

SUBJECT:	Investment Performance Quarter Ending 30th June 2012
REPORT OF:	Officer Management Team - Director of Resources Prepared by - Principal Accountant

1. Purpose of Report

- 1.1 To inform Members of the investment returns for the quarter ending 30th June 2012.

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 The Council's Treasury Management Strategy 2012/13 details the following sources for generating investment income for the year:

- (i) Set an estimated return on investment income for the year of £0.8 million.
- (ii) Set the sources for generating income for the year as follows:

	£'000
Fixed & Callable Deposits	657
Short Term Cash Flow and Other Investments	77
Stoke Poges Memorial Gardens Fund	66
Total	800

- 3.2 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.
- 3.3 The Council has adopted the CIPFA code of practice on Treasury Management, which includes the creation of a Treasury Management Policy Statement setting out the policies and objectives of the Council's treasury management activities.
- 3.4 The code recommends that reports on investment performance are made on a quarterly basis including a Mid-year Review Report. This report represents the first of these reports for 2012/13.

4. Investment Performance - Quarter to 30 June 2012.

- 4.1 **In House Investments** - Officers invest cash flow surpluses with approved counter parties. 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 money market briefings made available to the authority. 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

4.2 A summary of the Council's holdings of fixed deposits with a maturity of over one year at 30th June 2012 is shown below:

UK Institutions	August 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	3 Month Libor	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	(3)
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 LIBOR¹ in years 3,4 & 5.
- (2) RBS have exercised their option to switch to 3 month LIBOR in year 2.
- (3) The £3 million invested with the Bank of Scotland at 2.10% matured on 16th July 2012 and was reinvested with them at 3% from that date for a period of slightly less than one year maturing on 4th July 2013.

In addition the Council held the following investments of short term cash with duration of under one year at the end of the quarter:

	Fitch	Amount £	Interest Rate	Period
Nat West Bank	A	3,500,000	Base + 34 Basis Points	Instant Access
Nat West Bank	A	1,500,000	Base + 60 Basis Points	30 Day Notice Account
Bank of Scotland	A	1,000,000	3.00%	23/04/12 to 11/04/13
Bank of Scotland	A	1,000,000	2.00%	15/05/12 to 15/02/13
Clydesdale Bank	A	1,000,000	2.05%	15/05/12 to 15/11/12
Co-op Bank	BBB+	1,000,000	1.8125%	16/05/12 to 16/11/12
Close Brothers	A	1,000,000	2.10%	22/05/12 to 22/02/13
Total		10,000,000		

- 4.3 **Stoke Poges Memorial Gardens Fund:** The interest return from the fund 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.
- 4.4 The fund is managed on a passive basis by King & Shaxson .Due to the current cost of buying a new bond it is the current policy to reinvest any maturities within the Councils cash investment. The value of the fund at 30th June was £1,557,635

5. Treasury Management Strategy Update

- 5.1 The Treasury Management Strategy (TMSS) was approved by the Council on 21st February 2012. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as
 - Security of capital
 - Liquidity
- 5.2 The Council also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate the Sector view during the on going market uncertainties is to keep anything maturing short term for up to twelve months with the exception of investing in part Government institutions.
- 5.3 There is a total of £5 million of long term fixed investments which will mature during the autumn and for which reinvestment will need to be considered. These are listed below:

Counterparty	Fitch	Amount £	Interest Rate	Invested	Matures
Bank of Scotland	A	1,000,000	2.10%	04/10/11	04/10/12

¹ LIBOR - London Inter Bank Offered Rate

Cater Allen	A	1,000,000	2.50%	03/10/11	03/10/12
Cater Allen	A	1,000,000	2.50%	02/11/11	02/11/12
Cater Allen	A	2,000,000	2.50%	16/11/11	16/11/12
Total		5,000,000			

5.4 The Treasury Management Strategy 2012/13 approved a revised counterparty matrix which is shown at 4.1 above. Since the adoption of this matrix there has been a general downgrading of credit ratings by the ratings agencies including Fitch which the Council use. This has resulted in some of the Council's current investment portfolio no longer meeting the counterparty matrix as shown below.

(1) Cater Allen's (Santander UK) rating has now fallen from A+ to A which means the maximum amount invested long term (in excess of one year) with them should be £2 million rather than the £7 million currently invested. This situation will partly be rectified during October and November when the £4 million of investments matures and is reinvested elsewhere. The £2 million limit will be met when a further £1 million investment with them matures on 21st July 2013.

(2) In short term investments since the £1 million was invested with the Co-op on 16th May 2012 their credit rating has fallen from A- to BBB+ which is not included on the Council's counterparty list. The investment matures on 16th November 2012.

