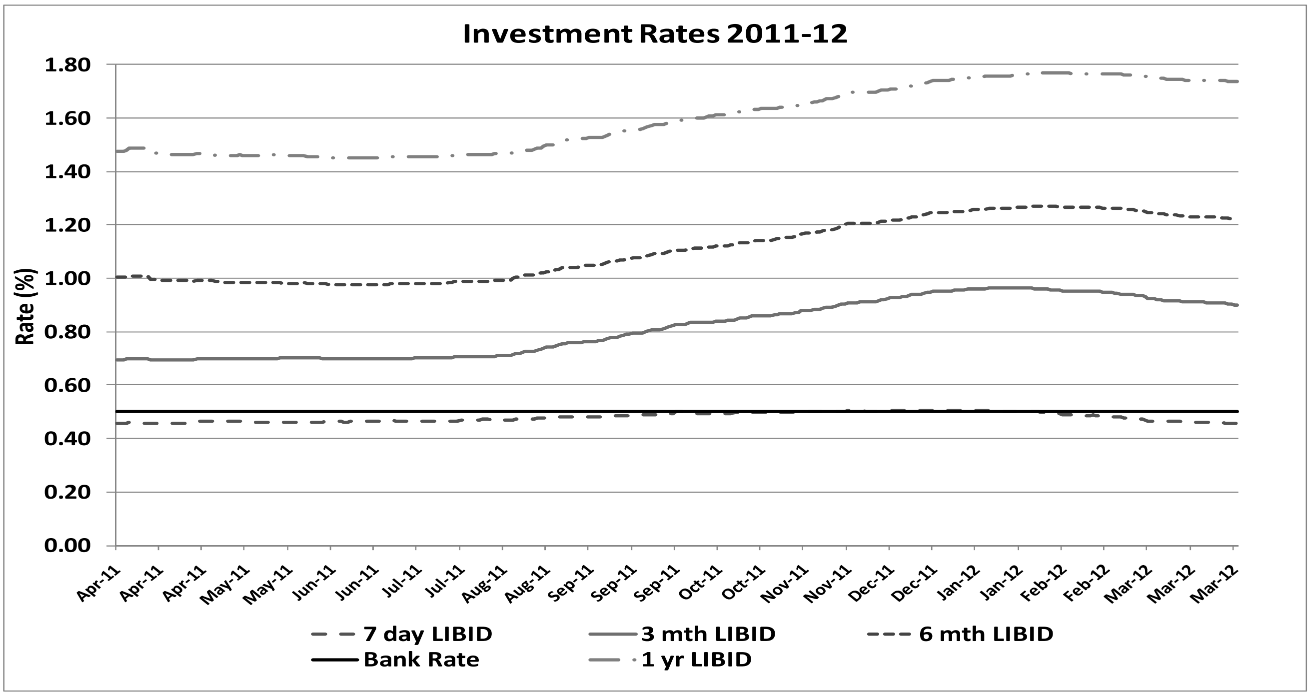
3.1 The Council's 2011/12 Annual Treasury Management and Investment Strategy was approved by Full Council on 1 March 2011 (report B410 refers). The investment strategy for 2011/12 was to give priority to the security and liquidity of investments whilst at the same time seeking to optimise the return on investments.

3.2 The target rate of return for investments for 2011/12 was 1.5%. This target rate was based upon investment rate projections for the year provided by Sector (the Council's treasury management advisors), together with consideration of the profile of the Council's portfolio of investments (i.e. mixture of liquid and fixed term investments). Based upon the anticipated funds available for investment in the year (taking into account planned capital expenditure and receipts from asset disposals) this gave a target investment income of £0.457m, equivalent to £11.97 for each Council Tax band D property. This figure was used in the preparation of the Council's budget for 2011/12.

Investment Rates in 2011/12

3.3 At the time when the strategy was set, Sector's prediction for interest rates during 2011/12 was that the Bank Rate would remain at 0.5% for the first half of the year, rising gently thereafter reaching 1% by March 2012. However, the tight monetary conditions following the 2008 financial crisis continued through 2011/12 and the bank base rate remained at its historical low of 0.5% throughout the year. The continuation of low investment returns was further compounded by continued counterparty concerns, highlighting the ongoing need for caution in treasury investment activity. These market concerns were fuelled by the growing Euro zone sovereign debt and banking crisis, which were translated into further rating downgrades. This resulting in further restrictions in the number of organisations with which the Council was able to place fund and the associated counterparty lending limits (i.e. value and duration of investments). Placing funds with a smaller number of highly rated organisations for shorter fixed term has served to place further pressure on investment returns. Against this economic background, action taken by the European Central bank to provide additional finance to Euro zone banks did result in a marginal increase in investment rates during the second half of the year, falling back again slightly by the year end as bank liquidity positions improved.

