SUBJECT:	**Treasury Management – Annual Report 2011/12**
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 2011/12.

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 2011/12.

4. Annual Report on Treasury Management 2011/12.

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 2011/12 details the following sources for generating investment income for the year:

- Set an estimated return on investment income for the year of £900,000.

- Set the sources for generating investment income for the year as follows:

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

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 2012/13 as follows.

	Fitch Credit Rating	Maximum Amount	Comment
UK Institutions	AAA	£10 million	The durations of the investment would be informed by the detailed credit rating information
	A+ or better	£7 million	
	A or better Banks with high UK Gov Support	£7 million	
	A or A-	£2 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

Details of the Councils fixed and callable investments at the end of the financial year and how they met this matrix are shown in 4.7 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.

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

	Fund Balance 1.4.2011 £,000	Fund Withdrawals £'000	Added to Fund £'000	Fund Balance 31.3.2012 £,000
Temp in house cash balances	2,561		893	3,454
Fixed Deposits	23,000	(19,500)	17,500	21,000
Stoke Poges Memorial Gardens Fund	1,509		49	1,558
Total	27,070	(19,500)	18,442	26,012

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.

4.7 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 2012 is shown below:-

UK Institutions	Fitch Credit Rating	Maximum Amount £7 Million* Principal £	Interest Rate	Invested	Matures	Notes
Royal Bank of Scotland	A					
Fixed Deposit		5,000,000	4.25%	08/02/12	08/02/17	(1)
Fixed Deposit		2,000,000	2.50%	02/06/11	02/06/14	(2)
Total RBS		7,000,000				
Cater Allen	A+					
Fixed Deposit		1,000,000	2.50%	03/10/11	03/10/12	
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%	02/11/11	02/11/12	
Fixed Deposit		2,000,000	2.50%	16/11/11	16/11/12	
Total CA		7,000,000				
Lloyds Bank	A					
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	A					
Fixed Deposit		3,000,000	2.10%	15/07/11	16/07/12	
Fixed Deposit		1,000,000	2.10%	04/10/11	04/10/12	
Total Lloyds Group		6,000,000				
Barclays	A					
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				
Total Deposits		21,000,000				

(1) RBS have the option to switch to 3 month LIBOR[1] in years 3, 4&5.

(2) RBS have the option to switch to 3 month LIBOR in years 2&3.

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	1,954,000	Base + 34 Basis Points	Instant Access
Nat West Bank	1,500,000	Base + 60 Basis Points	30 Day Notice Account
Total	3,454,000		

[1] LIBOR – London Inter Bank Offered Rate

4.8 Investments in the first quarter of 2012/13

During the discussion when the Treasury Management Strategy 2012/13 was approved on 12th January 2012 Members noted that £8 million of fixed deposits would mature during 2012/13 and would be available for reinvestment. Members supported the proposal to seek a greater diversification of the investment portfolio by increasing the number of counterparties used and also considering investing in corporate bonds always having regard of the need to balance risk against the rate of return.

4.9 There will be £3 million that matures in July 2012 with the balance maturing during October and November. In April Sector were asked to provide details of current corporate bonds that met the Council's credit rating of AA- and above, with a duration of 18 months however the results did not indicate any suitable investment opportunities. Sector have been asked to rerun the exercise for AA- and above and the results are shown at appendix A1 for UK or Supranational institutions with a duration of up to 2 years. As can be seen from the results the bid yield to maturity which gives the indication of the return the Council would receive is much lower than we are currently achieving in cash. Sector were also asked to run the exercise to show what additional UK or Supranational counterparties with a duration of up to 2 years and a return of over 2% would be available should Members wish to consider reducing the credit criteria further to A and the results of this exercise are shown at appendix A2. As can be seen this change would add a few opportunities however those with the highest rate of return Santander and RBS are those where the Council has already reached its maximum counterparty limit.