5.5 The fall in the credit ratings of UK banks have not tended to be specific but of a more generic nature where once one falls they all tend to follow therefore those banks that were rated as AA- a year ago are now rated as A although there are some exceptions to this. If credit ratings fall further and most of the UK banks are currently on a negative watch then the Council's current counterparty matrix will become no longer fit for purpose. As things stand the Council would have to significantly reduce its investments with most of the major UK banks as investments mature. It would also be faced with having a very limited range of counterparties to place funds of more than £1m with. Consideration will therefore need to be given on how to react to any further falls in credit ratings including if delegated powers should be given to the Director of Resources in conjunction with the Portfolio Holder in respect of the placing of short term investments before Members of this Pag could agree a revised counterparty matrix. The Audit Commission's report on Icelandic Banks included guide on the grading of credit ratings which is very useful and an extract in respect of Fitch ratings is shown below for Members information.

Audit Commission Grading	Fitch Long Term
Extremely Strong Grade	AAA
Very Strong Grade	AA+ AA AA-
Strong, but susceptible to adverse conditions	A+ A A-
Adequate Grade	BBB+ BBB BBB-
Speculative Grade	BB+ BB BB-
Very Speculative Grade	B+ B B-

Vulnerable Grade	CCC CC C
Defaulting Grade	D

As can be seen from the above the majority of the Council's cash investments are still regarded as strong with the exception of the Co-op which falls into the adequate category.

- 5.6 The longer money is invested, the lower the credit rating of the counterparty, the greater the return however this comes at a greater risk. The return on the Council's cash investments during July 2012 was 2.52% which I regard to be a good return given the current climate with a bank rate of only 0.50% and with some forecasts that it could fall further. As well as the counterparty matrix consideration needs to be given to investing in alternatives to cash to see if the Council could get a better return on some of its investments offset against the risk involved.
- 5.7 To enable a discussion on where the Council should invest so that the results can be built into the Treasury Management Strategy 2013/14 which Members will consider and approve in December 2012 I am arranging for Sector to attend an informal meeting with the Members of this Pag in October or November (**date to be confirmed**) where alternative options to cash can be considered including Corporate Bonds, Interest Rate Swaps, Equities, and Property investments. Sector will set out the advantages and disadvantages of the alternatives to cash including risk v return and legality and answer Members questions.

6. Investment Policy and Procedures

- 6.1 As detailed in 3.3 above the Council has adopted the CIPFA Code of Practice on Treasury Management.
- 6.2 The Code recommends the creation & maintenance of Treasury Management Policy & Procedures.
- 6.3 It is not normally expected that the procedures will need to be revised very often and any changes have therefore been delegated down to me as Chief Finance Officer. A copy of the document is brought to Members attention on an annual basis and a copy has therefore been attached at Appendix A for Members information.

7. Economic Background

7.1 The quarter of the saw:

- The economic outlook has generally weakened.
- Demand to the high street was volatile, as a result of temporary distortions.
- Employment rose and unemployment fall, but earnings growth remained weak.
- Inflation continued to fall.
- The Bank and the HM Treasury announced measures to help the UK banking sector.
- The MPC indicated another tranche of quantitative easing.
- Gilt yields fell on the back of deteriorating economic data and safe-haven flows from the euro-zone.
- Sentiment towards the Eurozone alternately rose on the announcement of measures to address the crisis, but then fell back as measures disappointed.

A more detailed Economic Background is shown at appendix B

8. Interest Rate Forecasts

8.1 The latest forecast for Bank Rate provided by Sector is shown below:

	Sep 12	Dec 12	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15
Sector	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%
UBS	0.50%	0.25%	0.25%	0.25%	0.25%	0.25%					
Capital Economics	0.50%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	

The Sector central forecast is for the first increase in bank rate to be in the last quarter of 2014 but there is downside risk to the projection. With growth predictions for the UK continuing to be reduced on an almost monthly basis by both the Office for Budget Responsibility and economic commentators generally, and financial markets unconvinced that politicians have resolved the Euro zone sovereign debt crisis in the medium-term, we are likely to continue to experience high levels of volatility. Other forecasts as shown above anticipate that bank rate will fall further.

A more detailed summary outlook on the prospects for interest rates is shown at appendix C

9. Resources, Risk & Other Implications

9.1 The investment budget set for the year is £800,000. The Council is currently on target to meet the investment budget for the year however the budget for 2011/12 had an assumption built in that interest rates would rise in the last quarter of the year which is no longer forecast to happen and there maybe a small underachievement in matching the target which will become more apparent as the year progresses.

10. Summary

10.1 The PAG is requested to:

1. Note the investment performance for the quarter to 30th June 2012.

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Background Papers:	None