	Finance and Audit Scrutiny Committee. 1st December 2009	Agenda Item No.

Title	Treasury Management Activity Report for the period 1st July 2009 to 30th September 2009.
For further information about this report please contact	Alison Pitt, Assistant Accountant. 01926 456808 alison.pitt@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Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No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	17/11/09	Andy Jones
Chief Executive	N/A	
CMT	N/A	
Section 151 Officer	18/11/09	Mike Snow
Legal	17/11/09	Peter Oliver
Finance	17/11/09	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 2009 to 30th September 2009.

2. **RECOMMENDATION**

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

2.2 That the Members of the Finance and Audit Scrutiny Committee note the decision to terminate the contract with Invesco for the reasons set out in paragraph 11.

3. **REASONS FOR THE RECOMMENDATION**

3.1 The Council's 2009/10 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.

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 £1,061,500 in round terms will be credited to the General Fund in 2009/10. The overall position is shown in the table below:

	Original 2009/10 Budget £	**Revised 2009/10 Budget £**
Gross Investment Interest	699,200	738,400
Less HRA allocation	(320,900)	(276,200)
	378,300	**462,200**
Plus VAT interest		599,300
Net interest to General Fund	**378,300**	**1,061,500**

6. **POLICY FRAMEWORK**

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

7. **BACKGROUND**

7.1 The general economic background is important in understanding how markets are behaving. After rapidly cutting interest rates to a record low of 0.5%, the MPC increased the amount of asset purchases under the Bank's quantitative easing (QE) programme from £125bn to £175bn in August. However, while QE does appear to have been successful in improving liquidity in financial markets, its impact on the real economy remains limited.

7.2 There were some signs of recovery in the market, with some sectors showing growth in the second quarter of 2009. Concerns remain about the fragile state of any recovery with the impact of rising unemployment; therefore, bank rate is expected to stay low for longer. Inflationary pressures in the economy continue to ease further, but more slowly than had been expected. This is largely, as a result in falls in the annual rate of food and utility price inflation.
More positive news came from the housing market which saw house prices rise at the fastest rate in over five years. The Nationwide house price index rose by 3.8% in Q2. Also, other major economies, including the US appear to have left the recession.

8. INTEREST RATE ENVIRONMENT

8.1. The major influence on the Councils investments is the Bank Rate. The Bank Rate remained at 0.5% for the whole of the quarter ending 30th September 2009. The Council's Treasury Management Advisors, Sector, provided the following forecast for future Bank Rates:

	Dec 2009	Mar 2010	Jun 2010	Sep 2010	Dec 2010	Mar 2011	June 2011	Sep 2011	Dec 2011	Mar 2012	June 2012	Sept 2012
Current Forecast:												
Bank Rate	0.50%	0.50%	0.50%	0.75%	1.25%	1.75%	2.50%	3.00%	3.75%	4.00%	4.25%	4.50%
Forecast as at February 2009, when Original Budgets were set:												
Bank Rate	0.50%	0.75%	1.00%	1.25%	1.75%	2.50%	3.25%	3.75%	4.00%	n/a	n/a	n/a

This new forecast indicates that the Bank Rate will remain at an historical low level for a longer period, with the first increase now not being expected until September 2010, by which time the economy is expected to have improved.

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 2009/10 was approved by Council on 23rd February 2009. This approved the current lending criterion which reflects 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 crisis in the banking sector.

9 IN HOUSE MANAGED INVESTMENTS

Money Market Investments

9.1. During 2009/10, the in house function has invested in both cash flow driven as well as 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	LIBID Benchmark	Out/(Under) performance
Up to 7 days			
April – June 2009	No investments made in this quarter.		
July – Sept 2009	No investments made in this quarter.		
Over 7 days & Up to 3 Months			
April – June 2009	1.16%	0.89%	+ 0.27%
Value of Interest earned – Q1	£2,706	£2,073	£633
July – Sept 2009	1.62%	0.48%	+1.14%
Value of Interest earned – Q2	£16,578	£4,905	£11,673
3 to 6 Months			
April – June 2009	1.85%	1.30%	+ 0.55%
Value of Interest earned	£11,531	£8,103	£3,428
July – Sept 2009	1.18%	0.72%	+0.46%
Value of Interest earned – Q2	£34,493	£21,028	£13,465
6 Months to 363 days			
April – June 2009	1.35%	1.54%	(0.19%)
Value of Interest earned – Q1	£13,537	£15,422	(£1,885)
July – Sept 2009	1.03%	0.99%	+0.04%
Value of Interest earned – Q2	£5,192	£4,991	£201
364 days and over			
April – June 2009	2.20%	1.66%	+ 0.54%
Value of Interest earned – Q1	£65,819	£49,664	£16,155
July – Sept 2009	1.46%	1.14%	+0.32%
Value of Interest earned – Q2	£58,438	£45,569	£12,869

