WARWICK DISTRICT COUNCIL	**Finance & Audit Scrutiny Committee - 15 November 2011**	**Agenda Item No. 7**

Title	Treasury Management Activity Report for the period 1st July 2011 to 30th September 2011.
For further information about this report please contact	Roger Wyton, Principal Accountant 01926 456801 roger.wyton@warwickdc.gov.uk
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Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No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
Equality & Sustainability Impact Assessment Undertaken	No – not relevant

Officer/Councillor Approval		
Officer Approval	**Date**	**Name**
Chief Executive/Deputy Chief Executive	27/10/2011	Andy Jones
Head of Service	27/10/2011	Andy Jones
CMT	N/A	
Section 151 Officer	26/10/2011	Mike Snow
Monitoring Officer	N/A	
Finance	25/10/2011	Roger Wyton
Portfolio Holder(s)	N/A	
Consultation & Community Engagement		
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 July 2011 to 30th September 2011.

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 2011/12 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. **POLICY FRAMEWORK**

4.1 Treasury Management will support the Council in achieving its aims as set out in "Fit for the Future"

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. The current estimate for investment interest in 2011/12 compared with the original budget is shown in the table below:

	Latest 2011/12 Budget (Aug 11)	**Original 2011/12 Budget (Jan 11) £**
Gross Investment Interest	494,221	462,484
Less HRA allocation	153,700	146,300
Net interest to General Fund	**340,521**	**316,184**

5.2 When the 2011/12 original budget for investment interest was calculated in January 2011, it was expected that Bank Rate would begin to rise from its current 0.50% in the quarter ending December 2011. Sector's latest forecast as at October 2011 is that Bank Rate will not now rise until the quarter ending September 2013 (previously June 2012) which will not affect the latest budget shown above as it was prudently prepared on the basis of Bank Rate remaining at 0.50% throughout 2011/12. Offsetting this is the fact that the Council has increased balances available for investment during 2011/12, partly due to slippage in the 2010/11 capital programme and this has resulted in increased investment interest over the original.

6. **ALTERNATIVE OPTION CONSIDERED**

6.1 None.

7. **ECONOMIC BACKGROUND**

7.1 A detailed commentary by our Treasury Consultants, Sector, of the economic background surrounding this quarter appears as Appendix A.

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 30th September 2011. The Council's Treasury Management Advisors, Sector, provided the following forecast for future Bank Rates:

Sector's Bank Rate Forecasts:

Qtr ending	Now (Oct 11)	Dec 2011	Mar 2012	Jun 2012	Sep 2012	Dec 2012	Mar 2013	Jun 2013	Sep 2013	Dec 2013	Mar 2014	Jun 2014
Current Forecast, as at October 2011:												
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%
Forecast, as at January 2011, (when Original Budgets were set):												
Bank Rate	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.25%	2.75%	3.00%	3.25%	3.25%

Sector has undertaken a review of its interest rate forecasts as a result of two major events;

1. The decision by the MPC to expand quantitative easing over the next four months by a further £75 billion which clearly underlines how concerned the MPC now is about the prospects for growth of the UK economy and that recession is now a much greater concern than inflation

2. The marked deterioration of growth prospects in the US, EU and UK, especially as concerns have further increased over Greece and the potential fall out of their debt situation. Current UK consumer sentiment e.g. job fears, high inflation eroding disposable income, small or no pay increases etc. makes it clear that it is unlikely in the near term that the consumer will provide the engine for the growth required to make the MPC decide to raise the Bank Rate.

These two factors support Sector's view that the first increase in Bank Rate will be considerably delayed beyond its last forecast (August 11) that Bank Rate would begin to rise from June 2012. The forecast as at January 2011 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 2011/12 was approved by Council on 9th March 2011. 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 either from the residual impact of the past crisis in the banking sector or the potential issues arising from the current Eurozone debt crisis.

