WARWICK DISTRICT COUNCIL	**Finance & Audit Scrutiny Committee - 1 March 2011**	**Agenda Item No.** **5**

Title	Treasury Management Activity Report for the period 1 October 2010 to 31 December 2010.
For further information about this report please contact	Roger Wyton, Principal Accountant 01926 456801 roger.wyton@warwickdc.gov.uk
Service Area	Finance
Wards of the District directly affected	All
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No
Date and meeting when issue was last considered and relevant minute number	n/a
Background Papers	Treasury Management File L2/9 Treasury Management Information via External Advisers, Brokers, External Investment Agents etc.

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	No
Included within the Forward Plan? (If yes include reference number)	No

Officer/Councillor Approval

With regard to officer approval all reports *must* be approved by the report authors relevant director, Finance, Legal Services and the relevant Portfolio Holder(s).

Officer Approval	**Date**	**Name**
Relevant Director	8/2/2011	Andy Jones
Chief Executive	N/A	
CMT	N/A	
Section 151 Officer	15/2/2011	Mike Snow
Legal	N/A	
Finance	7/2/2011	Roger Wyton
Portfolio Holder(s)	N/A	

Consultation Undertaken

None

Final Decision?	Yes

Suggested next steps (if not final decision please set out below)

1. **SUMMARY**

1.1 This report details the Council's Treasury Management Performance for the period 1st October 2010 to 31st December 2010.

2. **RECOMMENDATION**

2.1 That the Members of the Finance and Audit Scrutiny Committee note the contents of this report.

3. **REASONS FOR THE RECOMMENDATION**

3.1 The Council's 2010/11 Treasury Management Strategy and Treasury Management Practices (TMP's) require the performance of the Treasury Management Function to be reported to Members on a quarterly basis.

3.2 This report informs members of past performance, hence Members are just asked to note the information contained within it.

4. **ALTERNATIVE OPTION CONSIDERED**

4.1 None.

5. **BUDGETARY FRAMEWORK**

5.1 Treasury Management has a potentially significant impact on the Council's budget through its ability to maximise its investment interest income and minimise borrowing interest payable whilst ensuring the security of the capital. The Council is reliant upon interest received to help fund the services it provides and it is anticipated that total interest amounting to £353,000 in round terms will be credited to the General Fund in 2010/11. The overall position is shown in the table below:

	Original 2010/11 Budget £	**Latest 2010/11 Budget £**
Gross Investment Interest	466,455	440,000
Less HRA allocation	192,200	154,000
Net interest to General Fund	**274,255**	**286,000**

In addition to the figures in the table above, in 2010/11 the Council has received £67,000 from HMRC in respect of interest on a VAT refund.

6. **POLICY FRAMEWORK**

6.1 Treasury Management will support the 2008-11 Corporate Strategy through its contribution to the effective management of resources.

7. **ECONOMIC BACKGROUND**

7.1 Activity indicators suggested that the recovery still has a reasonable amount of momentum. Market surveys improved in the third quarter and are now consistent again with modest growth, having briefly pointed to a double-dip in prior months. The surveys suggested that the recovery weakened in the construction sector, but strengthened in the larger manufacturing sector. GDP

(Gross Domestic Product) expanded by 0.7%q/q in the third quarter of 2010. There were signs that consumer spending improved during the quarter. Retail sales volumes rose by a solid 0.7% and 0.3% in October and November respectively. Survey evidence has suggested that December's heavy snowfall has not had too much of a negative effect on retail spending over the festive period as a whole, with consumers making up for weaker spending in early December during the post-Christmas "sales" period.

7.2 House prices have also continued to fall during the quarter. The Nationwide measure fell by 0.7% m/m in October and 0.3%m/m in November, before rising by 0.4%m/m in December. The Halifax house price measure rose by 1.9% m/m in October, this only offset around half of the fall in September. The measure subsequently posted a small 0.1% m/m drop in November but a fall of 1.3% in December.

7.3 Public finances appear to have deteriorated during the quarter. Borrowing on the PSNB ex. measure was in line with 2009/10's figure in October but was £6bn higher than a year before in November. The figures therefore cast doubt on whether the Government will be able to meet its borrowing forecast of £149bn this year, some £7bn lower than last year's total. Elsewhere, there are still few signs that the external sector has begun to support the overall recovery. The trade in goods deficit widened again from £8.4bn to £8.5bn in October, while the overall deficit also grew from £3.8bn to £3.9bn. While export goods volumes rose by 2.2% m/m in October, import goods volumes rose by a larger 2.6%.

7.4 CPI (consumer price inflation) inflation edged up from 3.1% to 3.2% in October and then to 3.3% in November. Part of the rise may have reflected retailers pushing up their prices ahead of the VAT rise in January 2011. The rise also seems to have reflected the surge in commodity prices during the quarter and earlier in the year. If these commodities hold onto their recent price gains, then their inflationary effects will build over the next few months.

