WARWICK DISTRICT COUNCIL	Finance and Audit Scrutiny Committee. 9th August 2011.	Agenda Item No. 5

Title	Treasury Management Activity Report for the period 1st April 2011 to 30th June 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Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No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	21/07/2011	Andy Jones
Head of Service	21/07/2011	Andy Jones
CMT	N/A	
Section 151 Officer	21/07/2011	Mike Snow
Monitoring Officer	N/A	
Finance	25/07/2011	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 April 2011 to 30th June 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 and the current estimate for investment interest in 2011/12 is shown in the table below:

	Original 2011/12 Budget (Jan 11) £
Gross Investment Interest	462,484
Less HRA allocation	146,300
Net interest to General Fund	**316,184**

5.2 When the 2011/12 original budget for investment interest was calculated, 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 July 2011 is that Bank Rate will not now rise until the quarter ending June 2012. 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. The effect of these two factors on the forecast for investment interest is currently under review and the forecast will be updated as part of the usual budget monitoring process.

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

Sector's Bank Rate Forecasts:

Qtr ending	Now (Jun 11)	Sep 2011	Dec 2011	Mar 2012	Jun 2012	Sep 2012	Dec 2012	Mar 2013	Jun 2013	Sep 2013	Dec 2013	Mar 2014
Current Forecast, as at July 2011:												
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.00%	2.25%	2.50%
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 its normal quarterly review of interest rates and its central forecast now is for a June 2012 first increase in Bank Rate.The key question is how quickly will the UK economy respond to the stimulus of low Bank Rate and quantative easing. An anaemic economic recovery is most probably the likely outcome for the next three to four years as lack of credit is still stifling growth. The MPC looks likely to determine that further increases in CPI inflation towards 5% are due to one off factors which will drop out over the succeeding 12 months leading to inflation coming back to near the target of 2% over a two to three year horizon. These two factors also support the view that the first increase in Bank Rate will be considerably delayed. 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 from the residual impact of the past crisis in the banking sector.

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 overleaf 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 2011	No investments made in this quarter.		
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
Over 3 Months & Up to 6 Months			
April to June 2011	No investments made in this quarter.		
Over 6 Months to 363 days			
April to June 2011	1.91%	1.46%	+0.45%
Value of Interest earned – Q1	£18,891	£14,463	+£4,428
364 days and over			
April to June 2011	1.78%	1.40%	+0.38%
Value of Interest earned – Q1	£142,189	£111,962	+£30,227

9.2. During April to June, 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 so only 2 investments were made in the Over 7 Days and up to Three Months category during the quarter. These investments produced an average return of 0.93% compared to the LIBID benchmark of 0.49% which is an amalgam of the 1 and 3 month LIBID rates. This out performance of 0.44% was achieved due to the fact that the Building Societies with whom the investments were placed 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. Both investments were towards the three month end of the spectrum and when compared to the three month rate alone of 0.70% the out performance is 0.23% which is still very satisfactory.

9.3 One investment was made in the Over 6 Months and Up to 363 Days category and this was a maturing core investment which was re-invested with Santander for 361 days at 1.91%. When compared with the LIBID benchmark for 1 year which is more appropriate in this instance than the hybrid of 6 months and 1 year usually used the out performance was 0.45%..

9.4 During April to June, five other core investments matured and taking advantage of enhanced rates being offered for 364 day money, they were re-invested during this quarter in the 364 days part of the market and these earned rates between 1.52% and 1.95% with the average performance being 1.78%, this compares to a LIBID benchmark of 1.40% for the over 364 day category, showing an out performance of 0.38%. The investments were placed with Barclays Bank, Santander, Lloyds Banking Group and Coventry Building Society all of whom conform to our credit rating requirements for investments of 364 days.

9.5 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

9.6 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 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
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
Invesco Aim			
April to June 2011	0.57%	0.46%	+0.11%
Value of Interest earned - Q1	£939	£767	+£172
Prime Rate			
April to June 2011	0.83%	0.46%	+0.37%
Value of Interest earned – Q1	£12,239	£6,820	+£5,419

9.7 As referred to in paragraph 9.2 above, during the quarter ending June 2011the 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. It should be noted that as from 1st June 2011, Standard Life transferred its Money Market Fund to Deutsche Asset Management, a division of Deutsche Bank. The Council continues to trade in the Money Market Funds through the Money Market Fund Portal and is in the process of opening two new Money Market Funds with Goldman Sachs and Ignis..

9.8 On an annualised basis, the Council will earn £20,586 interest on its Money Market Fund investments in the quarter ending 30th June 2011. The average balance in the funds for the quarter was £11,872,668.

Business Reserve Accounts

9.9 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.

