Appendix A

Treasury Management Quarter 1

1. Background

The Treasury Management Strategy for 2010 has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for:

- The creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Authority's treasury management activities.

- The creation and maintenance of Treasury Management Practices, which set out the manner in which the Authority will seek to, achieve those policies and objectives.

- The receipt by the Full Council of an annual strategy report for the year ahead and an annual review report of the previous year.

- The delegation by the authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

Treasury management in this context 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. The Code of Practice recommends that members should be informed of TreasuryManagement activities at least twice a year, but preferably quarterly. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

<u>The economy and events in Q1</u>

- The UK continued to emerge from recession but the level of activity remained well below pre-crisis levels. The recovery is as yet fragile; GDP registered just 0.3% growth in the first calendar quarter of 2010. The final revision for 2010 Q1 GDP has been delayed by the ONS due to worries about data accuracy.
- Consumer price inflation remained well above the Bank of England's 2% target level, with a peak of 3.7% being reached in April. Year-on-year CPI for May 2010 was 3.4% and RPI was 5.1%. Temporary effects are thought to lie behind the elevated rate and inflation is expected to fall next year due to downward pressure from spare capacity. The measure of inflation excluding indirect taxes (CPIY) came down to 1.6% year-on-year. Arguably this is a much more relevant measure of inflationary pressure for forward thinking policy makers, as changes in the VAT rate aren't sending signals about the pressure on the use of resources in the economy.
- The Bank of England's Monetary Policy Committee on 5 August 2010 maintained the Bank Rate at 0.5% and Quantitative Easing at £200bn.
- The successful formation of a coalition government dispelled uncertainty surrounding a hung parliament result in May's General Election. The new government's Emergency Budget laid out tough action to address the UK's budget deficit, aiming to eliminate the structural deficit by 2014/15. This is to be achieved through austerity measures – £32bn of spending cuts and £8bn of net tax increases. The expected level of spending cuts and tax rises looks to be enough to extinguish the recent concern about inflation expectations. Therefore, rates 'lower for much longer' remained a relevant message.
- The US Federal Reserve kept rates on hold at 0.25% and the European Central Bank maintained rates at 1%. The major ongoing worries in Europe extended from sovereign weakness in the 'PIIGS' nations (Portugal, Italy, Ireland, Greece and Spain), the exposure of the continent's banking sector to the sovereign and corporate debt of these nations poses a risk that continuing uncertainties in the weaker European economies will spread to the UK.

3. Debt Management

	Balance on 01/04/2010 £000s	Debt Repaid £000s	New Borrowing £000s	Balance on 30/06/2010 £000s	Increase/ Decrease in Borrowing for Q1
Short Term Borrowing	5,006	10,000	18,000	13,006	8,000
Long Term Borrowing	156,253			156,253	
TOTAL BORROWING	161,259	10,000	18,000	169,259	8,000

The short term borrowing was of a temporary nature as part of the management of the Authority's cashflow. No permanent borrowing has as yet been entered into to finance 2009/10 capital expenditure. The position is being evaluated and action will be taken shortly.

4. Investment

The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Investments

	Balance on 01/04/2010 £000s	Invest-ments Made £000s	Invest-ments Repaid £000s	Balance on 30/06/2010 £000s	Increase/ Decrease in Invest-ments for Q1
Short Term Investments	59,350	136,300	130,900	64,750	5,400
Long Term Investments					
Investments in Pooled Funds-Lime fund	4,530			4,565	*35
Funds Managed Externally on segregated basis: -Investec	5,749			5,755	**6
TOTAL INVESTMENTS	69,629	136,300	130,900	75,070	5,441

* Units valued at market value

** valued at market value plus any interest rec'd – reinvested

The cash flow model has allowed the Council to get a better understanding of it cash requirements. It has meant that the Council isn't holding onto large amounts of money throughout the year, in order to cover the dips in the cashflow which only last a couple of days. Hence the increase in short term borrowing which was taken out at the end of the month and repaid days after.

In order to reduce the cost of covering these dips in cashflow the Council has taken the decision to cover any shortfalls in cash by going out to the money market, which is the flipside to the investment market allowing us to obtain short term debt for around 0.35% - 0.45%. The alternative would have been to make use of the overdraft facility provided by the bank, which would cost 1% + base for any amounts under £1m and 4% + base for and amount over £1m.

Overall, internally the Council has been able to obtain a rate of return well above its set benchmark of 3 month LIBID (which was 0.57%), the Council's average rate of return being 1.69%.

Externally Managed Funds:

The Council's Investment Property Fund, the Lime fund is steadily increasing in value. In the first quarter the fund has grown by £35k in capital and the first quarterly return is expected to be in the region of 5.5% before fees and 4.5% after fees.