8. INTEREST RATE ENVIRONMENT

8.1. The major influence on the Council's investments is the Bank Rate. The Bank Rate remained at 0.5% for the whole of the quarter ending 31st December 2010. The Council's Treasury Management Advisors, Sector, provided the following forecast for future Bank Rates:

<u>Sector's Bank Rate Forecasts:</u>

	Now	Dec 2010	Mar 2011	Jun 2011	Sep 2011	Dec 2011	Mar 2012	Jun 2012	Sep 2012	Dec 2012	Mar 2013
Current Forecast, as at 6TH January 2011:											
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.25%
Forecast, as at 23rd November 2009, (when Original Budgets were set):											
Bank Rate	0.75%	1.00%	1.50%	2.25%	2.75%	3.25%	3.50%	3.75%	4.25%	4.25%	4.25%

In line with previous criticism that the Bank's forecasts for GDP growth were too optimistic , The Bank of England Inflation Report in November downgraded the forecast for GDP growth for 2011 from 2.8% to around 2.3% and slightly upgraded the 2012 forecast to 3%. However, this relies on major assumptions around a continuation of healthy world growth rates as several factors are likely to dampen the UK growth rate including the facts that the public sector will be a negative contributor to the UK growth rate, personal expenditure growth rates are likely to be weak and credit is likely to be hard to come by. The forecast as at November 2009 is shown for comparison purposes as this forecast was used in calculating the original budgets.

8.2. The Council aims to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. The Annual Investment Strategy 2010/11 was approved by Council on 24th February 2010. This approved the current lending criteria which reflect the level of risk appetite of the Council. However, the Council continues to review its Standard Lending List as a result of frequent changes to Banking Institutions credit ratings, to ensure that it does not lend to those institutions identified as being at risk from the residual impact of the past crisis in the banking sector.

9 INVESTMENT PERFORMANCE

Money Market Investments

9.1. During 2010/11, the in house function has invested both cash flow driven and core cash funds in fixed term deposits in the Money Markets. The table below illustrates the performance of the in house function for each category normally invested in:

Period	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) performance
Up to 7 days			
April to June 2010	No investments made in this quarter.		
July to Sept 2010	No investments made in this quarter		
Oct to Dec 2010	No investments made in this quarter		
Over 7 days & Up to 3 Months			
April to June 2010	0.84%	0.44%	+0.40%
Value of Interest earned – Q1	£13,145	£6,913	+£6,232
July to Sept 2010	0.76%	0.46%	+0.30%
Value of interest earned – Q2	£19,643	£11,938	+£7,705
Oct to Dec 2010	0.82%	0.47%	+0.35%
Value of interest earned – Q3	£17,927	£10,311	+£7,616
Over 3 Months & Up to 6 Months			
April to June 2010	0.84%	0.64%	+0.20%
Value of Interest earned – Q1	£5,108	£3,856	+£1,252
July to Sept 2010	0.75%	0.69%	+0.06%
Value of interest earned – Q2	£13,100	£12,134	+£966

Oct to Dec 2010	0.68%	0.70%	-0.02%
Value of interest earned – Q3	£3,688	£3,821	-£133

Period	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) performance
Over 6 Months to 363 days			
April to June 2010	1.10%	0.99%	+0.11%
Value of Interest earned – Q1	£22,422	£20,133	+£2,289
July to Sept 2010	No investments made in this quarter		
Value of interest earned – Q2	N/A		
Oct to Dec 2010	No investments made in this quarter		
Value of interest earned – Q2	N/A		
364 days and over			
April to June 2010	1.47%	1.21%	+0.26%
Value of Interest earned – Q1	£146,416	£120,538	+£25,878
July to Sept 2010	1.41%	1.28%	+0.13%
Value of interest earned – Q2	£70,330	£64,031	+£6,299
Oct to Dec 2010	1.40%	1.30%	+0.10%
Value of interest earned – Q3	£153,152	£142,603	+£10,549

9.2. At this time of year, the length of time for which the Council's cash flow investments is invested reaches its maximum and in this period within the Over 7 Days and Up to 3 Months category 9 cashflow investments were made with Building Societies, all but one around three months duration. Overall, the investments in this category produced an average return of 0.82% compared to the LIBID benchmark of 0.47% which is an amalgam of the 1 and 3 month LIBID rates. This out performance of 0.35% was achieved due to the fact that the Building Societies were paying significantly above the LIBID rates but it was still felt appropriate to invest in them as they satisfied the Council's approved investment criteria including a maximum duration of three months. When compared to the three month rate alone of 0.62% the out performance is 0.20% which is still very satisfactory

9.3. As mentioned above, the Council's cashflow profile is at its lengthiest and in the Over Three and Up to Six Months category 2 further cashflow investments, both marginally over three months duration have been made which produced an average return of 0.68% compared to a LIBID benchmark of 0.70% which is a combination of the 3 and 6 month rates. This shows a slight under performance of 0.02%. In reality, as the 2 investments were only slightly over the three month period they are better compared to the three month rate alone of 0.62% which produced an out performance of 0.06%.

