

SUBJECT:	Treasury Management - Annual Report 2010/11 and Investment Performance Quarter Ending 30th June 2011
REPORT OF:	Officer Management Team - Director of Resources Prepared by - Principal Accountant

1. Purpose of Report

1.1 To report to Members on the Treasury Management performance of the Council for 2010/11.

1.2 To inform Members of the investment returns for the quarter ending 30th June 2011.

2. Links to Council Policies & Plans

2.1 The Council's Treasury Management function is a key element to the Financial Strategy, which in turn feeds into the prudent use of Resources, one of the Council's Management Principles.

3. Background

3.1 In December 2001, the Chartered Institute of Public Finance and Accountancy (CIPFA) published a Revised Code of Practice on Treasury Management which CIPFA amended in 2009 in light of the situation with the Icelandic banks. This Council adopted the code in June 2002 and the amended code in February 2010. The Council fully complies with the requirements of the amended code.

The primary requirements of the code are the: -

- (i) Creation and maintenance of a Treasury Management Policy Statement, which sets out the policies, and objectives of the Council's treasury management activities.
- (ii) Creation and maintenance of Treasury Management Practices, which sets out the manner in which the Council will achieve those policies and objectives.
- (iii) Receipt by the Cabinet and Council of an annual strategy report for the year ahead and an annual review report of the previous year.
- (iv) The delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

3.2 In addition the Department for Communities and Local Government (DCLG) requires each local authority to approve an annual Investment Strategy from 2004/05 onwards.

3.3 Treasury management in this context is defined as:

The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

3.4 This report represents the annual report 2010/11 and the investment performance for the first quarter on 2011/12.

4. Annual Report on Treasury Management 2010/11.

- 4.1 As a debt free authority the treasury management activities of the Council are exclusively concerned with the investment of its reserves, as the Council does not undertake any borrowing.
- 4.2 The Council's Treasury Management Strategy 2010/11 details the following sources for generating investment income for the year:
- Set an estimated return on investment income for the year of £1.050 million.
 - Set the sources for generating investment income for the year as follows:

	£'000
Fixed/Callable Deposits	807
Short Term Cash Flow and Other Investments	154
Stoke Poges Memorial Gardens Fund	89
Total	1,050

- 4.3 Officers invest cash flow surpluses with approved counter parties. Members approved a new matrix for in house investments as part of the Treasury Management Strategy 2010/11 as follows.

	Credit Rating ¹	Maximum Amount	Comment
UK Institutions	AAA	£10 million	The durations of the investment would be informed by the detailed credit rating information
	AA+ or AA-	£7 million*	
	A to A+	£1 million**	
Non UK Institutions	AA or better	£2 million	As above but also sovereignty rating must be AAA
Corporate Bonds	AA or better	£2 million	Investment decision will be based on balancing yield against duration

* Members agreed that for Royal Bank of Scotland only this limit is increased to £10 million whilst the bank substantially remained in state ownership.

** As part of the Councils Treasury Management Strategy 2011/12 Members agreed to add the Co-operative Bank (A-) with a limit of £1 million, on the basis of the competitive rates it currently offers.

Details of the Councils fixed and callable investments at the end of the financial year and how they met this matrix are shown in 4.8 of this report.

- 4.4 In addition Sector Treasury Services Ltd is engaged by the Council as its Treasury Management consultants providing advice on investment, performance and regulations where necessary.

¹ The Council uses Fitch IBCA as its source of credit ratings for counterparties

4.5 A summary of the movements in the year is as follows: -

	Fund Balance 1.4.2010 £,000	Fund Withdrawals £'000	Added to Fund £'000	Fund Balance 31.3.2010 £,000
Investec	3,865	(3,865)		0
Temp in house cash balances	6,103	(3,542)		2,561
Callable Deposits	5,000	(5,000)		0
Fixed Deposits	9,000	(9,000)	23,000	23,000
Stoke Poges Memorial Gardens Fund	1,501		8	1,509
Total	25,469	(21,407)	23,008	27,070

4.6 A comparison of returns to budget for the year is shown within the Resources, Risk and Other Implications section later in this report. Brief commentary on the year is shown below.

4.7 Investec: As part of the Treasury Management Strategy 2010/11 Members agreed to withdraw the funds held by the cash fund manager (Investec) and for them to be managed in house by officers. The remaining funds held by Investec were repaid to the Council early in April 2010.