9.2. At this time of year, the period for which the Councils cash flow is beginning to lengthen as cash is invested to cover immediate cashflow needs, typically around the two to three month period. The Council therefore, made investments in the 1 to 3 month category which did benefit from inflated interest rates and produced an average return of 1.62% compared to the LIBID benchmark of 0.48% which is an amalgam of the 1 and 3 month LIBID rates. This shows an out performance of 1.14%, this was achieved by investing in Building Societies whom were paying above the LIBID rates but whom satisfied the Council's approved investment criteria.

9.3. Several core investments matured during the quarter, which were in general invested for three month periods following advice from our Treasury Consultants. Deals placed in the 3 to 6 month category produced an average rate of return of

1.18% which compares to a LIBID benchmark of 0.72% which is an amalgam of the 3 and 6 month LIBID rates. This shows an outperformance of 0.46%.

9.4 One six month core investment was placed during the quarter at 1.03% which compares to a LIBID benchmark of 0.99% which is an amalgam of the 6 and 12 month LIBID rates. This shows an out performance of 0.04%. If compared to just the 6 month LIBID benchmark of 0.83% there is an out performance of some 0.20%.

9.5 The final category invested in was the 364 day period, where two core investments were made at an average rate of 1.46% which compares to a LIBID benchmark of 1.14% for 12 months. This shows an out performance of 0.32%.

9.6 Given that the current Bank Rate is 0.50% the levels of outperformance achieved this quarter are pleasing and reflect the effect that interest rates payable are still above where they should be because of the liquidity concerns in the market.

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 %	LIBID Benchmark %	Out/(Under) Performance %
Standard Life			
April to June 2009	0.87%	0.49%	+0.38%
Value of Interest earned – Q1	£3,690	£2,075	£1,615
July to Sept 2009	0.50%	0.54%	(0.04%)
Value of Interest earned – Q2	£1,919	£2,063	(£144)
Invesco Aim			
April to June 2009	0.75%	0.49%	0.26%
Value of Interest earned - Q1	£3,006	£1,954	£1,052
July to Sept 2009	0.56%	0.54%	+0.02%
Value of Interest earned – Q2	£4,468	£4,341	£127
Prime Rate			
April to June 2009	1.38%	0.49%	0.89%
Value of Interest earned – Q1	£15,997	£5,671	£10,326
July to Sept 2009	1.23%	0.54%	+0.69%
Value of Interest earned – Q2	£15,443	£6,754	£8,689

9.8 During the quarter ending September 2009, 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 has recently opened up a Money Market Fund Portal, which will be used for future trading in other new Money Market Funds.

9.9 The Council earned £21,830 interest on its Money Market Fund investments in the quarter ending 30th September 2009. The average principal maintained in the funds was £9,668,551.

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 2009 is shown below:
(The previous quarter is shown for comparison)

Type of Investment	Opening Balance Q1 As at 1st July 2009	Closing Balance Q1 As at 30th September 2009
In House		
Money Markets	£23,500,000	£29,500,000
Money Market Funds	£10,830,000	£8,036,000
Business Reserve Accounts	£0	£0
Total	**£34,330,000**	**£37,536,000**

9.12 The above table shows how the Council cash balances increase on a cumulative basis throughout the year.

9.13 The original estimate of annual external investment interest for 2009/10 was £699,200 gross and the latest estimate is £738,400. This slight increase is mainly accounted for by an increase in balances due to slippage within the capital programme.

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 Councils £500,000 overdraft facility with HSBC. The interest rate on this facility is 1% 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 quarter interest amounting to £39 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 EXTERNAL FUND MANAGERS

11.1 Invesco Asset Management Ltd continue to act as the Council's external cash management agents and currently manage £5 million on our behalf.

