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TREASURY MANAGEMENT HALF YEARLY REPORT - 2012/2013

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.

The second main function of a treasury management service is the funding of an authority's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasions any debt previously drawn may be restructured to meet Council risk or cost objectives. Currently, however, the Council has not chosen to finance its capital investment by way of borrowing, so these activities are not presently engaged in.

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 treasury management function is carried out in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) current Code of Practice on Treasury Management (revised November 2011).

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.

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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. It has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2012/13
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- A review of the Council's investment portfolio for 2012/13

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

3.1 Economic performance to date

Economic sentiment, in respect of the prospects for the UK economy to recover swiftly from recession, suffered a major blow in August when the Bank of England substantially lowered its expectations for the speed of recovery and rate of growth over the coming months and materially amended its forecasts for 2012 and 2013. It was noted that the UK economy is heavily influenced by worldwide economic developments, particularly in the Eurozone, and that continuing negative sentiment in that area would inevitably permeate into the UK's economic performance.

With regard to the Eurozone, investor confidence remains weak because successive "rescue packages" have first raised, and then disappointed, market expectations. However, the uncertainty created by the continuing Eurozone debt crisis is having a major effect in undermining business and consumer confidence not only in Europe and the UK, but also in America and the Far East/China.

In the UK, consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on real incomes from high inflation and low pay rises, all taking a toll. Whilst inflation has fallen considerably (CPI at 2.2% in September), UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession.

This weak recovery has caused social security payments to remain high and tax receipts to be depressed. Consequently, the Chancellor's plan to eliminate the annual public sector borrowing deficit has been pushed back further into the future. The Monetary Policy Committee has kept Bank Rate at 0.5% throughout the period while quantitative easing was increased by £50bn to £375bn in July. In addition, in June, the Bank of England and the Government announced schemes to free up banking funds for business and consumers.

On a positive note, despite all the bad news on the economic front, the UK's sovereign debt remains one of the first ports of call for surplus cash to be invested in and gilt yields, prior to the European Central Bank (ECB) bond buying announcement in early September, were close to zero for periods out to five years and not that much higher out to ten years.

3.2 Outlook for the next six months of 2012/13

The risks in economic forecasts continue. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while America is hamstrung by political deadlock which prevents a positive approach to countering weak growth. Whether the presidential election in November will remedy this deadlock is debatable but urgent action will be required early in 2013 to address the US debt position. However, on 13 September the Federal Reserve announced an aggressive stimulus programme for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, and this time with no time limit. They also announced that it was unlikely that there would be any increase in interest rates until at least mid 2015.

Eurozone growth will remain weak as austerity programmes in various countries curtail economic recovery. A crunch situation is rapidly developing in Greece as it has failed yet again to achieve deficit reduction targets and so may require yet another (third) bail out. A financial crisis was also rapidly escalating over the situation in Spain. However, in early September the ECB announced that it would purchase unlimited amounts of shorter term bonds of Eurozone countries which have formally agreed the terms for a bailout. Importantly, this support would be subject to conditions and include supervision from the International Monetary Fund. This resulted in a surge in confidence that the Eurozone has at last put in place the framework for adequate defences to protect the Euro. However, it remains to be seen whether Spain and Italy will accept such loss of sovereignty. The Eurozone crisis is therefore far from being resolved as yet. The immediate aftermath of this announcement was a rise in bond yields in safe haven countries, including the UK. Nevertheless, this could prove to be as short lived as previous "solutions" to the Eurozone crisis.

The Bank of England Quarterly Inflation Report in August pushed back the timing of the return to trend growth and also lowered its inflation expectations. Nevertheless, concern remains that the Bank's forecasts of a weaker and delayed robust recovery may still prove to be over optimistic given the world headwinds the UK economy faces. Weak export markets will remain a drag on the economy and consumer expenditure will continue to be depressed due to a focus on paying down debt, negative economic sentiment and job fears. The Government, meanwhile, is likely to be hampered in promoting growth by the requirement of maintaining austerity measures to tackle the budget deficit.

