WARWICK DISTRICT COUNCIL	Finance & Audit Scrutiny Committee - 7 June 2011	Agenda Item No. **9**

Title	Treasury Management Activity Report for the period 1st January 2011 to 31st March 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Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No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	20/5/2011	Andy Jones
Head of Service	20/5/2011	Andy Jones
CMT	N/A	
Section 151 Officer	24/5/2011	Mike Snow
Monitoring Officer	N/A	
Finance	19/5/2011	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 January 2011 to 31st March 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 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. **POLICY FRAMEWORK**

4.1 Treasury Management will support the 2008-11 Corporate Strategy through its contribution to the effective management of resources. This report has no direct bearing on "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 total interest amounting to £363,000 in round terms has been credited to the General Fund in 2010/11. The overall position is shown in the table below:

	Original 2010/11 Budget £	**2010/11 Actual £**
Gross Investment Interest	466,455	452,144
Less HRA allocation	192,200	156,400
Net interest to General Fund	**274,255**	**295,744**

In addition to the figures in the table above, in 2010/11 the Council has received £67,715 from HMRC in respect of interest on a VAT refund.

6. **ALTERNATIVE OPTION CONSIDERED**

6.1 None.

7. **ECONOMIC BACKGROUND**

7.1 Output in the services sector rose by 1.3% m/m in January. But given that output fell by 1.1% in December, the level of output was only a little above November's level, suggesting that the underlying growth rate in the sector was close to zero. Official construction data revealed that output in the sector fell by 7.7% m/m in January, following December's large 16.6% fall. However, the recovery in manufacturing gathered further pace. Industrial production rose by 0.5% m/m in January.

7.2 There were signs that the recovery in consumer spending had run out of steam. The official measure of retail sales volumes rose by 1.5% m/m in January. Sales volumes fell by 0.8% in February, leaving the level of sales essentially unchanged on its level of six months ago. The GfK composite measure of consumer confidence was consistent with quarterly falls in overall household spending in all three months of the quarter. Meanwhile, data on the labour market painted a mixed picture. On the one hand, employment rose by 36,000 in the three months to January. The weighted average of the employment balance of the CIPS surveys also rose in January and February, pointing to faster employment growth ahead. However, ILO unemployment rose by 37,000 in the three months to January.

7.3 Data on the housing market suggested that house prices found a floor. The Halifax measure rose by 0.8% m/m in January, although it then fell by 0.9% in February. The Nationwide measure was stronger – it fell by 0.1% in January, but then rose by 0.7% in February and 0.5% in March.

7.4 The fiscal tightening intensified at the start of the year, with the hike in VAT in early January. The latest public finance figures suggested that borrowing was still on track to undershoot the OBR's full-year forecast of £148.5bn in 2010/11, perhaps by £5bn. The Budget on 23rd March left the scale of the fiscal squeeze largely unchanged. Elsewhere, there were still few signs that the net trade boost to growth was coming through. However, the trade in goods and services deficit narrowed from £5.5bn to £3.0bn in January, but this was largely driven by temporary factors, such as a bounce-back in exports following December's snow and the imposition of a new tax on aircraft imports.

7.5 Meanwhile, inflation continued to rise. CPI inflation rose from 3.7% to 4.0% in January and then to 4.4% in February. The rise in inflation did not just reflect higher food and energy costs – core inflation also rose from 2.9% to 3.4%. This probably reflected January's VAT rise, given anecdotal evidence suggesting that retailers passed on a larger proportion of this year's VAT rise onto consumers than last year's. Pipeline price pressures also continued to build – in particular, oil prices surged from around $95pb at the end of December to $115pb at the end of March. But high inflation still looked set to be temporary. Households' inflation expectations did not rise further – indeed, the YouGov/Citigroup measure of long term inflation expectations fell from 3.8% in December to 3.5% in March. And the annual rate of average earnings growth (exc. bonuses) was only 2.2% in January.

7.6 Nonetheless, the rise in inflation persuaded two more members of the Monetary Policy Committee (MPC) to start voting for rate hikes (Andrew Sentance was first joined by Martin Weale in January and then Spencer Dale in February). What's more, the Bank of England's February Inflation Report forecasts suggested that interest rates would need to rise broadly in line with the markets' expectations (then, for a 150bp rise in interest rates by the end of 2012) in order for inflation to hit the 2% CPI inflation target at the two year horizon. However, continued uncertainty about the underlying strength of the recovery persuaded the majority of MPC members to keep rates on hold at 0.5%. In financial markets, UK equities underperformed.

