Agenda Item 6

Finance Sub Committee – 12 September 2012

Treasury Management Update as at 30 June 2012

Purpose of report

The primary purpose of this report is to provide Members with an update on the activity of the Treasury Management function for the second half of 2011/12. However, the report also covers treasury management activities in the period up to 30 June 2012 and the likely performance for the remainder of the 2012/13 financial year.

Attachment(s)

None

1.0 Background

1.1 The Treasury Management Strategy for 2011/12 was underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009. The Treasury Management Strategy for 2011/12 was approved by the Policy & Resources Committee on 11 April 2011.

1.2 The CIPFA Code recommends that Members are informed of treasury management activities at least twice a year; this report therefore embraces best practice.

1.3 The report is designed to provide Members with:

- A summary of the economic conditions affecting the Council's investment strategy
- Details of investments made during the second half of the year
- A summary of the Council's current investment portfolio.

1.4 The Treasury Management Strategy for 2012/13 was approved by Council on 29 February 2012.

2.0 Market Conditions

2.1 At the time of determining the 2011/12 strategy in February 2011, there were tentative signs that the UK was emerging from recession with the worst of the financial crisis behind it. Recovery in growth was expected to be slow and uneven as the austerity measures announced in the 2010 Comprehensive Spending Review were implemented in order to bring down the budget deficit and government borrowing and rebalance the economy and public sector finances. Inflation measured by the Consumer Price Index (CPI) had remained stubbornly above 3% Unemployment was at a 16-year high at 2.5 million and was expected to rise further as the public and private sector contracted. There was a also high degree of uncertainty surrounding Eurozone sovereign debt sustainability.

2.2 During 2011-12 inflation remained high with CPI (the official measure) and RPI rising in September to 5.2% and 5.6% respectively primarily due to escalating utility prices and the January 2011 increase in VAT to 20%. Inflation eased slowly as reductions in transport costs, food prices, intensifying competition amongst retailers and supermarkets and the VAT effect falling out in 2012, pushed February 2012's CPI down to 3.4% and RPI to 3.7%. This, however, was not enough to offset low wage growth and, as a result, Britons suffered the biggest drop in disposable income in more than three decades.

2.3 Growth, on the other hand, remained elusive. The Bank's Quarterly Inflation Reports painted a bleak picture as the outlook was downgraded to around 1% in 2011 and 2012. The unresolved problems in the Eurozone weighed negatively on global economic prospects. UK GDP was positive in only the first and third calendar quarters of 2011; annual GDP to December 2011 registered just 0.5%. Unemployment rose to 2.68 million and, youth unemployment broke through the 1 million barrier. House prices struggled to show sustained growth and consumer confidence remained fragile.

2.4 It was not surprising that the Bank of England's Monetary Policy Committee maintained the status quo on the Bank Rate, which has now been held at 0.5% since March 2009, but increased asset purchases by £75bn in October 2011 and another £50bn in February 2012 taking the Quantitative Easing (QE) total to £325bn.

2.5 The policy measures announced in the March 2012 Budget statement were judged to be neutral. The government stuck broadly to its austerity plans as the economy was rebalancing slowly. The opinion of the independent Office for Budget Responsibility (OBR) was that the government was on track to meet its fiscal targets; the OBR identified oil price shocks and a further deterioration in Europe as the main risks to the outlook for growth and in meeting the fiscal target.

2.6 The latest forecast for the Bank of England Base rate, based on information from the Council's treasury advisers Arlingclose, is shown in table 1 below.

Table 1 - Bank of England Base Rate Forecast

	Jun -12	**Sep -12**	**Dec -12**	**Mar -13**	**Sep -13**	**Mar - 14**	**Sep -14**	**Mar -15**
Official Bank Rate								
Upside Risk				0.25%	0.50%	0.50%	0.50%	0.50%
Central Case	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**
Downside Risk		-0.25%	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%	-0.25%

2.7 Table 1 shows that the Bank of England Base rate is forecast to remain low for the foreseeable future. The impact of this on treasury performance is shown in section 3.

2.8 It is estimated that any new investment deals are likely to yield between 0.5% and 1.0%. The rates included in the Treasury Management Strategy for 2012/13 are in table 2.

Table 2 - Forecast Investment Returns

Year	**Average Return Original Estimates**	**Average Return Revised Estimates**
2012/13	1.00%	0.75%
2013/14	1.50%	0.75%
2014/15	2.00%	0.75%
2015/16	3.00%	0.75%

2.9 Table 2 shows that, due to the expected continuation of a Bank of England base rate at 0.5% until at least 2015, the returns the Council can expect on its investments will remain at current levels for longer than previously forecast.

3.0 Treasury Management Position and Performance

Investments

3.1 Table 3 summarises the council's portfolio of investments as at 31st March 2012 and the rates of return on the instant access accounts. The interest rates on the fixed term deposits are, as the name suggests, fixed for the duration of the investment term.

3.2 **Table 3 - Investments as at 31 March 2012**

Lender	Amount	Rate %	End Date
Instant Access Accounts			
Santander UK	1,989,613	0.80	
Barclays Bank	674	0.60	
Bank of Scotland	2,392	0.75	
Nat West SIBA	3,174	0.80	
Prime Rate Sterling Liquidity Fund (Money Market Fund)	2,277,520	0.88	
Deutsche Bank Sterling Fund (Money Market Fund)	2,614,606	0.77	
Fixed Term Deposits			
Lancashire County Council	3,000,000	0.40	14/06/12
	9,887,979		

3.3 The average return on the council's portfolio for 2011/2012 is 0.98%. This is 0.46% above the average 7 day LIBID rate of 0.52%.