However the externally managed funds with Investec have not performed well, as it is currently structured with a rate of return of 0.4% before fees and under 0.3% after fees. The Council will be holding a meeting with Investec and it's advisors Arlingclose to explore ways in which the fund can be restructured.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2010/11. This restricted new investments to the following:

- the Debt Management Office
- Other Local Authorities
- AAA-rated Stable Net Asset Value Money Market Funds
- Deposits with UK Banks and Building Societies systemically important to the UK Banking System and which have minimum long-term ratings of 'A+' or equivalent from Fitch, Moody's and S&P
- Deposits with select non-UK Banks (Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US). These countries, and the Banks within them, have been selected after analysis and careful monitoring of:
  - Credit Ratings (minimum long-term counterparty rating of A+)
  - Credit Default Swaps
  - GDP; Net Debt as a Percentage of GDP
  - Sovereign Support Mechanisms /potential support from a well-resourced parent institution
  - Share Price
- Bonds issued by Multilateral Development Banks, such as the European Investment Bank

Counterparty Update

- Following the challenging economic conditions facing Spain, the fiscal challenges ahead for the country, concerns over the effect of rising debt funding costs, and the downgrade of Spain's sovereign rating to AA by Standard and Poor's, the Council has suspended deposits with Spanish banks in Q1 2010 (BBVA and Banco Santander).

- Deposits with Santander UK Plc (a wholly owned subsidiary of Banco Santander) have been restricted to one month as a consequence of the factors outlined above.

5. Compliance with Prudential Indicators

The Council can confirm that it has complied with its Prudential Indicators for 2010/11, which were set in 25th Feb 2010 as part of the Council's Treasury Management Strategy

6. Outlook for Q2

At the time of writing this quarterly activity report in June 2010, the outlook for interest rates was as follows:

	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Official Bank Rate											
Upside risk		0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**0.50**	**0.50**	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**	**2.00**	**2.50**	**2.75**	**3.00**
Downside risk				-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

Gilts will remain volatile, more so in the election's aftermath.

The path of base rates reflects the fragile state of the recovering economy and the significantly greater fiscal tightening of the emergency budget. With growth and underlying inflation likely to remain subdued, the Bank of England is anticipated to maintain its "lower for longer" stance on policy rates.

The potential for downgrades to sovereign ratings has receded, but the negative outlook (S&P) will remain for now.

7. Summary

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first quarter of 2010/11. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

8. Other Information

- **CLG Investment Guidance –** The revised guidance came into effect on 1st April 2010. The guidance reiterated the need to focus on security and liquidity, rather than yield. It also recommended that strategies include details of assessing credit risk, reasons for borrowing in advance of need and the use of treasury advisers.

- **Reform of Council Housing Finance –** The consultation deadline was 6th July 2010. It is expected that the reforms will go ahead as they have received cross-party support. The consultation proposes a removal of the subsidy system by offering a one-off reallocation of debt. It is expected that there will be voluntary uptake from 2011/12 and compulsory uptake by 2012/13.

- **PWLB Intraday Rate Setting –** On 26th April 2010 the PWLB introduced twice daily rate settings at 9:30 and 12:30. This was set out in Circular 143. It was also announced that the

DMO/PWLB plans to increase the number of regular intra-daily re-sets to three times a day in the near future. A further announcement on this is expected in due course.

Appendix 1

Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

- The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached.
- The Council's Affordable Borrowing Limit was set at £221m for 2010/11.
- The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.
- The Operational Boundary for 2010/11 was set at £211m.
- There were no breaches to the Authorised Limit and the Operational Boundary during the period to 30/06/10; borrowing at its peak was £169.3m.

(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

- These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.
- The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2010/11 £/%
Upper Limit for Fixed Rate Exposure	100%
Compliance with Limits:	Yes
Upper Limit for Variable Rate Exposure	35%
Compliance with Limits:	Yes

(c) Maturity Structure of Fixed Rate Borrowing

- This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. The maturity of the councils borrowing is profiled in order that no more than 20% matures in any one financial year.

Maturity Structure of Fixed Rate Borrowing	**Actual Fixed Rate Borrowing £000 as at 30/06/10**	**% Fixed Rate Borrowing as at 30/06/10**	**Compliance with Set Limits?**
under 12 months	13,006	7.7	Yes
12 months and within 24 months	651	0.4	Yes
24 months and within 5 years	28,973	17.1	Yes
5 years and within 10 years	16,060	9.5	Yes
10 years and within 15 years	12,734	7.5	Yes
15 years and within 20 years	19,398	11.5	Yes

20 years and within 25 years	2,522	1.5	Yes
25 years and within 30 years	0	0.0	Yes
30 years and above	75,916	44.8	Yes

(d) **Total principal sums invested for periods longer than 364 days**

- This indicator allows the Council to manage the risk inherent in investments longer than 364 days.
- The limit for 2010/11 was set at £20m.
- The Council's policy response since the onset of the credit crunch in 2007 was to keep investment maturities to a maximum of 12months. No investments were made for a period greater than 364 days during this period.