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

Sector's Bank Rate Forecasts:

Qtr ending	Now (Mar 11)	Mar 2011	Jun 2011	Sep 2011	Dec 2011	Mar 2012	Jun 2012	Sep 2012	Dec 2012	Mar 2013	Jun 2013
Current Forecast, as at 17TH May 2011:											
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.00%	2.25%
Forecast, as at 23rd November 2009, (when Original Budgets were set):											
Bank Rate	1.50%	1.50%	2.25%	2.75%	3.25%	3.50%	3.75%	4.25%	4.25%	4.25%	4.25%

The Bank of England has commented that growth in the medium term is highly uncertain and that its forecasts for the speed of recovery and of increases in GDP growth rate have consistently been over optimistic since the recession started in 2009. They expect CPI to increase in 2011 due to temporary supply side factors but that these factors will drop out within 12 months as will the VAT increases leading to a fall in inflation to below target in time. Sector's central forecast is for a November 2011 first increase in Bank Rate but with reservations that it could well slip back in time unless there is some good news on the UK economic recovery before then. 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		
Jan to Mar 2011	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
Jan to Mar 2011	0.71%	0.51%	+0.20%
Value of interest earned – Q4	£5,227	£3,786	+£1,441
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
Jan to Mar 2011	No investments made in this quarter		
Value of interest earned – Q4	Not Applicable		
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	Not Applicable		
Oct to Dec 2010	No investments made in this quarter		
Value of interest	Not Applicable		

earned – Q3			
Jan to Mar 2011	No investments made in this quarter		
Period	**Investment Return (Annualised)**	**LIBID Benchmark (Annualised)**	**Out/(Under) performance**
Value of interest earned – Q4	Not Applicable		
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
Jan to Mar 2011	1.47%	1.37%	+0.10%
Value of interest earned – Q4	£29,220	£27,375	+£1,845

9.2. During January to March, the Council's cash flow investments began to unwind themselves as cash outflows (Precepts, NNDR payments to DCLG etc.) exceeded the inflows and only 4 investments were made in the Over 7 Days and up to Three Months category during the quarter. Overall, the investments in this category produced an average return of 0.71% compared to the LIBID benchmark of 0.51% which is an amalgam of the 1 and 3 month LIBID rates. This out performance of 0.20% 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. When compared to the three month rate alone of 0.67% the out performance is 0.04% which is still satisfactory

9.3 During quarter 4 no investments were placed in either the Over Three and Up to Six Months or the Over 6 Months and Up to 363 Days category.

9.4 Taking advantage of enhanced rates being offered for 364 day money, two maturing core investments were re-invested during this quarter in the 364 days part of the market and these earned rates between 1.40% and 1.53% with the average performance being 1.47%, this compares to a LIBID benchmark of 1.37% for the over 364 day category, showing an out performance of 0.10%. The investments were placed with Clydesdale Bank and Leeds Building Society both of whom conform with 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			
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
Jan to Mar 2011	0.58%	0.45%	+0.13%
Value of interest earned – Q4	£4,431	£3,440	+£991
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
Jan to Mar 2011	0.52%	0.45%	+0.07%
Value of interest earned – Q4	£952	£827	+£125
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
Jan to Mar 2011	0.84%	0.45%	+0.39%
Value of interest earned – Q4	£9,856	£5,267	+£4,589

9.7 During the quarter ending March 2011, 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. 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, 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.

9.8 On an annualised basis, the Council will earn £15,239 interest on its Money Market Fund investments in the quarter ending 31st March 2011. The average balance
in the funds for the quarter was £8,592,348.

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 March 2011 is shown below:

(The previous quarter is shown for comparison)

Type of Investment	Closing Balance Q3 As at 31st December 2010	Closing Balance Q4 As at 31st March 2011
	£	£
Money Markets	37,000,000	29,000,000
Money Market Funds	10,643,000	3,686,000
Business Reserve Accounts	0	0
Total	**47,643,000**	**32,686,000**

9.11 The original estimate of annual external investment interest for 2010/11 was £466,455 gross and the actual is £452,144. This decrease is accounted for by the reduced interest rates prevalent throughout 2010/11 compared to those forecast when the original estimate was prepared. This has been offset to some degree by increased balances available for investment resulting from, for example, slippage in the Council's capital programmes and increased reserves.

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 January to March 2011 quarter interest amounting to £275 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.