9 INVESTMENT PERFORMANCE

Money Market Investments

9.1. During 2011/12, 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 during this quarter and also at the half year for each category normally invested in:

Period	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) performance
Up to 7 days			
April to June 2011	No investments made in this quarter.		
July to Sept 2011	No investments made in this quarter		
April to Sept 2011	No investments made in half year		
Over 7 days & Up to 3 Months			
April to June 2011	0.93%	0.49%	+0.44%
Value of Interest earned – Q1	£4,564	£2,402	+£2,162
July to Sept 2011	0.91%	0.63%	+0.28%
Value of Interest earned – Q2	£13,171	£9,163	+£4,008
April to Sept 2011	0.91%	0.56%	+0.35%
Value of Interest earned – half year	£17,735	£11,565	+£6,170
Over 3 Months & Up to 6 Months			
April to June 2011	No investments made in this quarter.		
July to Sept 2011	No investments made in this quarter		
April to Sept 2011	No investments made in half year		
Over 6 Months to 364 days			
April to June 2011	1.71%	1.46%	+0.25%
Value of Interest earned – Q1	£68,255	£58,212	+£10,043
July to Sept 2011	1.14%	1.26%	-0.12%
Value of Interest earned – Q2	£20,997	£23,183	-£2,186
April to Sept 2011	1.53%	1.36%	+0.17%
Value of Interest earned – half year	£89,252	£81,395	+£7,857
365 days and over			
April to June 2011	1.85%	1.40%	+0.45%
Value of Interest earned – Q1	£92,825	£70,067	+£22,758
July to Sept 2011	2.01%	1.50%	+0.51%
Value of Interest earned – Q2	£80.500	£60,036	+£20,464
April to Sept 2011	1.92%	1.45%	+0.47%
Value of Interest earned – half year	£173,325	£130,103	+£43,222

9.2 In order to more accurately align the categories above with the appropriate maximum length of investments as specified in the Annual Investment Strategy ,it should be noted that the previous Over 6 Months to 363 Days category has now been re-defined to include 364 day investments and the relevant quarter 1 investments have been transferred from the previous 364 Days and Over category with that category now re-titled 365 Days and Over.

9.3. During July to September, the majority of the Council's cash flow investments were made into the three Money Market Funds due to the short time span between the cash being received e.g. Council Tax and NNDR instalments and then paid out again e.g. County Council and Police Authority precepts but 5 investments were made in the Over 7 Days and up to Three Months category during the quarter. These investments produced an average return of 0.91% compared to the LIBID benchmark of 0.63% which is an amalgam of the 1 and 3 month LIBID rates. This out performance of 0.28% was achieved due to the fact that the Building Societies with whom the investments were placed were paying 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. All the investments were for three months in each case and when compared to the three month rate alone of 0.74% the out performance is 0.17% which is still very satisfactory.

9.4 Two investments were made in the Over 6 Months and Up to 364 Days category and both were cash flow driven producing a return of 1.14%. When compared with the hybrid of 6 months and 1 year LIBID rates which was 1.26% there was an underperformance of 0.12%. In both instances the duration of the investment was around seven months and when compared with the 6 month LIBID rate alone which was 1.03% there is an out performance of 0.11% .

9.5 During July to September two core investments with the Bank of Scotland matured and they were re-invested in the same high interest deposit account for a further 365 days earning an average of 2.01%. This compares to a LIBID benchmark of 1.50% for the over 365 day category, showing an out performance of 0.51%.

9.6 Given that the current Bank Rate is only 0.50% the level of outperformance achieved in this quarter continues 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 together with a summary of the first half year performance is shown in the table overleaf:

Fund	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) Performance
Standard Life to 31st May 2011 (Deutsche from 1st June 2011)			
April to June 2011	0.61%	0.46%	+0.15%
Value of Interest earned – Q1	£4,454	£3,382	+£1,072
July to Sept 2011	N/A	N/A	N/A
April to Sept 2011	0.61%	0.46%	+0.15%
Value of Interest earned – half year	£4,454	£3,382	+£1,072
Deutsche from 1st June 2011			
April to June 2011	0.66%	0.46%	+0.20%
Value of Interest earned – Q1	£2,954	£2,071	+£883
July to Sept 2011	0.66%	0.48%	+0.18%
Value of Interest earned – Q2	£6,637	£4,814	+£1,823
April to Sept 2011	0.66%	0.47%	+0.19%
Value of Interest earned – half year	£9,591	£6,885	+£2,706
Invesco Aim			
April to June 2011	0.57%	0.46%	+0.11%
Value of Interest earned - Q1	£939	£767	+£172
July to Sept 2011	0.57%	0.48%	+0.09%
Value of Interest earned – Q2	£794	£668	+£126
April to Sept 2011	0.57%	0.47%	+0.10%
Value of Interest earned – half year	£1,733	£1,435	+£298
Prime Rate			
April to June 2011	0.83%	0.46%	+0.37%
Value of Interest earned – Q1	£12,239	£6,820	+£5,419
July to Sept 2011	0.86%	0.48%	+0.38%
Value of Interest earned – Q2	£12,620	£7,070	+£5,550
April to Sept 2011	0.85%	0.47%	+0.38%
Value of Interest earned – half year	£24,859	£13,890	+£10,969