The overall balance of risks is, therefore, weighted to the downside:

- We expect low growth in the UK to continue, with Bank Rate unlikely to rise in the next 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 eventually 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, tempering any increases in yield.
- This interest rate forecast is based on an assumption that growth starts to recover in the next three years to a near trend rate (2.5%). However, if the Eurozone debt crisis worsens as a result of one or more countries having to leave the Euro, or low growth in the UK continues longer, then Bank Rate is likely to be depressed for even longer than in this forecast.

3.3 <u>Sector's Interest Rate Forecast (as at 17/09/12)</u>

	17.9.12 actual	**Dec 2012**	**Mar 2013**	**June 2013**	**Sep 2013**	**Dec 2013**	**Mar 2014**	**June 2014**	**Sep 2014**	**Dec 2014**	**Mar 2015**
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
5yr PWLB	1.89	1.50	1.50	1.50	1.60	1.70	1.80	1.90	2.00	2.10	2.30
10yr PWLB	2.91	2.50	2.50	2.50	2.60	2.70	2.80	2.90	3.00	3.20	3.30
25yr PWLB	4.15	3.70	3.70	3.70	3.80	3.80	3.90	4.00	4.10	4.20	4.30
50yr PWLB	4.32	3.90	3.90	3.90	4.00	4.00	4.10	4.20	4.30	4.40	4.50

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The above Sector forecasts for Public Works Loans Board (PWLB) rates incorporate the introduction of the PWLB certainty rate in November 2012 which will reduce PWLB borrowing rates by 0.20% for most local authorities. The actual PWLB rates on 17.9.12 ought therefore to be reduced by 0.20 to provide a true comparison to the forecasts.

4 Treasury Management Strategy Statement

The Treasury Management Strategy Statement (TMSS) for 2012/13 was approved by Full Council on 22 February 2012. 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. Currently investments are only being made with U.K. financial institutions.

Investments during the first six months of the 2012/13 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 22 February 2012 is still fit for purpose in the current economic climate.

5 Investment Portfolio 2012/13

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 £8.25m of investments as at 30 September 2012 and had an average level of funds available for investment purposes in the first 2 quarters of 2012/13 of £11.7m. The investment portfolio yield for the first six months of the year is 1.00% against a target of 1.00%. The Council's budgeted investment return for 2012/13 is £154,680. As at the end of the first 2 quarters of 2012/13 £57,975 of interest has been earned.

A full list of investments held as at 30 September 2012 is shown in Annex A.

6 Borrowing Position 2012/13

It is not currently intended to borrow to finance capital investment in 2012/13. The only borrowing envisaged by the 2012/13 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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7 Prudential Indicators 2012/13

Treasury management activity during the first half year has been carried out within the parameters set by the prudential indicators contained in the approved 2012/13 Treasury Management Strategy. Consequently, there is no intention to revise any of the indicators for the remainder of the year.

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Annex A

INVESTMENTS OUTSTANDING AT 30/09/2012

DATE INVESTED	NAME OF BORROWER	PRINCIPAL £
	FIXED TERM INVESTMENTS	**-**
	DEPOSIT, ETC ACCOUNTS	
	HALIFAX BANK OF SCOTLAND DEPOSIT ACCOUNT (Rate of Interest 0.75%)	**1,250,000**
	ROYAL BANK OF SCOTLAND 30 DAY NOTICE ACCOUNT (Rate of Interest 1.1%)	**1,450,000**
	ROYAL BANK OF SCOTLAND DEPOSIT ACCOUNT (Rate of Interest 0.90%)	**5,550,000**
	TOTAL INVESTMENTS	**8,250,000**
	HERITABLE BANK INVESTMENT	
15/09/2008	**HERITABLE BANK *(Landsbanki)***	**630,479**

(Please note that payments of £403,250, £317,649, £155,396, £157,437, £103,815, £118,358, £156,863, £101,810, £104,919, £83,407, £95,089, £71,528 were received from the Heritable Bank administrators on 30 July 2009, 18 December 2009, 30 March 2010, 16 July 2010, 18 October 2010, 14 January 2011, 19 April 2011, 15 July 2011, 20 October 2011, 23 January 2012, 20 April 2012 and 20 July 2012 respectively)