3.4 Details of market investment rates applicable during 2011/12 are provided below tables (Source: Sector).



NB - London Interbank Bid Rate (LIBID) is the rate that banks are willing to pay to attract deposits from other banks in London.

The Council's Lending Criteria 2011/12

3.5 The Council's Annual Treasury Management and Investment Strategy requires that deposits are only placed with a limited number of high quality banks and building societies whose credit rating is independently assessed as sufficiently secure by the Council's treasury advisers (Sector) or, for non rated building societies, subject to their meeting minimum financial criteria (based on asset base size).

3.6 The unprecedented nature of the current economic and banking crisis has forced local authorities to keep their lending criteria under constant review to ensure that the balance between security of capital, liquidity of investments and yield on investment income is adequately maintained. The Council's original 2011/12 lending criteria (as set out in the 2011/12 Annual Treasury Management and Investment Strategy) was subject to review by members of the Treasury Management Sub-Committee during December 2012 and at the Sub Committee's meeting on 23 January 2012. This review was in response to increasing difficulties being experienced in finding sufficient approved counterparties with which to place Council funds. The review resulted in an extension to the credit limits applied to part nationalised banks (i.e. Royal Bank of Scotland and Lloyds banking groups) together with changes in the use of the Credit Default Swap (CDS) data supplied by Sector in determining the credit limits applicable to individual counterparties. The changes were approved under the delegated authority of the Chief Finance Officer and Portfolio Holder Performance and Resources with effect from 13 December 2011, following consultation with the members of the Treasury Management Sub Committee, with a full report on the changes being made to the Treasury Management Sub Committee meeting of 23 January 2012.

3.7 The below tables shows the credit criteria applicable at the 1 April 2011 and from 13 December 2011:

Credit Criteria: Rated Banks and Institutions

Sector Colour Code Key*	Credit Criteria 1/4/11	Credit Criteria 13/12/11
Purple	Max £10m for max of 2 years (subject to max 30% of portfolio)	No change
Orange	£9m for max of 2 years (subject to max 30% of portfolio)	No change
Red	£8m for max of 1 year (subject to max 25% of portfolio)	No change
Green	£4m for max of 6 months (subject to max 20% of portfolio)	No change
Blue (nationalised / substantially owned by the UK government)	£9m for max 1 years	£12m for max 2 years

Credit Criteria: Rated Building Societies

Sector Colour Code Key*	Credit Criteria 1/4/11	Credit Criteria 13/12/11
Red	£8m for max of 1 year (subject to max 25% of portfolio)	No change
Green	£4m for max of 1 year (subject to max 20% of portfolio)	No change

***CDS changes – 23/11/12** - limits applied to highly rated banks and building societies were extended by using the Suggested Duration Weekly Outlook Adjusted column in Sector's weekly credit list as opposed to the Suggested Duration CDS Adjusted with Manual Override column – subject to CDS status remaining "in range" or "monitoring".*

Credit Criteria: Non- Rated Building Societies

Asset Base**	Credit Criteria 1/4/11	Credit Criteria 13/12/11
Asset base > £2,500m	£3m for max 6 months	No change
Asset base > £1,000m	£2.5m for max 6 months	No change

** In order to simplify the complex system of commercial credit ratings, Sector has developed a system of colour codings which reflect the relative strengths of individual banking institutions. Details of these colour codings are provided in the Council's Annual Treasury Management and Investment Strategy.*
*** Further restrictions on non-rated building societies include a requirement for societies to be covered by a Dun and Bradstreet credit rating.*

4 Compliance with Treasury Limits

4.1 During the financial year the Council operated within the approved Treasury limits and Prudential Indicators (as set out in the Council's Treasury Policy Statement and Annual Treasury Strategy Statement, including the above approved changes to lending limits). No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

5 Investment Outturn 2011/12

5.1 Investments were made with counterparties that met the agreed lending criteria and investment periods. Investment periods range from overnight to two years (one year for new investments), dependent on the Council's cash flows, the view on interest rates and the actual interest rates on offer.

5.2 Market investments in the year are summarised as follows:

	Number	Value (£m)
Opening balance 1st April 2011	29	32.40
Add: Investments made during the year (includes 25 transfers to business reserve accounts)	68	86.75
Sub Total		119.15
Investments realised during the year (includes 26 withdrawals from business reserve accounts)	78	87.15
Balance at 31st March 2012	19	32.00

5.3 Where possible, investments were made in fixed term investments in order to lock into interest rates which exceed the Council's budgeted rate and to provide some certainty of return for a proportion of the Council's investments.