9.8 As referred to in paragraph 9.3 above, during the quarter ending September 2011 the majority of the Council’s cash flow investments were into the Money Market Funds and the policy of using these funds in preference to the Business Reserve Accounts for liquidity balances was continued 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. It can be seen from the table above that the out performance of the benchmark continued to be satisfactory. The Council continues to trade in the Money Market Funds through the Money Market Fund Portal and has recently opened two new Money Market Funds with Goldman Sachs and Ignis.

9.9 On an annualised basis, the Council will earn £20,051 interest on its Money Market Fund investments in the quarter ending 30th September 2011. The average balance in the funds for the quarter was £10,596,677.

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 September 2011 is shown below:

(The previous quarter is shown for comparison)

Type of Investment	Closing Balance Q1 As at 30th June 2011	Closing Balance Q2 As at 30th Sept 2011
	£	£
Money Markets	29,000,000	34,000,000
Money Market Funds	12,763,000	5,847,000
Business Reserve Accounts	0	0
Total	**41,763,000**	**39,847,000**

9.12 The original estimate of annual external investment interest for 2011/12 was £462,484 gross and this was revised in August to £494,221, the additional amount being partly due to increased balances available for investment resulting from slippage in the capital programmes.

10. BENCHMARKING

10.1 At its last meeting members of this Committee asked whether an alternative benchmark to the LIBID rates could be found which would prove more challenging. To date one has not been found although research is continuing and this will be raised at the next meeting of the newly formed Sector Treasury Management Benchmarking Club of which this Council is a member in case any of the other members have found such a benchmark.

10.2 With regard to the Sector Treasury Management Benchmarking Club, the Council is part of a local group comprising both District and County Councils and analysis of the results for the September quarter show that the Councils weighted average rate of return on its investments made in the September quarter at 1.37% was in line with Sector’s model portfolio rate of return based on the risk in our portfolio which was 1.35% and considerably above the group’s rate of return which was 0.95%. Further analysis indicates that the groups relatively low rate of return was in part due to significant amounts of investments, particularly by the County Councils, being placed with the Governments overnight and short term Debt Management Office facility which offers high security but at the expense of significantly lower interest rates than could be obtained from investing in Money Market Funds thus depressing the groups weighted average rate of return. Money Market Funds are themselves of equal security being AAA rated and were widely used by this Council during the September quarter thus contributing to the out performance.

11 BORROWING

11.1 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 June to September 2011 quarter no overdraft interest was paid . Overdraft interest 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.

12 PRUDENTIAL INDICATORS

12.1 The 2011/12 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.

APPENDIX A

1. SECTOR COMMENTARY ON THE CURRENT ECONOMIC BACKGROUND.

1.1 Activity indicators suggest that the economic recovery has ground to a halt. Indeed, the weighted output balance of the CIPS/Markit surveys fell in August to a level that has been consistent with contraction in the past. The surveys also exclude retail activity – and the latest news from the high street suggests that the sector is in a similar position. While sales volumes rose by 0.2% m/m in July, they fell by the same amount in August.

1.2 However, output for the first quarter was depressed by a variety of factors (including the one-off Bank Holiday for the Royal Wedding in April and the after-effects of the Japanese earthquake), so the economy might still register growth in the second quarter.

1.3 Meanwhile, the fading of the economic recovery has impacted on the job market. The Labour Force Survey measure of employment fell by 70,000 in the three months to July, the first fall this year. And the ILO measure of unemployment rose by 80,000 over the same period – the largest rise in two years. The timelier (but narrower) claimant count measure also rose by a monthly 33,700 in July and 20,300 in August. The pace of job losses across the whole economy looks unlikely to ease off in the coming months. Job vacancies in the three months to August were 1.3% lower than a quarter ago, while the employment balances of all three of the CIPS surveys were below the 50-mark in July and August (below 50 marks a contraction in expectations).