4.8 In House Investments: Decisions on investing in callable and fixed deposits are taken by Officers in the light of advice from the Council's treasury consultants and brokers acting in the local authority money market, combined with general intelligence available from market briefings made available to the authority.

A summary of the Council's holdings of callable and fixed deposits at 31st March 2011 is shown below:-

UK Institutions	Credit Rating	Maximum Amount £7 Million* Principal £	Interest Rate	Invested	Matures	Notes
Royal Bank of Scotland	AA-					
Fixed Deposit		5,000,000	4.25%	08/02/11	08/02/16	(1)
Fixed Deposit		2,000,000	2.75%	02/06/10	02/06/13	(2)
Total RBS		7,000,000				
Cater Allen	AA-					
Fixed Deposit		1,000,000	2.25%	01/04/10	03/10/11	
Fixed Deposit		1,000,000	3.50%	21/07/10	21/07/13	
Fixed Deposit		2,000,000	3.20%	30/09/10	30/09/13	
Fixed Deposit		1,000,000	2.50%	02/11/10	02/11/11	
Fixed Deposit		2,000,000	2.50%	16/11/10	16/11/11	
Total CA		7,000,000				
Lloyds Bank	AA-					
Fixed Deposit		1,000,000	3 Month Libor, Floor 2.85%, Cap 5.85%	11/05/10	11/05/15	
Fixed Deposit		1,000,000	3 Month Libor, Floor 3.07%, Cap 5.00%	19/05/10	19/05/15	
Bank of Scotland	AA-					
Fixed Deposit		3,000,000	2.10%	15/07/10	15/07/11	
Fixed Deposit		1,000,000	1.90%	04/10/10	04/10/11	(3)

UK Institutions	Credit Rating	Maximum Amount £7 Million* Principal £	Interest Rate	Invested	Matures	Notes
Fixed Deposit		1,000,000	2.05%	14/02/11	14/02/12	
Total Lloyds Group		6,000,000				
Barclays	AA-					
Fixed Deposit		1,000,000	3 Month Libor, Floor 3.05%, Cap 5.00%	24/05/10	26/05/15	
Total Barclays		1,000,000				
Co-operative Bank	A-					
Fixed Deposit		1,000,000	2.50%	14/02/11	14/02/12	
Total Co-op Bank		1,000,000				
Total Deposits		23,000,000				

* Members have agreed a £10 million limit for RBS whilst it substantially remains in state ownership.

- (1) RBS have the option to switch to 3 month LIBOR² plus 30 basis points in years 3, 4&5.
- (2) RBS have the option to switch to 3 month LIBOR plus 20 basis points in years 2&3.
- (3) 20% of the investment can be withdrawn on 32 days notice.

In addition the Council held the following investments of short term cash at the end of the year with its banker Nat West:

	Amount £	Interest Rate	Notes
Nat West Bank	1,561,000	Base + 34 Basis Points	Instant Access
Nat West Bank	1,000,000	Base + 60 Basis Points	30 Day Notice Account
Total	2,561,000		

- 4.9 Stoke Poges Memorial Gardens Fund: The interest return from the fund's investments is no longer credited directly to the Stoke Poges Memorial Gardens cost centre but has been incorporated with all of the Council's other investment returns.
- 4.10 Due to the current cost of buying a new bond it is the current policy to reinvest any maturities within the Council's cash investment. There were no maturities from the Stoke Poges Memorial Gardens Fund due in 2010/11. The current market value of the fund at 31st March 2011 was £1,508,659.80.

5. Investment Policy & Procedures

- 5.1 As detailed in 3.1 above the Council has adopted the CIPFA Code of Practice on Treasury Management.
- 5.2 The Code recommends the creation & maintenance of Treasury Management Policy & Procedures. These are already in place and were last reported to Members in September 2010.
- 5.3 It is not expected that the procedures will need to be revised very often and any changes have therefore been delegated down to the Chief Finance Officer. However it is the

² LIBOR - London Inter Bank Offered Rate

intention that a copy of the document is brought to Members attention on an annual basis and will be reported to the February meeting of this PAG.

