Subject:	**TREASURY MANAGEMENT QUARTER ONE REPORT**
Meeting and Date:	**Governance Committee – 26 September 2013**
Report of:	**Mike Davis, Director of Finance, Housing & Community**
Classification:	**Unrestricted**
Purpose of the report:	To provide details of the Council's treasury management for the quarter ended 30th June 2013 (Q1) and an update of activity to date.
Recommendation:	That the report is received

1. **Summary**

As at 30th June 2013, the Council's in-house investments (approximately £4.5m or 26% of total investments) and investments with the investment managers, Investec (approximately £12.9m or 74% of total investments) are currently outperforming their benchmark[1]. The total interest received for the quarter is £42k, which is £16k below budget for the period, with deposit interest rates offered continuing to drop and Investec currently under-performing against the budget.

The Council has remained within its Treasury Management and Prudential Code guidelines during the period.

2. **Introduction and Background**

CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2009: it recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this council is implementing best practice in accordance with the Code.

In order to comply with the CIPFA code referred to above, but minimise the resource requirements in producing this report, a brief summary is provided below, and Appendix 1 contains a full report from the Council's Treasury Management Advisers, Sector.

Council adopted the 2013/14 Treasury Management Strategy on 6th March 2013 as part of the 2013/14 Budget and Medium Term Financial Plan.

3. **Annual investment strategy**

The investment portfolio as at the end of June is attached at Appendix 2. Since the end of quarter one, £2m has been invested with Lloyds for six months. In addition, a number of externally managed investments have matured or been sold since the end of the quarter. An update is attached at Appendix 4.

Sector have reviewed their own 'creditworthiness methodology' and removed from their calculations the credit default swap elements where activity has been very low (i.e average contracts outstanding of less than 1000 over the last five years). This brings some banks back within our investment parameters, for example, Santander UK.

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[1] The "benchmark" is the interest rate against which performance is assessed. DDC use the London Inter-Bank Bid Rate or LIBID, as its benchmark.

The investment manager, Investec has returned lower rates than those achieved through in-house investments. Investec have continued to be used as they are able to offer a wider spread of our counter party risks and use of additional financial instruments (e.g. gilts). A review will be undertaken in the year to assess whether to keep the same level of investments with Investec, transfer additional investments back in-house or investigate alternative options.

4. **Economic background**

The report attached contains information up to the end of June 2013; since then we have received the following update from Sector (please note that their references to Q1 and Q2 are based on *calendar* years):

Economic Growth

After avoiding recession in the first quarter of 2013, with a 0.3% quarterly expansion, the economy grew 0.7% in Q2. There have been signs of renewed vigour in household spending in the summer, with a further pick-up in retail sales, mortgages, house prices and new car registrations.

Employment and Earnings

The strengthening in economic growth appears to have supported the labour market, with employment rising at a modest pace and strong enough to reduce the level of unemployment further. Pay growth also rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the top rate of income tax. Excluding bonuses, earnings rose by just 1.3% y/y, well below the rate of inflation at 2.7% in May, providing continuing pressure on household's disposable income.

Funding for Lending Scheme

The Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding, particularly to small and medium size enterprises. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with mortgage interest rates falling further to new lows. Together with the Government's Help to Buy scheme, which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. Mortgage approvals by high street banks have risen as have house prices, although they are still well down from the boom years pre 2008.

Borrowing

Turning to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in Q2 looked to be broadly in line with last year's figures, highlighting the government's difficulty in reducing borrowing while economic growth was relatively lacklustre. The 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan, and monetary policy was unchanged in advance of the new Bank of England Governor, Mark Carney, arriving. Bank Rate remains at 0.5% and quantitative easing also stayed at £375bn. In August, the MPC provided forward guidance that Bank Rate is unlikely to change until unemployment first falls to 7%, which was not expected until mid 2016. However, 7% is only a point at which the MPC would review Bank Rate, not necessarily take action to change it. In mid August, the June three month average rate was 7.8% although the much more volatile one month rate was 7.4%.

Inflation and Markets
CPI inflation (the MPC targets a rate of 2.0%), fell marginally from 2.9% to 2.8% in July. The Bank of England is expected to fall back to 2.0% in 2015.

Financial markets sold off following a Federal Reserve statement that suggested the central bank may 'taper' its asset purchases earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK. Equity prices fell too, initially, as Fed purchasing of bonds has served to underpin investor moves into equities out of low yielding bonds. However, as the market moves to realign its expectations, bond yields and equities are likely to rise further.

Overseas
In the US, the statement from the Fed took the limelight. The Fed's comments above sparked a sharp sell-off in the Treasuries market. The Fed move was a response to the improving economic outlook in the US; increases in payroll figures showed further improvement helping to pull the unemployment rate down from a high of 8.1% to 7.3%, and continuing house prices helped to bring more households out of negative equity.

Tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a potential flare-up. Economic survey data improved consistently over the first half of the year, pointing to a return to growth in Q2, so ending six quarters of Eurozone recession.

5. Interest Rates

With the introduction of forward guidance by the Bank of England, Sector has reviewed its interest rate forecasts and does not expect any interest rate changes before 2016.

6. New Borrowing

The Council's borrowing portfolio is attached at Appendix 3. No new borrowing was undertaken during the quarter.

7. Debt Rescheduling

At this time it is not of benefit to the Council to consider rescheduling of its long-term debt, as advised by Sector.

8. Compliance with Treasury and Prudential Limits

The Council has operated within the treasury limits and Prudential Indicators and in compliance with the Council's Treasury Management Practices.

9. Iceland update

The Icelandic Supreme Court found in favour of UK local authorities and other UK wholesale depositors last year. This judgement means that UK local authorities' claims have been recognised as deposits with priority status over other creditors' claims and that they will be paid first when it comes to getting their money back.

The winding up board published details of LBI's (formerly Landsbanki) financial position as at 31st December 2012. This showed that LBI's assets, including partial payments already made in respect of priority claims were greater than the sum of the priority claims. It is therefore still considered likely that UK local authorities will recover 100% of their deposits. However, the value recovered will fluctuate due to currency valuations as the sums are being paid in sterling, US dollars, Euros and Icelandic Kroner.

To date we have received £499,515, leaving a balance of £500,485, as shown in Appendix 2, which is approximately 50% of the original investment.

We were also notified on 11th September 2013 that a fourth partial payment by the winding up board is in the process of being made to us, which will reduce the balance owed by a further £53,000 approx. This is expected to be received in our bank account(s) by the middle of September.

10. Appendices

Appendix 1 – Sector treasury management report for quarter one
Appendix 2 – Investment portfolio as at 30th June 2013
Appendix 3 – Borrowing portfolio as at 30th June 2013
Appendix 4 – Investment portfolio as at 31st July 2013 (Investec) and 31st August 2013 (In-House)

11. Background Papers

Medium Term Financial Plan 2012/13 – 2014/15

Contact Officer: Stuart Groom, extension 2072