1.4 Meanwhile, the public finances are on track to miss this year's fiscal forecasts. If the trend in borrowing seen over the first five months of the fiscal year continues, it will be around £5bn higher than the OBR expects. Admittedly, the full impact of some tax changes have yet to be felt, but the lags between developments in the economy and the public finances suggest that the recent slowdown is unlikely to have had its full effect on receipts.

1.5 Conditions in the housing market have also continued to deteriorate. Whilst the number of mortgage approvals for new house purchase rose from 48,800 in June to 52,400 in August, this has not prevented renewed falls in house prices. The Nationwide index ended the second quarter 0.2% lower than at the end of the first.

1.6 The trade in goods and services deficit was £4.5bn in July, compared to an average monthly deficit of £3.8bn in Q1. The survey measures of export orders also point to falls in exports ahead – the new export orders balance of the CIPS Manufacturing survey, for example, fell to its lowest level since May 2009 in September. At that level, it points to a quarterly drop in the volume of manufactured goods exports of around 5%.

1.7 Inflation continued to climb in the second quarter. CPI inflation rose from 4.2% in June to 4.4% in July and 4.5% in August. A series of rises in electricity and gas prices also took effect in late August and September which, together with a rise in food inflation reflecting past rises in agricultural commodity prices, could push inflation close to 5% in September.

1.8 Inflation may creep a little higher in the third quarter – but recent developments suggest that it should fall quite sharply next year. Oil prices fell from $113 per barrel at the end of Q1 to $106 at the end of Q2. Agricultural prices also fell over the past quarter. Surveys of manufacturers pricing intentions in Q2 also pointed to a fall in producer output price inflation ahead. Meanwhile, the continued weakness of the broad money supply and lending data in Q2 and the persistence of a large degree of spare capacity in the economy also suggest that inflation will fall sharply in 2012.

1.9 Measures of inflation expectations have drifted up – the Bank of England's measure of households' inflation expectations in the year ahead rose from 3.9% to 4.2% in Q2. However with conditions in the labour market continuing to deteriorate, these expectations seem unlikely to become ingrained. The annual rate of average earnings growth including bonuses fell from 3.1% to 2.9% in July (the rate excluding bonuses fell from 2.2% to 1.7%). Real pay growth has thus remained negative.

1.10 Meanwhile, the MPC became distinctly more dovish during Q2. Spencer Dale and Martin Weale both abandoned their votes for a rate hike at the meeting in August. The minutes of September's meeting also suggested that QE2 will be launched soon, although, no other members have yet joined Adam Posen in voting for more QE. Most have however accepted that the case for policy stimulus has significantly strengthened and that "a continuation of the conditions seen over the past month would probably be sufficient to justify an expansion of the asset purchase programme at a subsequent meeting."

1.11 Financial market sentiment deteriorated sharply in the second quarter, reflecting declining prospects for economic growth and renewed risk aversion as a result of the intensification of the euro-zone sovereign debt crisis. The FTSE 100 finished the quarter at 5,128 – about 14% lower than its level at the end of the first quarter. Ten year gilt yields plummeted from 3.38% to 2.43%, reflecting falling interest rate expectations, safe-haven flows as a result of a perceived rise in default risk on sovereign debt in the euro-zone and perhaps expectations that further QE might soon be on the way. Meanwhile, a global shift away from risk saw the dollar strengthen. As a result, sterling weakened against the dollar from about $1.60 to $1.56, but strengthened slightly against the euro from €1.16 to €1.10.

1.12 In the US, economic data was weak, but a little stronger than in the UK. The US ISM indices pointed to annualised quarterly GDP growth of around 1.5% in July and August. Growth in payrolls also stagnated in August. And while President Obama proposed a $450bn job creation bill, equivalent to nearly 3% of GDP, it seems unlikely to be passed by Congress in full.

1.13 Growth has also slowed sharply in the euro-zone. In particular, the ECB composite PMI now pointed to outright falls in GDP in August. A steep drop in the EC Economic Sentiment Indicator in August also left the index consistent with a sharp slowdown in annual GDP growth in the region.