11.2 Invesco's performance up to the end of September 2009 is shown below:

Quarter	Portfolio Net Return %	LIBID Benchmark %	Out/(Under) performance %
July to Sept 2009	0.24%	0.10%	0.14%
Year to date	(0.02%)	0.19%	(0.21%)

11.3 Invesco has returned 0.24% for the quarter net of fees versus a benchmark of 0.10%, an outperformance of 0.14%. Given the very poor performance in the first quarter, it is unlikely that Invesco will be able to turn things around and consequently end up with a reasonable year. As such the year to date results still reflect an under performance of some (0.21%)

11.4 Invesco made both gilt sales and purchases during the quarter. Profit which was made from gilt sales in August and September failed to compensate for the huge loss made in July, when Invesco decided to sell all of their gilt holdings. The most substantial loss was made on 1st July when a holding of 2% 2014 was sold. This was made worse on the 10th July when 2.250% 2014 gilt was sold at a loss. Possibly as a consequence of new strategic positioning, they ended the second quarter with 8.83% of the portfolio being invested in gilts.

11.5 A purchase of a small 4.5% EIB 2013 Supranational Bond was made on the 17th August, but was sold later in September for an overall tiny gain.

11.6 In respect of CD's Invesco confined themselves to short dated maturities. These purchases were funded by rolling over maturities and by the sales of the gilt holdings.

11.7 Throughout the quarter Invesco held a substantial proportion of the portfolio in cash, more than half, using the in house money market fund.

11.8 Invesco has had a very poor first quarter of the financial year 2009/10. They lost substantial sums in the gilt market and turned a negative return for the period. Their reading of the gilt market appears to have been poor although they were keen to continue holding a position in this asset class. The gilt disposals made during July contributed to the poor performance. However, as gilt purchases were made later in the quarter, the strategic holding in gilts could pay dividends if their interest rate view prevails. This could work well in the next quarter if the gilt market improves in price terms, so enhancing their return.

11.9 At the end of September 2009, the value of the portfolio stood at £5,006,456 and the breakdown is shown in the table below:

Type of Investment	Amount
Gilts	£442,018
Certificates of Deposit	£3,313,612
Temporary Deposits	£1,250,826
Total	**£5,006,456**

11.10 It is estimated that the Invesco portfolio will earn £17,500 in interest for 2009/10 on the basis of its revised central case return of 0.35%. This is a reduction of £95,000 on the original budgets when Invesco's central rate forecast was 2.25%

11.11 The Council's Treasury Management Advisors, Sector, has analysed the performance of seven external fund managers, including Invesco. The annualised results up to the end of September show that five performed better than Invesco and one was equal to Invesco. This analysis also shows that Invesco do not achieve a level of return commensurate with the level of risk within the portfolio.

11.12 Invesco's performance has been kept under review since receiving £5M back from the portfolio in May 2007. At that time it was decided to halve the portfolio because of their poor performance. However, at that time, interest rates were falling and this is when fund managers traditionally perform well. Tactical trades in the gilt market can achieve capital gains which enhance yield. It was therefore, decided to continue to use Invesco to manage the remaining £5M portfolio, in order that their expertise in the gilt market could be utilised during this favourable part of the interest rate cycle. Restrictions on the trading limits were also removed at this time, allowing Invesco the freedom to invest up to 100% of the remaining portfolio in gilts in order to maximise capital gains.

11.13 Given the more recent poor performance of Invesco, the Council has discussed with Sector if Invesco should continue to be employed as External Fund Manager for the Council. Performance this year has been well below that of the In house Treasury function. A management fee of £7,500 per annum is paid to Invesco for the management of the Council's £5M portfolio, which could be saved if the contract is terminated.

11.14 Sector is of the view that we are now at the trough in the interest rate cycle, with future rates moving upwards. Therefore, the opportunity for enhanced performance from trading in gilts is unlikely to arise. Given the recent poor reading of the gilt market, it is not anticipated that continuing to employ Invesco will add any value to the performance currently achieved by the In House Team. The In House Team are considering the use of certain investment vehicles such as Certificates of Deposits (CD's) which may further improve the In House performance. Further details about such proposals will be included in the Treasury Management Strategy Report for 2010/11, which will be reported to the February Executive.

11.15 However, in counter argument, it must be noted that as long standing clients, the Council have a good contract with Invesco. It would be very unlikely that if in the future, External Fund Managers were required to be reappointed; a portfolio of only £5M would be viable nor would it be likely that such a low management fee could be negotiated.

11.16 The contract with Invesco has no formal length and is determinable with immediate effect by either party by giving notice in writing. The Head of Finance is responsible for Treasury Management operations within the agreed Treasury Management Strategy and on the basis of their continued poor performance intends to terminate the contract with Invesco and bring the £5M funds back in house.

12 PRUDENTIAL INDICATORS

12.1 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.