6. Investment Performance Quarter Ending 30th June 2011

6.1 The Council's Treasury Management Strategy 2011/12 details the following sources for generating investment income for the year:

- (i) Set an estimated return on investment income for the year of £900,000
- (ii) Set the sources for generating income for the year as follows:

	£'000
Fixed & Callable Deposits	646
Short Term Cash Flow and Other Investments	179
Stoke Poges Memorial Gardens Fund	75
Total	900

6.2 The counterparty matrix for investments for 2011/12 is the same as that shown in 4.3 above.

6.3 A summary of the Council's holdings of callable and fixed deposits at 30th June 2011 is shown below:

UK Institutions	Credit Rating	Maximum Amount £7 Million* Principal £	Interest Rate	Invested	Matures	Notes
Royal Bank of Scotland	AA-					
Fixed Deposit		5,000,000	4.25%	08/02/11	08/02/16	(1)
Fixed Deposit		2,000,000	2.50%	02/06/11	02/06/14	(2)
Total RBS		7,000,000				
Cater Allen	AA-					
Fixed Deposit		1,000,000	2.25%	01/04/10	03/10/11	
Fixed Deposit		1,000,000	3.50%	21/07/10	21/07/13	
Fixed Deposit		2,000,000	3.20%	30/09/10	30/09/13	
Fixed Deposit		1,000,000	2.50%	02/11/10	02/11/11	
Fixed Deposit		2,000,000	2.50%	16/11/10	16/11/11	
Total CA		7,000,000				
Lloyds Bank	AA-					
Fixed Deposit		1,000,000	3 Month Libor, Floor 2.85%, Cap 5.85%	11/05/10	11/05/15	
Fixed Deposit		1,000,000	3 Month Libor, Floor 3.07%, Cap 5.00%	19/05/10	19/05/15	
Bank of Scotland	AA-					
Fixed Deposit		3,000,000	2.10%	15/07/10	15/07/11	
Fixed Deposit		1,000,000	1.90%	04/10/10	04/10/11	(3)
Fixed Deposit		1,000,000	2.05%	14/02/11	14/02/12	
Total Lloyds Group		6,000,000				
Barclays	AA-					
Fixed Deposit		1,000,000	3 Month Libor, Floor 3.05%, Cap 5.00%	24/05/10	26/05/15	
Fixed Deposit		1,000,000	1.415%	15/04/11	15/02/12	
Total Barclays		2,000,000				
Clydesdale Bank	AA-					

UK Institutions	Credit Rating	Maximum Amount £7 Million* Principal £	Interest Rate	Invested	Matures	Notes
Fixed Deposit		1,000,000	1.25%	19/04/11	19/01/12	
Total Clydesdale		1,000,000				
Co-operative Bank	A-					
Fixed Deposit		1,000,000	2.50%	14/02/11	14/02/12	
Total Co-op Bank		1,000,000				
Total Deposits		25,000,000				

* Members have agreed a £10 million limit for RBS whilst it substantially remains in state ownership.

- (1) RBS have the option to switch to 3 month LIBOR plus 30 basis points in years 3, 4&5.
- (2) RBS have the option to switch to 3 month LIBOR in years 2&3.
- (3) 20% of the investment can be withdrawn on 30 days notice.

In addition the Council held the following investments of short term cash at the end of the quarter:

	Amount £	Interest Rate	Notes
Nat West Bank	2,520,000	Base + 34 Basis Points	Instant Access
Nat West Bank	4,000,000	Base + 60 Basis Points	30 Day Notice Account
Total	6,520,000		

6.4 Since 31st March 2011 the following investment fixed investments have been made:

- Investment of £1 million in a fixed deposit with Barclays from 15th April 2011 for a period of 10 months at 1.415%.
- Investment of £1 million in a fixed deposit with Clydesdale Bank from 19th April 2011 for a period of 9 months at 1.25%.
- The RBS £2 million 3 year fixed deposit paying 2.75% interest but with an option to switch annually into 3 month LIBOR plus 20 basis points was reinvested into a new 3 yearly fixed deposit from the first switch date of 2nd June 2011 paying 2.50% with RBS having the option to switch into 3 month LIBOR annually. This action was taken in order to avoid the investment being switched to 3 Month LIBOR plus 20 basis points at its first anniversary and to maintain a reasonable rate of return.

6.5 Overall the approach followed has been to protect the overall level of return being achieved within the counterparty criteria set for the year. The approach has also attempted to balance the length of the investments so that there is always a reasonable proportion due to mature within a year, so that when rates start to pick up the Council will be in a position to start to take advantage of the situation.