5.4 During the year, for cash flow generated balances, use was made of the instant access and 30 day notice business reserve accounts with Barclays Bank, Clydesdale Bank and the Bank of Scotland. At 31st March 2012, in order to maintain liquidity whilst at the same time achieving earnings in excess of base rate, £6m was held in these accounts at interest rates between 0.70% and 0.85%.

5.5 At the financial year end the balance of the portfolio, £26.0m, was held in 16 separate investments maturing before the end of March 2013, in rates varying from 1.01% to 3.1%.

5.7 The average daily investment for the year was £39.14m and ranged from a high of £45.0m in January 2012 to a low of £32.0m in March 2012.

5.8 The total interest earned in 2011/12 from the Council's investments amounted to £0.582m against a budget of £0.457m, an overachievement of £0.125m against budget. This represented an average return in the period of 1.48% compared to the original target of 1.5%. This level of interest represents an income per Council Tax Band D equivalent property of £14.02 in 2011/12 (compared to a budgeted income of ££11.97 per band D property).

6 Financial Commentary: The Economy and Interest Rates in 2011/12

6.1 Sector Treasury Services Ltd has provided the following commentary on the performance of the economy and interest rates in 2011/12.

6.2 2011/12 was the year when financial markets were apprehensive, fearful of the potential of another Lehman's type financial crisis, prompted by a precipitous Greek Government debt default. At almost the last hour, the European Central Bank (ECB) calmed market concerns of a liquidity crisis among European Union (EU) banks by making available two huge three year credit lines, totalling close to €1 trillion at 1%. This also provided a major incentive for those same banks to then use this new liquidity to buy EU sovereign debt yielding considerably more than 1%.

6.3 A secondary benefit of this initiative was the bringing down of sovereign debt yields, for the likes of Italy and Spain, below unsustainable levels. The final aspects in the calming of the EU sovereign debt crisis were two eleventh hour agreements: one by the Greek Government of another major austerity package and the second, by private creditors, of a "haircut" (discount) on the value of Greek debt that they held, resulting in a major *reduction in the total outstanding level of Greek debt. These agreements were a prerequisite for a second EU / IMF bailout package for Greece which was signed off in March.*

6.4 *Despite this second bailout, major concerns remain that these measures were merely a postponement of the debt crisis, rather than a solution, as they did not address the problem of low growth and loss of competitiveness in not only Greece, but also in other EU countries with major debt imbalances. These problems will, in turn, also affect the financial strength of many already weakened EU banks during the expected economic downturn in the EU. There are also major questions as to whether the Greek Government will be able to deliver on its promises of cuts in expenditure and increasing tax collection rates, given the hostility of much of the population. In addition, an impending general election in May 2012 will deliver a democratic verdict on the way that Greece is being governed under intense austerity pressure from the northern EU states.*

6.5 *The UK coalition Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Key to retaining this rating will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within the austerity plan timeframe. The USA and France lost their AAA ratings from one rating agency during the year.*

6.6 *UK growth proved mixed over the year. In quarter 2, GDP growth was zero, but then quarter 3 surprised with a return to robust growth of 0.6% q/q before moving back into negative territory (-0.3%) in quarter 4. The year finished with prospects for the UK economy being decidedly downbeat due to a return to negative growth in the EU in quarter 4, our largest trading partner, and a sharp increase in world oil prices caused by Middle East concerns. However, there was also a return of some economic optimism for growth outside the EU and dovish comments from the major western central banks: the Fed in America may even be considering a third dose of quantitative easing to boost growth.*

6.7 *UK CPI inflation started the year at 4.5% and peaked at 5.2% in September. The fall out of the January 2011 VAT increase from the annual CPI figure in January 2012 helped to bring inflation down to 3.6%, finishing at 3.5% in March. Inflation is forecast to be on a downward trend to below 2% over the next year.*

6.8 *The Monetary Policy Committee agreed an increase in quantitative easing (QE) of £75bn in October on concerns of a downturn in growth and a forecast for inflation to fall below the 2% target. QE was targeted at further gilt purchases. The MPC then agreed another round of £50bn of QE in February 2012 to counter the negative impact of the EU debt and growth crisis on the UK.*

6.9 *Gilt yields fell for much of the year, until February, as concerns continued building over the EU debt crisis. This resulted in safe haven flows into UK gilts which, together with the two UK packages of QE during the year, combined to depress PWLB rates to historically low levels.*

