WARWICK DISTRICT COUNCIL	**Finance & Audit Scrutiny Committee** 23rd November 2010	**Agenda Item No.** **5**

Title	Treasury Management Activity Report for the period 1st July 2010 to 30th September 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Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No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	01/11/2010	Andy Jones
Chief Executive	N/A	
CMT	N/A	
Section 151 Officer	02/11/2010	Mike Snow
Legal	N/A	
Finance	01/11/2010	Roger Wyton
Portfolio Holder(s)	N/A	
Consultation Undertaken		
Please insert details of any consultation undertaken with regard to this report. 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 2010 to 30th September 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. The Council is reliant upon interest received to help fund the services it provides and it is anticipated that total interest amounting to £251,200 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	322,837
Less HRA allocation	192,200	71,606
Net interest to General Fund	**274,255**	**251,231**

In addition, in 2010/11 the Council has received £64,000 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 have suggested that the recovery has lost considerable pace with surveys indicating that quarterly growth in GDP is slowing to around only 0.2% by the end of the year, well below the long term average of about 0.5%.The recovery in the non retail sectors may have picked up at a faster pace in Q2 but the recovery in retail spending through shops seems to have deteriorated over the quarter as retail sales volumes fell by 0.5% on the previous month in August. An average fall of -18 in Q1 to -20 in Q2 in consumer confidence may have also played a role in the fall in retail spending.

7.2 The recovery in the housing market has also begun to falter. Only 47,400 mortgages for new house purchase were approved in August on the Bank of England's official measure; this is nearly 20% lower than at the end of 2010. Furthermore, the Nationwide house price index fell by 0.5% and 0.8% in July and August respectively before rising by 0.1% in September.

7.3 August's public finances figures severely dented hopes that the fiscal position is on a clearly improving trend. The public borrowing figure of £15.9bn in August was nearly £2bn larger than at the same time a year ago. However, this figure still left a cumulative borrowing total in the first five months of the fiscal year of £58.1bn, around £4bn below last year's equivalent figure of £61.9bn. The UK's trade deficit widened further in the third quarter, despite the continued weakness of sterling. The trade in goods deficit rose from £7.5bn to £8.7bn in July which was the largest deficit on record.

7.4 CPI (consumer price inflation) inflation fell from 3.2% to 3.1% in July, and remained unchanged in August. Inflation therefore fell in this quarter but at a slower pace than in the previous quarter. While oil price inflation has begun to ease, an easing in clothes deflation and a pick-up in food and drink inflation were responsible for preventing CPI inflation from falling further in August. The Bank of England's quarterly Inflation Report in August once again projected inflation to fall to below the 2% target and remain there at the two year policy horizon. The MPC (Monetary Policy Committee) voted to maintain the outstanding stock of asset purchases under quantitative easing (QE) at £200bn at each meeting in the quarter. The minutes to September's MPC meeting revealed that for most members "the probability that further action would become necessary to stimulate the economy and keep inflation on track to hit the target in the medium term had increased." Also, the majority of members on the MPC voted in each meeting to keep official interest rates on hold, apart from Andrew Sentence who voted for a 25bp rise.

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 2010. The Council's Treasury Management Advisors, Sector, provided the following forecast for future Bank Rates:

Sector's Bank Rate Forecasts:

	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 23rd August 2010:											
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.50%	3.00%
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%

Recent UK and US statistics indicate that economic recovery is likely to be anaemic. The Bank of England Inflation Report in August downgraded the forecast for GDP growth for 2011 from 3.4% to 2.8% but even 2.8% is widely viewed as being optimistic. In addition the increased risk of further quantitative easing in the UK and US (i.e. a further loosening of monetary policy) implies that the forecast for the first increase in Bank Rate has to be put back from the first quarter of 2011 to the third. 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 IN HOUSE MANAGED INVESTMENTS

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		
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
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
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	N/A	N/A

Period	Investment Return (Annualised)	LIBID Benchmark (Annualised)	Out/(Under) performance
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

9.2. At this time of year, the length of time for which the Council's cash flow investments is invested although beginning to lengthen is still on the short side and in this period within the Over 7 Days and Up to 3 Months category 5 cashflow investments with Building Societies were made, typically of a two month duration. This quarter also showed several core investments maturing which were re-invested with Building Societies for a three month duration. Overall, the investments in this category produced an average return of 0.76% compared to the LIBID benchmark of 0.46% which is an amalgam of the 1 and 3 month LIBID rates. This out performance of 0.30% 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. In the case of the core investments referred to above the average return was 0.88% compared with a 3 month LIBID rate of 0.61%.

9.3. As mentioned above, the Council's cashflow profile is beginning to lengthen and in the Over Three and Up to Six Months category 6 cashflow investments have been made which produced an average return of 0.75% compared to a LIBID benchmark of 0.69% which is a combination of the 3 and 6 month rates. This shows an outperformance of 0.06%. In reality, 5 out of the 6 investments were only slightly over the three month period and if compared to a benchmark of the three month rate alone of 0.61% produced an out performance of 0.10%.

9.4 During quarter 2 no investments were placed in the Over 6 Months and Up to 363 Day category.

9.5 Three core investments were made during this quarter in the 364 or 365 days part of the market and these earned rates between 1.18% and 1.50%, with the average performance being 1.41%, this compares to a LIBID benchmark of 1.28% for the over 364 day category, showing an outperformance of 0.13%. The investments were placed with Nationwide Building Society, Clydesdale Bank and Bank of Scotland all conforming with our credit rating requirements for investments of 364 days or longer. The significant drop in interest earned between quarter 1 and quarter 2 is due to the fact that quarter 1 saw the investment of the £5m fund previously managed by Invesco.

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
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
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

9.8 During the quarter ending September 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 would not earn the top level, equivalent to bank rate. The Council continues to trade on the Money Market Funds through the Money Market Fund Portal, which will also be used for future trading in other new Money Market Funds.

9.9 On an annualised basis, the Council will earn £15,842 interest on its Money Market Fund investments in the quarter ending 30th September 2010. The average principal maintained in the funds was £8,469,324.

Business Reserve Accounts

9.10 The Council operates two Business Reserve accounts with Abbey National and Bank of Scotland. If sufficient balances are maintained these accounts offer a guaranteed rate of return equivalent to Bank Rate. 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 2010 is shown below:

(The previous quarter is shown for comparison)

Type of Investment	Closing Balance Q1 As at 30th June 2010	Closing Balance Q2 As at 30th September 2010
Money Markets	29,000,000	34,000,000
Money Market Funds	11,557,000	5,889,000
Business Reserve Accounts	0	0
Total	**40,557,000**	**39,889,000**

9.12 The original estimate of annual external investment interest for 2010/11 was £466,455 gross and the latest estimate is £322,837. 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 July to September 2010 quarter interest amounting to £3 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.