3.4 The amount of interest earned on the council's portfolio for 2011/2012 was £143k against an initial annual budget of £135k.

3.5 Table 4 summarises the council's portfolio on investments as at 30th June 2012.

3.6 **Table 4 - Investments as at 30 June 2012**

Lender	Amount	Rate %	End Date
Instant Access Accounts			
Santander UK	1,840,614	0.80	
Barclays Bank	2,009,449	0.60	
Bank of Scotland	2,396	0.75	
Nat West SIBA	978	0.80	
Prime Rate Sterling Liquidity Fund (Money Market Fund)	3,001,690	0.71	
Deutsche Bank Sterling Fund (Money Market Fund)	2,730,767	0.63	
Fixed Term Deposits			
DMADF (Debt Management Account Deposit Facility – DMO)	1,800,000	0.25	(1week fixed to 06/07/12)
	11,385,894		

3.7 Due to uncertainty within the market and ongoing weakness in the banking sector, the council has followed its strategy of keeping liquid money in AAA rated money market funds and instant access accounts with banks that meet the minimum criteria of A- as set out in the policy. This has become an increasing challenge with numerous banks being downgraded and advice from Arlingclose to reduce the amounts held with any one counter party. This limits our ability to maximise interest income on a daily basis. The market has seen various banks and institutions downgraded, as the Euro crisis deepens. The impact of more and more banks and institutions not meeting the criteria set out in the current treasury strategy limits the counter parties available to place money that is deemed to be secure while ensuring that the Council's funds are liquid.

3.8 In order to manage this situation, monies were placed with other Local Authorities and the Debt Management Office (DMO). A review is being undertaken to assess the benefit of a Money Market Portal to facilitate the placement of funds into more institutions than the Council currently has access to. This will enable greater diversification of the Council's portfolio, minimise the risk and retain the asset's liquidity.

3.9 During the first quarter of 2012/2013 there has been little opportunity to invest surplus cash into a fixed rate deposit. Due to the uncertainty in the banking sector, advice from Arlingclose was to hold surplus cash in overnight deposits with a number of counterparties. This advice has recently been revised to extend duration limits from overnight to 35 or 100 days for these counterparties, and we have been able to utilise this advice by placing fixed deposits this week for periods of three months. The revised duration limits will also reduce the need to place surplus funds, as an option into the DMADF (Debt Management Account Deposit Facility), earning 0.25%. The market continues to remain fairly volatile and this advice could change.

3.10 With the current counterparty list available, and if base rates were to fall further as indicated above in Table 1, the challenge to achieve budgeted interest, and to maximise interest on a daily basis will continue. As such the Council's investment priorities in priority order are:

- Security of the invested capital
- Liquidity of the invested capital
- The return received from the investment

Borrowing

3.11 When the Council approved its capital programme on 29 February 2012 an element of the funding was planned from temporary borrowing. This temporary borrowing would be used to manage the timing of cash flows between expenditure commitments on capital investment and the receipt of monies from sale of assets. The forecast amount of temporary borrowing for 2012/13 was £678k.

3.12 At present the Council has not had to undertake any temporary borrowing to finance its capital programme. This is because the capital programme is in the early stages of the financial year and capital reserves are being utilised to fund capital expenditure first.

3.13 However, based on the current spending forecast for the capital programme (see report elsewhere on the agenda) the Council will need to use temporary borrowing. It should be noted that the Council will seek to use its surplus cash resources to finance its capital programme in the first instance rather than borrowing externally from the market. This is known as "internal borrowing". This approach would used as it is likely to be a lower cost option, i.e. it will be cheaper to forgo a return on investment than pay the cost of borrowing the money from the market. When implementing this approach the Council will need to be mindful not to run its cash balances too low.

3.14 The temporary borrowing position and how it is financed will be kept under review throughout the year.

3.15 It should be noted the level of temporary borrowing to finance capital spending in 2012/13 is dependent on the Council realising monies by selling assets. The budgeted amount for asset sales in 2012/13 is £860k. If this does not materialise in year the Council will need to either increase its temporary borrowing requirement (with an additional interest burden on the revenue budget) or delay spending on its capital programme until monies are realised from asset sales.

4.0 Equality and Diversity Implications

4.1 This report is for information. There are no equality and diversity implications arising from the content.

5.0 Legal Implications

5.1 This report is for information. There are no legal implications arising from the content.

6.0 Risk Management

6.1 This report is for information. There are no significant risks arising.

7.0 Financial Implications

7.1 The financial implications of the current economic climate on the expected level of investment income are set out in paragraphs 2.7 and 4.3.

8.0 Corporate Outcomes

8.1 The report demonstrates support for the following corporate outcomes:

- Good Value for Money
- Effective Management

9.0 Recommendation

9.1 The Working Party is recommended to

Note the Treasury Management performance

(Reason – in accordance with CIPFA guidance and best practice in Treasury Management)

Legal	Power: Local Government Act 2003 (Prudential Code) Other considerations:				
Background Papers: Treasury Management Strategy 2011/12 and 2012/13					
Person Originating Report: **Glenn Hammons, Chief Finance Officer**					
Date: 25 August 2012					
CFO		**MO**		**CX**	