APPENDIX A

TREASURY MANAGEMENT HALF YEARLY REPORT - 2011/2012

1. Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

As a consequence Treasury Management is defined as:

“The management of the local authority’s investments and 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. ”

2. Introduction

The Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 24 February 2010.

The primary requirements of the Code are as follows:

(1) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council’s treasury management activities.

(2) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

(3) Receipt by the Full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, and an Annual Report (stewardship report) covering activities during the previous year. In addition, the production of a **Mid-Year Review Report** for scrutiny by Members. For this Council the delegated body to review treasury management and receive the Mid-Year Review Report is the Audit and Risk Committee.

(4) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices. For this Council the delegated body is the Cabinet (for implementing) and the Audit and Risk Committee (for monitoring). Delegation by the Council for the execution and administration of treasury management decisions. For this Council this is delegated to the Executive Director (Resources and Support Services).

(5) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is The Transformation and Resources Overview and Scrutiny Committee.

(6) The Mid-year Review Report to members is intended to provide a mid-year update of the treasury management strategy and performance for the period April –September of the financial year.

This mid year report has been prepared in compliance with CIPFA’s Code of Practice, and covers the following:

- An economic update for the first six months of 2011/12
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- A review of the Council's investment portfolio for 2011/12

3. Economic Update – as provided by the Council's Treasury Management Advisors (Sector Treasury Services Ltd)

3.1 Global economy

The Euro zone sovereign debt crisis continued with Spain, and particularly Italy, being the focus of renewed market concerns that they may soon join with Greece, Ireland and Portugal in needing assistance. This uncertainty and the lack of a co-ordinated or credible Euro zone response, left commentators concerned over the potential impact of sovereign default and resulting effect on the Euro zone banking sector. The approval by various countries of the €440bn bail out fund in September has brought temporary relief to financial markets but this does not provide a credible remedy to the scale of the Greek debt problem or the sheer magnitude of the potential needs of other countries for support.

This, coupled with political difficulties in the US over their plans to address the budget deficit, the size and control over the US sovereign debt, and the subsequent loss of the AAA credit rating from Standard and Poor's, has led to a much more difficult and uncertain outlook for the world economy.

Growth prospects in the US, UK and the euro zone have been lower than expected, with future prospects similarly cut. Whilst not a central view, concerns of a double dip recession in some Western countries have increased. World stock markets fell in the second quarter of 2011/12 as a consequence.

3.2 UK economy

Following zero growth in the final half of 2010/11 the UK economy grew by a weaker than expected 0.1% in the first quarter of 2011/12, providing a knock on effect to future growth prospects. Growth prospects will be governed by UK consumer sentiment, which is currently subdued due to falling disposable income. Higher VAT, overhanging debt, high inflation and concerns over employment are likely to weigh heavily on consumers into the future.

The announcement by the MPC on 6 October of a second round of quantitative easing of £75bn emphasised how seriously the MPC now views recession as being a much bigger concern than inflation. Although inflation remains stubbornly high, the Monetary Policy Committee's expectation of future falls resulting in an undershoot of its 2% target opened the way for this new round of QE.

International investors continue to view UK government gilts as being a safe haven from the EU sovereign debt crisis. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and sent PWLB borrowing rates to low levels.

3.3 Outlook for the next six months of 2011/12

There remain huge uncertainties in economic forecasts due to the following major difficulties:

- the increase in risk that the UK, US and EU could fall into recession
- the likely political gridlock in the US preventing significant government fiscal action to boost growth ahead of the Presidential elections in November 2012
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial

markets and the global and UK economies
- the degree to which government austerity programmes will dampen economic growth;
- the potential for further quantitative easing, and the timing of this in both the UK and US
- the speed of recovery of banks' profitability and balance sheet imbalances and the risk of substantial losses being incurred on EU sovereign debt
- We expect low growth in the UK to continue, with a low Bank Rate to continue for at least 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB borrowing rates is for them to rise, primarily due to the need for a high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. However the current safe haven status of the UK may continue for some time, postponing any increases until 2012.