9.4 During quarter 3 no investments were placed in the Over 6 Months and Up to 363 Day category.

9.5 Taking advantage of enhanced rates being offered for 364 day money, seven maturing core investments were re-invested during this quarter in the 364 or 365 days part of the market and these earned rates between 1.25% and 1.45% although one investment with Santander was placed at 1.73% with the average performance being 1.40%, this compares to a LIBID benchmark of 1.30% for the over 364 day category, showing an out performance of 0.10%. The investments were placed with Nationwide Building Society, Royal Bank of Scotland, Barclays Bank and Santander all conforming with our credit rating requirements for investments of 364 days or longer.

9.6 Given that the current Bank Rate is only 0.50% the levels of outperformance achieved in this quarter continue to be satisfactory.

Money Market Funds

9.7 The in house function continues to utilise the Money Market Funds to assist in managing its short term liquidity needs. Their performance in this period is shown in the table below:

Fund	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) Performance
Standard Life			
April to June 2010	0.48%	0.42%	+0.06%
Value of Interest earned – Q1	£1,769	£1,550	+£219
July to Sept 2010	0.54%	0.43%	+0.11%
Value of interest earned – Q2	£2,893	£2,288	+£605
Oct to Dec 2010	0.57%	0.43%	+0.14%
Value of interest earned – Q3	£4,106	£3,074	+£1,032
Invesco Aim			
April to June 2010	0.49%	0.42%	+0.07%
Value of Interest earned - Q1	£4,598	£3,997	+£601
July to Sept 2010	0.52%	0.43%	+0.09%
Value of interest earned – Q2	£1,765	£1,456	+£309
Oct to Dec 2010	0.53%	0.43%	+0.10%
Value of interest earned – Q3	£551	£446	+£105
Prime Rate			
April to June 2010	0.91%	0.42%	+0.49%
Value of Interest earned – Q1	£11,350	£5,272	+£6,078
July to Sept 2010	0.92%	0.43%	+0.49%
Value of interest earned – Q2	£11,184	£5,236	+£5,948
Oct to Dec 2010	0.87%	0.43%	+0.44%
Value of interest earned – Q3	£9,953	£4,944	+£5,009

9.8 During the quarter ending December 2010, the policy was to continue using the Money Market Funds in preference to the Business Reserve Accounts for liquidity balances as the Money Market Funds were paying rates equal to or above the current Bank Rate. The comparable rates being offered by the Business Reserve Accounts were lower than the Money Market Fund rates because for the levels of investments being held in the accounts we would not earn the top level, equivalent to bank rate or slightly higher. The Council continues to trade in the Money Market Funds through the Money Market Fund Portal, which will also be used for future trading in other new Money Market Funds and which may be extended to include Money Market investments as well.

9.9 On an annualised basis, the Council will earn £14,610 interest on its Money Market Fund investments in the quarter ending 31st December 2010. The average principal maintained in the funds was £7,773,496.

Business Reserve Accounts

9.10 The Council operates two Business Reserve accounts with Santander and Lloyds Banking Group. If sufficient balances are maintained these accounts offer a guaranteed rate of return equivalent to Bank Rate or slightly higher. However, because the Money Market Funds were offering rates above the Business Reserve Accounts for the levels of investments held, the Business Reserve Accounts were not used.

9.11 An analysis of the overall in house investments held by the Council at the end of December 2010 is shown below:

(The previous quarter is shown for comparison)

Type of Investment	Closing Balance Q2 As at 30th September 2010	Closing Balance Q3 As at 31st December 2010
Money Markets	34,000,000	37,000,000
Money Market Funds	5,889,000	10,643,000
Business Reserve Accounts	0	0
Total	**39,889,000**	**47,643,000**

9.12 The original estimate of annual external investment interest for 2010/11 was £466,455 gross and the latest estimate is £440,004. This decrease is mainly accounted for by the reduced interest rates used in the calculations as a result of the revised Bank Rate forecast provided. This forecasts that interest rates will be at a lower level for a longer period than had been originally anticipated.

10 BORROWING

10.1 During the quarter it was not necessary to undertake any Money Market borrowing to fund cashflow deficits, with any deficits being managed within the Council's £100,000 overdraft facility with HSBC. The interest rate on this facility is 2% above Bank Rate and is charged on the cleared balance at the end of each day when that balance is in debit i.e. overdrawn. In the October to December 2010 quarter interest amounting to £20 was paid on debit balances. This is normally offset by the interest earned at 1% below Bank Rate on the days when the end of day balance was in credit; however, with Bank Rate at 0.50% this is not applicable.

11 PRUDENTIAL INDICATORS

11.1 The 2009/10 Treasury Management Strategy included a number of Prudential Indicators within which the Council must operate. The two major ones are the Authorised Limit and Operational Boundary for borrowing purposes and it is confirmed that during the quarter neither indicator has been exceeded.