SUBJECT:	Treasury Management – Annual Report 2012/13
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 2012/13.

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 2012/13.

4. Annual Report on Treasury Management 2012/13.

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 2012/13 details the following sources for generating investment income for the year:

- Set an estimated return on investment income for the year of £800,000.

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

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

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 2013/14 as follows.

	Duration	Maximum Amount	Fitch Rating	Comment
UK Institutions	Up to 5 years	£5m	A- or better	
	Up to 3 years	£5m	BBB+ or better	
Non UK Institution	Up to 3 years	£2m	A- or better	Sovereignty rating AA or better
Corporate Bonds/Bond Funds	Up to 5 years	£5m	A- or better	

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 1.4.2012 £,000	Fund Withdrawals £'000	Added to Fund £'000	Fund Balance 31.3.2013 £,000
Temp in house cash balances	3,454		1,197	4,651
Fixed Deposits	21,000	(16,000)	14,000	19,000
Stoke Poges Memorial Gardens Fund	1,558	(210)	41	1,389
Total	26,012	(16,210)	15,238	25,040

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 2013 is shown below:-

UK Institutions	Fitch Credit Rating	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	3.50%	21/07/10	21/07/13	
Fixed Deposit		2,000,000	3.20%	30/09/10	30/09/13	
Total CA		3,000,000				
Lloyds Bank	A					
Fixed Deposit		1,000,000	3 Month Libor, Floor 2.85%, Cap 5.85%	11/05/10	12/05/15	
Fixed Deposit		1,000,000	3 Month Libor, Floor 3.07%, Cap 5.00%	19/05/10	19/05/15	
Total Lloyds Group		2,000,000				
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				
Close Brothers	A					
Fixed Deposit		1,000,000	2.80%	04/10/12	04/10/13	
Fixed Deposit		1,000,000	2.70%	22/02/13	22/08/14	
Total Close Brothers		2,000,000				
Total Deposits		15,000,000				

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

(2) RBS have exercised their option to switch to 3 month LIBOR in year 2.

In addition the Council held the following investments of short term cash with a duration of less than one year at 31st March 2013.

	Fitch	Amount £	Interest Rate	Notes
Nat West Bank	A	1,651,000	Base + 28 Basis Points	Instant Access
Nat West Bank	A	3,000,000	Base + 47 Basis Points	30 Day Notice Account
Bank of	A	3,000,000	3%	16/7/12 to 4/7/13

[1] LIBOR – London Inter Bank Offered Rate

	Fitch	Amount £	Interest Rate	Notes
Scotland				
Bank of Scotland	A	1,000,000	3%	23/4/12 to 11/4/13
Total		8,651,000		

4.8 Investments in the first quarter of 2013/14

The Funding for Lending Scheme resulting in cheap credit becoming available to the banks has had an impact in the money market where rates have fallen significantly. As a result Nat West has reduced their rates for the investment of short term cash from May 2013 from bank rate plus 47 basis points (0.97%) for 30 day notice money and bank rate plus 28 basis points (0.78%) for overnight money to the bank rate only (0.50%). Officers have therefore invested an element of short term cash in 95 day notice accounts with Nat West paying 0.80% and in Lloyds/Bank of Scotland paying 0.75%.

4.9 The £1 million invested with the Bank of Scotland paying 3% that matured on 11th April 2013 was invested with Close Brothers from 12th April 2013 for 18 months until 13th October 2014 at 1.50%.

4.10 At the March meeting of this PAG Members agreed to diversify up to £5 million of the Council's investment portfolio into individual corporate bonds, but not until it was felt that market conditions were appropriate. Appendix C shows a number of corporate bonds that would meet the Council's counterparty criteria, and which offer an effective yield of 1.75% or better. Members can consider whether the time may be right to make some limited investment in this area, or whether to hold off for a period in anticipation of bond yields improving.

4.11 Stoke Poges Memorial Gardens Fund: The next maturity from the fund takes place in April 2014.The current market value of the fund at 31st March 2013 was £1,389,512.01.