3.4 Sector's Interest Rate Forecast (as at 07/10/11)

	NOW	Dec11	Mar12	Jun12	Sep12	Dec12	Mar13	Jun13	Sep13	Dec13	Mar14	Jun14	Sep14	Dec14	Mar15
	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50	2.00	2.25	2.50
PWLB															
5yr	2.30	2.30	2.30	2.30	2.30	2.40	2.50	2.60	2.70	2.80	2.90	3.10	3.30	3.35	3.70
10yr	3.30	3.30	3.30	3.30	3.40	3.40	3.50	3.60	3.70	3.80	4.00	4.20	4.40	4.60	4.80
25yr	4.20	4.20	4.20	4.20	4.30	4.30	4.40	4.50	4.60	4.70	4.80	4.90	5.00	5.10	5.20
50yr	4.30	4.30	4.30	4.30	4.40	4.40	4.50	4.60	4.70	4.80	4.90	5.00	5.10	5.20	5.30

4 Treasury Management Strategy Statement

The Treasury Management Strategy Statement (TMSS) for 2011/12 was approved by Full Council on 23 February 2011. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with highly credit rated financial institutions using the Sector suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information provided by Sector Treasury Services Ltd.

Investments during the first six months of the 2011/12 financial year have been in line with the strategy, and there have been no deviations from the strategy.

As outlined in Section 3 above, there is still considerable uncertainty and volatility in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy approved on 23 February 2011 is still fit for purpose in the current economic climate.

On 8 September 2011 Sector advised all clients to keep fixed investments short dated i.e. less than three months with the exception of semi-nationalised institutions which include the Halifax Bank of Scotland (Lloyds Banking Group) and the Royal Bank of Scotland with whom deposits can still be placed for a period of up to twelve months. Our investment portfolio as at this date already complied with the above recommendation.

On 7 October 2011 Sector issued a newsflash to confirm that Moody's Investors Service had downgraded the ratings of 12 UK financial institutions, concluding its review of systemic support assumptions from the UK government for these institutions. Moody's has not implemented these cuts because it believes there has been a market deterioration in the financial strength of the banking system or the UK government, but rather because it believes the government has re-evaluated its role in supporting banking institutions. Moody's believes that the government is likely to continue to provide some level of support to systemically important financial institutions, however, it is more likely now to allow smaller institutions to fail if they become financially troubled. As at the time of writing this report Sector Treasury Services have confirmed that this has not affected their announcement on 8 September 2011.

5 Investment Portfolio 2011/12

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. The continuing Euro zone sovereign debt crisis, and its potential impact on banks, prompts a low risk and short term strategy. Given this risk adverse environment, investment returns are likely to remain low.

The Council held £12m of investments as at 30 September 2011 and had an average level of funds available for investment purposes in the first 2 quarters of 2011/12 of £16m. The investment portfolio yield for the first six months of the year is 1.01% against a target of 1.00%. The Council's budgeted investment return for 2011/12 is £218,000. As at the end of the first 2 quarters of 2011/12 £112,000 of interest has been earned.

A full list of investments held as at 30 September 2011 is shown in Annex A.

6 Borrowing Position 2011/12

It is not currently intended to borrow to finance capital investment. The only borrowing envisaged by the 2011/12 Treasury Management Strategy is temporary borrowing to cover short-term cash flow deficits. In fact no borrowing has taken place for the first half of the financial year.

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Investments held as at 30 September 2011:

INVESTMENTS OUTSTANDING WEEK ENDING 30/09/2011

DATE INVESTED	NAME OF BORROWER	PRINCIPAL (£)	DATE	NO. OF DAYS
03/08/2011	**HALIFAX BANK OF SCOTLAND (Lloyds Banking Group)**	1,250,000	03/11/2011	92
03/08/2011	**SANTANDER UK**	1,000,000	03/10/2011	61
07/09/2011	**HALIFAX BANK OF SCOTLAND (Lloyds Banking Group)**	4,000,000	07/12/2011	91
		6,250,000		
	SANTANDER BUSINESS RESERVE ACCOUNT	**1,250,000**		
	ROYAL BANK OF SCOTLAND 30 DAY NOTICE ACCOUNT	**3,000,000**		
	HALIFAX BANK OF SCOTLAND (Lloyds Banking Group) Deposit Account	**1,750,000**		
	TOTAL INVESTMENTS	**12,250,000**		
	HERITABLE BANK INVESTMENT			
15/09/2008	**HERITABLE BANK (Landsbanki)**	**985,422**	14/09/2009	

(Please note that payments of £403,250, £317,649, £155,396, £157,437, £103,815, £118,358, £156,863, £101,810 have been received from the Heritable Bank administrators (Ernst and Young) by 30/09/11. A ninth dividend of £104,919 has also been received on 20/10/11 reducing the balance to **£880,503**.

Annex to Appendix A