4.10 With regard to the investment of short term cash flow a review of the Council's requirements for the year and indicated that it would be possible to invest £4 million in fixed deposits for 6 and 9 months in order to obtain better returns, and these are detailed below. This will help to maximise the returns on our short term cash particularly as the Council's banker, Nat West, are in the process of reducing the rates they pay on their short term investment account and have given notice that they will reduce the rates that they are paying to the Council from 13th July 2012 for instant access from base plus 34 basis points(0.84%) to base (0.50%) and on the 30 day notice account from base plus 60 basis points (1.10%) to base plus 25 basis points (0.75%). These investments will also add an element of diversification to the portfolio.

- £1 Million with Clydesdale Bank (A) fixed for 6 months on 15/05/12 at 2.05%
- £1 Million with Co-op Bank (A-) fixed for 6 months on 16/05/12 at 1.8125%
- £1 Million with Lloyds/Bank of Scotland (A) fixed for 9 months on 15/05/12 at 2.00%
- £1 Million with Close Brothers Treasury*(A) fixed for 9 months on 22/05/12 at 2.10%

* Close Brothers Treasury has a Fitch rating of A with a stable outlook and therefore meets the Council's credit criteria. Close Brothers Group is a specialist financial services group which makes loans, trades securities and provides advice and investment management solutions. It was established in 1878 and is a member of the FTSE 250. They are a domestic UK focused bank transacting mostly in sterling and with only a minimal currency exposure. The group does not hold sovereign debt issues by Greece, Ireland, Italy, Portugal or Spain.

4.11 Stoke Poges Memorial Gardens Fund: There were no maturities from the Stoke Poges Memorial Gardens Fund due in 2011/12. The current market value of the fund at 31st March 2012 was £1,557,634.88.

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 October 2011.

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

6. Economic Background & Interest Rate Forecast

6.1 The original expectation for 2011/12 was that Bank Rate would start gently rising from quarter 4 2011. However, GDP growth in the UK was disappointing during the year under the weight of the UK austerity programme, a lack of rebalancing of the UK economy to exporting and weak growth in out biggest export market the EU. The EU sovereign debt crisis grew in intensity during the year until February when a refinancing package was eventually agreed for Greece. This weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £75bn in October and another £50bn in February. Bank Rate therefore ended the year unchanged at 0.5% while CPI inflation peaked in September at 5.2% but then fell to 3.4% in February, with further falls expected to below 2% over the next two years.

Gilt yields fell for much of the year, until February, as concerns continued building over the EU debt crisis. This resulted in safe haven flows into UK gilts which, together with the two UK packages of QE during the year, combined to depress PWLB rates to historically low levels.

Risk premiums were also a constant factor in raising money market deposit rates for periods longer than 1 month. Widespread and multiple downgrades of the ratings of many banks and sovereigns, continued Euro zone concerns, the significant funding issues still faced by many financial institutions, meant that investors remained cautions of longer-term commitment.

6.2 A more detailed assessment of the economic background provided by Sector is shown at appendix B.

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

	Jun 12	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%

The Sector central forecast is for a March 2014 first increase in Bank Rate.

7. Resources, Risk & Other Implications

7.1 A comparison between the actual returns for 2011/12 and the budget is shown in the table below:

	Budget 2011/12 £'000	Actual 2011/12 £'000	Variance 2011/12 £'000
Fixed Deposits	646	699	(53)
Short Term officer Investments	155	79	76
Paper Sort Loan [2]	24	24	0
Other Miscellaneous Interest[3]	0	9	(9)
Less Other Interest[4]	0	(12)	12
Stoke Poges Memorial Gardens Fund	75	75	0
Total Returns	900	874	26

7.2 There was an under achievement of £26K budget during 2011/12 which is mainly a result of 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.

7.3 Meeting the interest target of £800,000 for 2012/13 will be dependant on interest rates not reducing further 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.

8. Summary

8.1 The PAG is requested to:

1. Note the investment performance for 2011/12.

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Background Papers:	**None**

[2] 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%.

[3] Miscellaneous interest includes interest from car loans, Swan Road, the sale of the Manor House and in respect of transferred debt from the reorganisation of Local Government in 1974.

[4] Interest is credited separately to a number of the Council's earmarked funds but mainly the monies from the section 106 agreements.