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 2012.

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 During the quarter ended 31st March 2013:

- Indicators suggest that the economy was very near to a second consecutive quarter of negative growth in GDP;
- Household spending strengthened, both on and off the high-street;
- Unemployment rose for the first time for a year;
- Inflation remained stubbornly above the MPC's 2% target;
- Three members of the MPC voted for further QE;
- UK equity prices rose and sterling fell;
- The US economic recovery gathered pace.

6.2 The original expectation for 2012/13 was that Bank Rate would not rise in 2012/13 or 2013/14 and for it to start gently rising from quarter 4 2014. This forecast rise has now been pushed back to start in quarter 1 2015 at the earliest. Economic growth (GDP) in the UK was virtually flat during 2012/13, due to the UK austerity programme, subdued domestic consumer expenditure, a lack of rebalancing of the UK economy to exporting and week growth in our biggest export market – the European Union (EU). The weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £50bn in July to a total of £375bn. Bank Rate, therefore, ended the year unchanged at 0.5%, while CPI inflation has remained stubbornly high and above the 2% target, starting the year at 3.0% and still being at 2.87% in March; however it is forecast to fall to 2% in three years time. The EU sovereign debt crisis was an ongoing saga during the year, with an eventual very protracted agreement of a second bailout for Greece in December followed by a second major crisis, this time over Cyprus, towards the end of the year.

6.3 Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into/out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB rates depressed for much of the year at historically low levels.

6.4 The Funding for Lending Scheme, announced in July, has resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling drastically in the second half of the year. However, perceptions of counterparty risk have improved after the ECB statement in July that it would do "whatever it takes" to support struggling Eurozone countries. This has resulted in some return of confidence to move away from only very short term investing.

6.5 The UK coalition Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Moody's followed up this warning by actually downgrading the rating to AA+ in February 2013 and Fitch then placed their rating on negative watch after the Budget in March and subsequently downgraded their rating to AA+.

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

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

	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15
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 2015 first increase in Bank Rate.

6.8 Sector undertook a review of its interest rate forecasts following the issue of the latest Bank of England Inflation Report in February 2013. Sector has left unchanged its forecast for the first increase in Bank Rate to be in March 2015. However, forecasts for PWLB rates have been increased as a result of the marked recovery in confidence in equity markets, anticipating stronger economic recovery in America, supported by growth in the Far East. The rise in equity prices has, conversely, resulted in a selloff in bonds and some diminution of the UK as a safe haven from more risky assets. However, towards the end of March, the Cyprus crisis has partially reversed these general trends during the quarter, although this is likely to be a temporary phase – at least, until the next Eurozone crisis.

6.9 A summary outlook from Sector and forward view is shown at Appendix B.

7. Resources, Risk & Other Implications

7.1 A comparison between the actual returns for 2012/13 and the budget is shown in the table below:

	Budget 2012/13 £'000	Actual 2012/13 £'000	Variance 2012/13 £'000
Fixed Deposits	657	678	21
Short Term officer Investments	53	76	23
Paper Sort Loan [2]	24	24	0
Other Miscellaneous Interest[3]	0	7	7
Less Other Interest[4]	0	(9)	(9)
Stoke Poges Memorial Gardens Fund	66	66	0
Total Returns	800	842	42

7.2 There was an achievement of £42K over the budget during 2012/13 mainly resulting from fixed and short term deposits.

7.3 Meeting the interest target of £775,000 for 2013/14 will be challenging in the current low interest rate environment. The first half of the year is partly underpinned by some investments that are running at 3% and above however when these mature it will be interesting to see what is on offer particularly in respect of corporate bonds for the reinvestment of these maturities. The risk is therefore to the downside.

8. Recommendation

8.1 The PAG is requested to, note the investment performance for 2012/13, and consider whether to make any investment in corporate bonds at this time.

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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%. This arrangement ceases after 31/03/13.

[3] Miscellaneous interest includes interest from car loans, Swan Road, 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.