7. Economic Background

7.1 The second calendar quarter of the year saw:

- The economic recovery struggle to regain momentum.
- Conditions on the high street deteriorate
- Mixed signals on the strength of the labour market recovery
- Public sector borrowing come out disappointingly high

- The near term outlook for CPI inflation deteriorate further
- The Monetary Policy Committee move away from raising interest rates
- UK equities stay broadly flat over the quarter and gilt yields fall
- Economic growth slow in the US and euro-zone

7.2 A more detailed assessment of the economic background is shown at appendix A.

8. Interest Rate Forecasts

8.1 The prospect for future interest rate rises is illustrated in the latest Sector forecast for interest rates shown in the table below:

	Sep 11	Dec 11	Mar 12	Jun 12	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
Bank Rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.00%	2.25%	2.50%	3.00%

The Sector central forecast is for a June 2012 first increase in Bank Rate.

Sector has undertaken its normal quarterly review of interest rate forecasts after the issue of the Bank of England's quarterly inflation report. The key Bank of England comments are shown below:

- Mervyn King said after the May Inflation Report was published that 'Bank Rate cannot stay down indefinitely' but this does not equate to saying 'there will be a first increase in Bank Rate in November 2011'. Financial markets over-reacted to this statement at that time.
- Growth in the medium term is 'highly uncertain'.
- BoE forecasts for the speed of recovery and of increases in GDP growth rate have consistently been over optimistic since the recession started in 2009.
- CPI will blip up in 2011 due to temporary supply side shock factors but these will drop out within 12 months - as will VAT increases.
- Unless the output gap is closed (unlikely for some considerable time) inflation will eventually fall below target.
- CPIY (CPI less the effects of increase in direct taxation) has been at or below 2% during 2010 and peaked at 3.0% for one month in 2011 in May.

8.2 A detailed summary outlook and the risks to the Sector forecast are shown at appendix B.

9. Resources, Risk & Other Implications

9.1 A comparison between the actual returns for 2010/11 and the budget is shown in the table below:

	Budget 2010/11 £'000	Actual 2010/11 £'000	Variance 2010/11 £'000
Fixed /Callable Deposits	807	595	212
Short Term officer Investments	135	113	22
Paper Sort Loan ³	24	24	0
Other Miscellaneous Interest ⁴	0	255	(255)
Less Other Interest ⁵	-5	-2	(3)

³ The Council is a partner with Chiltern DC and Wycombe DC in a scheme that provides paper sort facilities. As part of the set up arrangements the Council made a loan of £300K to the facility, which is repayable over a period of 20 years at an interest rate of 8%.

⁴ This relates to interest payable on a back dated VAT refunds.

⁵ Interest is credited separately to a number of the Council's earmarked funds.

	Budget 2010/11 £'000	Actual 2010/11 £'000	Variance 2010/11 £'000
Stoke Poges Memorial Gardens Fund	89	76	13
Total Returns	1,050	1,061	(11)

9.2 There was an achievement of £11k over budget during 2010/11 which is mainly a result of the following:

- Lower than anticipated interest rates achieved for in house investments, due to the prolonged period of historically low interest rates. The original budget for the year assumed a modest recovery in rates in the last quarter of the year which did not materialise. This underachievement is offset by additional miscellaneous interest detailed below.
- Miscellaneous interest includes a one off amount of £248K interest paid by HMRC in respect of a vat refund on the treatment of green fees plus miscellaneous interest paid from car loans and interest on loan charges in respect of transferred debt from the reorganisation of Local Government in 1974.

9.3 Meeting the interest target of £900,000 for 2011/12 will be dependant on interest rates not reducing, and there being a move in the markets later in the year to expect some modest increase in rates. In the current economic circumstances the risk for the target is to the downside.

9.4 The Council's Treasury Management Policy and Procedures state that there should be quarterly reports on the Council's Treasury Management activities one of which will be an Annual Report for the previous financial year. However there are only five meetings of this PAG in 2011/12 and due to the timing of the meetings it will be difficult to achieve the reporting timetable laid down. As the next meeting of the PAG is on 31st October it is proposed to email Members with the report on the performance to September 2011 during November 2011 in order to meet the reporting timetable. The Treasury Management Strategy will be considered by the PAG on it's meeting of 12th January 2012 and the report on the performance for the December 2011 quarter will be reported to the PAG on 5th March 2012.

10. Summary

10.1 The PAG is requested to:

1. Note the investment performance for 2010/11.
2. Note the investment performance for the first quarter of 2011/12.
3. Note the change to the in the quarterly performance reporting detailed in 9.4 above.

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Background Papers:	None