Subject:	**TREASURY MANAGEMENT QUARTER TWO REPORT**
Meeting and Date:	**Governance – 5 December 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 30 September 2013 (Q2) and an update of activity to date.
Recommendation:	That the report is received

1. Summary

As at 30 September 2013, the Council's in-house investments (approximately £6.5m or 33% of total investments) and investments with the investment managers, Investec (approximately £12.9m or 67% of total investments) are currently outperforming their benchmark[1]. The total interest received for the quarter is £87k, which means that income for the year-to-date is now £11k ahead of budget. With deposit interest rates offered continuing to drop, and Investec currently under-performing against the budget, this position may change by the end of the year.

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

However, for a brief time during the period (15th – 20th November), Barclays Bank moved into "Monitoring" on Capita's ratings, which means that the suggested duration for investment dropped one position to "No Colour", effectively meaning that no money should be invested. Dover has a £5m in-house investment with Barclays, which also attracts bonus interest of 0.36% (£18k p.a.) if the deposit remains with them for a full 12-month period. Nevertheless Dover has instant access to these funds and they can be withdrawn at any time.

The Treasury Management Strategy states that "sole reliance will not be placed on the use of this external service [Capita]. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that supporting government." The Council reviewed the half-yearly report for Barclays and, in particular, information available on the Financial Times website to ascertain that Barclays Bank was still creditworthy and therefore, by keeping the deposit with Barclays, the Council was not jeopardising these funds. The portfolio holder was advised and agreed with this approach. The fact that the Capita rating for Barclays Bank has come back to 'within range for investment' in less than one week, supports our approach as having been a reasonable one.

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

[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.

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, Capita.

Council adopted the 2013/14 Treasury Management Strategy on 6 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 September is attached at Appendix 2. Since the end of quarter two, a £1.2m deposit with Nordea Group has matured and been reinvested with them for a further three months.

An update is attached at Appendix 4. There is a temporary increase in cashflow funds from 30th September (£16.0m – see Appendix 2) to 15th November (£23.8m – see Appendix 4), but this will reduce when the precepts are paid on 22nd November (£4m approx).

Capita 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.

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 September 2013; since then we have received the following update from Capita (please note that their references to Q1 and Q2 are based on *calendar* years):

Bank of England Inflation Report (November 2013)

Britain's unemployment rate will fall much faster than previously expected due to a strengthening economic recovery, the Bank of England said in its latest Inflation Report, but it stressed that it was in no hurry to raise interest rates. New central bank governor Mark Carney committed in August to keep interest rates at a record low 0.5% until unemployment fell to 7% - something the BoE predicted could take three years. But in a new set of economic forecasts, the central bank said unemployment could hit 7% in the last three months of 2014, if interest rates stay at a record low 0.5%, around two years earlier than it expected in August.

"In the United Kingdom, recovery has finally taken hold. The economy is growing robustly as lifting uncertainty and thawing credit conditions start to unlock pent-up demand," the BoE said in its quarterly Inflation Report. However, the central bank stressed that it was not about to raise interest rates any time soon, as headwinds remained, particularly from the Eurozone.

UK GDP

Britain's economy picked up more speed between July and September, growing at its fastest pace in more than three years and building on an unexpected turnaround that has buoyed the government. Gross domestic product rose 0.8%, faster than 0.7% in the April-June period. Britain's economy has staged a surprising recovery since early 2013 when it avoided falling back into recession and since then has accelerated to out-pace most other advanced economies. The turnaround has given a boost to Conservative finance minister George Osborne who defied calls from the International Monetary Fund and the opposition Labour party to bring forward spending in order to get the economy off the ropes.

UK Inflation

British inflation unexpectedly dropped to its lowest rate for more than a year in October, offering reassurance for the Bank of England that it has ample time to allow the economy to strengthen before it raises interest rates. Consumer price inflation fell to an annual rate of 2.2% in October from 2.7% in September, echoing a similar sharp fall in inflation in the Eurozone last month. This is well below economists' forecasts of an average drop to 2.5% and is the lowest rate since September 2012, due to lower petrol prices and other transport costs and technical effects related to a multi-year programme of university tuition fee rises.

UK PMI Services

Activity in Britain's services sector increased at the fastest rate since May 1997 last month, raising the prospect of a big jump in economic growth in the final three months of 2013. Financial data company, Markit, said its services Purchasing Managers' Index **(PMI)** rose to 62.5 in October from September's 60.3, easily beating economists' forecasts for a fall to 59.8. Britain's economy - which looked on the verge of its third recession in five years at the start of 2013 - has repeatedly surprised on the upside this year, and Markit's composite PMI is its highest since records began in 1996.

UK PMI Manufacturing

The fastest growth in export orders in more than two years helped British manufacturing grow solidly last month, in a sign that the country's economic recovery may be gaining a broader base. Britain's manufacturing sector has grown strongly in recent months, but it remains around 9 percent smaller than before the financial crisis, unlike the services sector which has now recovered the ground it lost in the 2008-09 recession.

US Non Farm/GDP

U.S. job growth unexpectedly accelerated in October as employers shrugged off a government shutdown, suggesting the budget standoff had a more limited impact on the economy than initially feared. Employers added 204,000 new jobs to their payrolls last month. The unemployment rate, however, rose to 7.3% from September's nearly five-year low of 7.2%.

The U.S. economy grew faster than expected in the third quarter as businesses restocked shelves, but a slowdown in consumer and business spending pointed to an underlying weakness. Gross domestic product expanded at a quarterly annualised rate of 2.8% in the third quarter and rose 1.6% on the year, the quickest pace since the third quarter of 2012. It was an acceleration from a 2.5% reading in the second quarter, beating economists' expectations for a 2.0% rate.

European Central Bank

The European Central Bank cut its main interest rate to a new record low of 0.25%, responding to a surprise drop in inflation by easing policy to support the Eurozone's weak economic recovery. The quarter-point cut was largely unexpected and highlights the ECB's concern about the slowdown in Eurozone inflation to 0.7% in October - a rate far below its target of just under 2%.

5. **Interest Rates**

Although the Bank of England inflation report suggests unemployment could fall to 7% (the trigger for the BoE to consider interest rate rises) by the end of 2014, it is unlikely that it will consider raising interest rates at that time. Capita 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 Capita.

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 31 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 £552,242, leaving a balance of £447,758 as shown in Appendix 2, which is approximately 55% of the original investment.

10. **Appendices**

Appendix 1 – Capita treasury management report for quarter one

Appendix 2 – Investment portfolio as at 30 September 2013

Appendix 3 – Borrowing portfolio as at 30 September 2013

Appendix 4 – Investment portfolio as at 31 October 2013 (Investec) and 15 November 2013 (In-House)

11. **Background Papers**

Medium Term Financial Plan 2012/13 – 2014/15

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