6.10 *Bank Rate was unchanged at 0.5% throughout the year while expectations of when the first increase would occur were steadily pushed back until the second half of 2013 at the earliest. Deposit rates picked up in the second half of the year as competition for cash increased among banks.*

6.11 *Risk premiums were also a constant factor in raising money market deposit rates for periods longer than 1 month. Widespread and multiple downgrades of the credit ratings of many banks and sovereigns, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, meant that investors remained cautious of longer-term commitment.*

Appendix 2

INVESTMENTS AS AT 31 MARCH 2012

Principal	Counterparty	Start Date	Maturity Date	Interest Rate (%)
£0	Santander UK Business Reserve Account	Inst/Acc	Inst/Acc	0.65
£250,000	Bank of Scotland Call A/C	Inst/Acc	Inst/Acc	0.75
£0	Bank of Scotland BasePLUS Account	Inst/Acc	Inst/Acc	0.50
£4,000,000	Barclays Reserve Account	Inst/Acc	Inst/Acc	0.70
£1,750,000	NatWest Call Account	Inst/Acc	Inst/Acc	0.80
£0	Clydesdale 30 Day Notice Account	30 day	30 day	0.85
£1,000,000	Nationwide Building Society	03/10/2011	03/04/2012	1.17
£1,500,000	Skipton Building Society	01/12/2011	30/04/2012	1.05
£1,500,000	Leeds Building Society	01/12/2011	01/06/2012	1.27
£1,000,000	Principality Building Society	02/12/2011	06/06/2012	1.30
£1,500,000	Nationwide Building Society	03/01/2012	15/06/2012	1.25
£2,000,000	NatWest Bank	03/01/2012	19/06/2012	1.01
£2,000,000	Cater Allen	05/07/2011	03/07/2012	2.50
£1,500,000	NatWest Bank	03/01/2012	16/07/2012	1.01
£2,000,000	Bank of Scotland	01/06/2011	27/07/2012	2.65
£2,000,000	Bank of Scotland	02/08/2011	31/07/2012	2.05
£1,500,000	Bank of Scotland	06/03/2012	04/09/2012	1.75
£2,000,000	Cater Allen	29/09/2011	28/09/2012	2.50
£1,000,000	Cater Allen	17/11/2011	16/11/2012	2.50
£1,000,000	Cater Allen	14/12/2011	14/12/2012	2.00
£2,000,000	Bank of Scotland	14/12/2011	13/02/2013	3.10
£2,500,000	Bank of Scotland	16/02/2012	13/02/2013	3.10
£32,000,000	**TOTAL**			

INVESTMENTS AS AT 30 JUNE 2012

Principal	Counterparty	Start Date	Maturity Date	Interest Rate (%)
£0	Santander UK Business Reserve Account	Inst/Acc	Inst/Acc	0.65
£250,000	Bank of Scotland Call A/C	Inst/Acc	Inst/Acc	0.75
£0	Bank of Scotland BasePLUS Account	Inst/Acc	Inst/Acc	0.50
£4,000,000	Barclays Reserve Account	Inst/Acc	Inst/Acc	0.70
£4,950,000	NatWest Call Account	Inst/Acc	Inst/Acc	0.85
£0	Clydesdale 30 Day Notice Account	30 day	30 day	0.85
£2,000,000	Cater Allen	05/07/2011	03/07/2012	2.50
£1,500,000	NatWest Bank	03/01/2012	16/07/2012	1.01
£2,000,000	Bank of Scotland	01/06/2011	27/07/2012	2.65
£2,000,000	Bank of Scotland	02/08/2011	31/07/2012	2.05
£1,500,000	Nationwide Building Society	02/04/2012	15/08/2012	1.16
£2,000,000	Nationwide Building Society	02/04/2012	22/08/2012	1.18
£1,500,000	Bank of Scotland	06/03/2012	04/09/2012	1.75
£2,000,000	Cater Allen	29/09/2011	28/09/2012	2.50
£2,000,000	Nationwide Building Society	01/06/2012	02/10/2012	1.00
£1,000,000	Cater Allen	17/11/2011	16/11/2012	2.50
£1,000,000	Nationwide Building Society	06/06/2012	22/11/2012	1.13
£1,000,000	Cater Allen	14/12/2011	14/12/2012	2.00
£2,000,000	Bank of Scotland	14/12/2011	13/02/2013	3.10
£2,500,000	Bank of Scotland	16/02/2012	13/02/2013	3.10
£1,500,000	Bank of Scotland	01/05/2012	11/04/2013	3.00
£34,700,000	**TOTAL**			