9.10 An analysis of the overall in house investments held by the Council at the end of June 2011 is shown below:

(The previous quarter is shown for comparison)

Type of Investment	Closing Balance Q4 As at 31st March 2011	Closing Balance Q1 As at 30th June 2011
	£	£
Money Markets	29,000,000	29,000,000
Money Market Funds	3,686,000	12,763,000
Business Reserve Accounts	0	0
Total	**32,686,000**	**41,763,000**

9.11 The original estimate of annual external investment interest for 2011/12 was £462,484 gross and at this point in time remains the latest estimate.

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 April to June 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.

11 PRUDENTIAL INDICATORS

11.1 The 2010/11 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 The economic recovery has been struggling to regain momentum after underlying activity more or less stagnated between October and March. The additional bank holiday for the Royal Wedding pulled down both industrial and services output in April. But the CIPS/Markit business surveys have failed to pick up by much since. An average of the surveys over the last three months point to quarterly GDP growth in Q2 of just 0.3% - less than half its trend rate.

1.2 The industrial recovery appears to have lost momentum quite quickly. The CIPS/Markit manufacturing survey has fallen to a level consistent with falls in manufacturing output. The output expectations balance of the CBI industrial trends survey has fallen more modestly, but has nonetheless dropped for the past three months in a row.

1.3 Meanwhile, the consumer outlook has darkened. The pick-up in the consumer sector seen during the spring appears to have been only temporary, reflecting the good weather and extra bank holiday. Retail sales volumes fell in May, more than reversing April's increase. The CBI's distributive trades survey fell in June. And a number of well-known retailers have recently fallen into administration.

1.4 Consumers appear to be reacting to the squeeze on their real incomes. Household real disposable incomes fell by 0.8% in Q1. Inflation is outpacing average earnings by about 2.5%. Consumer confidence also fell back in June and remains consistent with further falls in consumer spending.

1.5 Meanwhile, the news on the labour market has been mixed. The Workforce Jobs measure of employment rose strongly in Q1. But the timelier Labour Force Survey measure flattened off in April and May. And the number of job vacancies continued to fall throughout the quarter. The claimant count measure of unemployment also continued to rise over the last three months. This only partly reflected a rise in the number of lone parents claiming Jobseeker's Allowance due to recent benefit changes.

1.6 The housing market has continued to tread water. The number of mortgage approvals for new house purchase was broadly unchanged over the quarter at a very low level of just 46,000 or so. House prices have also remained broadly flat. The Nationwide index ended the second quarter at about the same level as it ended the first.

1.7 Meanwhile, net trade looks unlikely to provide as big a contribution to GDP growth in Q2 as it did in Q1. Net trade boosted quarterly GDP growth by some 1.4% in Q1. However, the trade deficit was unchanged in April compared to March.

1.8 The weakness of the economy appears to be having some adverse effect on the public finances. Borrowing in the first two months of the fiscal year totalled £27.4bn, compared to last year's £25.9bn. It is early days but, at this rate, borrowing will overshoot the OBR's Budget full-year forecast of £122bn.

1.9 Oil prices rose but then fell back during the quarter, and so ended Q2 at $113 per barrel, close to the level seen at the end of Q1. Agricultural prices fell sharply over the past quarter.

1.10 But the near-term outlook for inflation has deteriorated further. Although CPI inflation held steady at 4.5% in May, it now looks likely to rise to 5.5% or even higher within the next few months. Food price inflation is likely to rise further. And Scottish Power announced in June a 19% rise in gas prices and 10% rise in electricity prices to take effect in August. Other utility suppliers are likely to follow suit.

1.11 Households' inflation expectations rose sharply in June. But so far, there are no signs of any pick-up in pay growth. The median pay settlement was unchanged at 2.5% in May.

1.12 Most Monetary Policy Committee members still think that the rise in inflation will be only temporary and that inflation will fall back sharply next year. So despite the worsening of the near-term inflation outlook, the weakness of the activity data has pushed most members further away from an interest rate rise.

1.13 Some members have even started to discuss the prospect of giving the economy more support. Admittedly, the hurdle for more quantitative easing will be quite high. However, it is certainly possible if the economy remains as weak as we expect.

1.14 In financial markets, the FTSE 100 finished the quarter at around 5,950 – about the same level as at the end of the first quarter. This was broadly in line with international stock markets – the S&P500 was also little changed over the period. Ten year gilt yields fell from 3.69% to 3.38% on the back of a drop in interest rate expectations. At the end of March, markets were expecting interest rates to have risen by this July. But now they expect rates to stay on hold until July next year. Meanwhile, sterling was broadly unchanged against the dollar at about $1.60, and fell only a touch against the euro.

1.15 In the US, the recovery also appears to have lost a significant amount of momentum. The ISM manufacturing index fell sharply in May and reversed only a fraction of this drop in June. Payrolls employment rose by a disappointing 54,000 in May. Meanwhile, the euro-zone economy expanded at a healthy pace in Q1, but recent falls in most leading indicators suggest that growth is slowing there too. Germany has continued to outperform the rest of the region. The risk of an imminent Greek disaster appears to have eased, but European policymakers' inability to deal with the crisis quickly and effectively is hitting the rest of the periphery.