Subject:	**TREASURY MANAGEMENT QUARTER THREE REPORT**
Meeting and Date:	**Governance – 20 March 2014**
Report of:	**Director of Finance, Housing & Community**
Portfolio Holder:	**Corporate Resources and Performance**
Purpose of the report:	To provide details of the Council's treasury management for the quarter ended 31 December 2013 (Q3) and an update of activity to date.
Recommendation:	That the report is received

1. **Summary**

As at 31 December 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 £59k, which means that income for the year-to-date is in line with 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.

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, 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 December is attached at Appendix 2. Since the end of quarter two, the Investec deposits with various banks have all matured (exceeding £10m) and the majority have been reinvested with the same institutions for periods of three or six months. An in-house deposit with Lloyds also matured (£3m) and has been reinvested with Lloyds for 12 months.

[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.

A further update is attached at Appendix 4. There is a temporary increase in cashflow funds from 31st December 2013 (£19.9m – see Appendix 2) to 28th February 2014 (£24.2m – see Appendix 4), but this will reduce when the precepts are paid on 17th March (£4m approx.) and the PWLB loan repayment on 28th March (£2.3m approx.).

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 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 December 2013; since then we have received the following update from Capita (please note that their reference to Q4 is based on *calendar* years):

UK GDP

The second estimate of Q4 GDP provided further reassurance that the economic recovery is becoming better balanced and is therefore set to last. As was widely expected, the initial estimate of a 0.7% quarterly rise in GDP was left unrevised. And while GDP is now thought to have grown by 1.7%, rather than 1.8%, in 2013 as a whole, this small revision does little to change the overall picture. Meanwhile, the expenditure breakdown of Q4 GDP showed that the recovery has become less dependent on the consumer. The recent improvement in many surveys of firms' investment intentions suggests that the economy's supply potential will continue to expand in response to stronger demand. This indicates that the recovery is unlikely to cause inflation to pick up and, as a result, suggests that the MPC may be able to leave interest rates on hold for longer than the year or so currently anticipated by the markets. At the same time, the recovery in consumer spending seems unlikely to fizzle out either. Further gains in employment, easing credit constraints and a return to rising real pay should provide firm foundations for a further pick-up in spending in 2014.

UK Retail Sales & Public Finances

The sharp monthly drop in retail sales volumes in January is unlikely to herald the start of a consumer spending slowdown. Meanwhile, the fiscal consolidation remains on track despite January's disappointingly small budget surplus. While January's 1.5% monthly fall in retail sales volumes was the biggest drop seen since April 2012 and was larger than the 1% decline anticipated by the consensus, it should not cause concern. A fall back in sales volumes after their hefty 2.5% monthly rise in December had always looked likely.

Meanwhile, January's public finances were a little weaker than expected. Usually the public finances return to surplus in January as it is a bumper month for corporation and income tax receipts. However, the underlying budget surplus (which excludes the temporary effects of financial interventions and Royal Mail and APF transfers) was just £4.7bn this year, somewhat smaller than the £6bn attained last year.

UK Labour data/MPC minutes

The latest labour market data showed that there is still plenty of spare capacity in the job market. Since the minutes of February's MPC meeting confirmed that the Committee is committed to eliminating most of the slack in the economy before tightening policy, the first rise in interest rates still appears to be some way off. Employment rose by a strong 193,000 in the three months to December. However, the workforce also expanded rapidly over the same period, so unemployment fell by just 125,000. This brought the unemployment rate down from 7.6% in the three months to September to 7.2% in the three months to December. The minutes of February's MPC meeting showed that all Committee members were content to support the new form of forward guidance set out in the recent Inflation Report. Although there was not a formal vote on the new communications, the minutes were notable for the absence of any major disagreements amongst the members.

UK CPI

January's consumer prices figures showed that inflationary pressures are continuing to ease steadily and so presented another reason to be upbeat about the outlook for GDP growth this year. CPI inflation fell from 2% in December to 1.9%, the first reading below the MPC's 2% target since November 2009. While January's figure matched our forecast, it was the fifth consecutive month that inflation has undershot the consensus forecast. The drop was largely down to a fall in core inflation from 1.7% to 1.6%, reflecting very generous discounting over the January sales period. A smaller contribution to inflation from energy prices, as petrol prices fell and the first utility company dropped its prices to reflect the Government's recent cuts to environmental levies, also helped.

5. Interest Rates

Following the release of the latest Bank of England inflation report (February) Capita has updated its interest rate forecast and now expects the base rate to increase in the fourth quarter of 2015 rather than the second quarter of 2016, which is different to the table in Appendix 1 which is stated based on the previous inflation report.

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 meant that UK local authorities' claims were recognised as deposits with priority status over other creditors' claims and that they would 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 was therefore considered likely that UK local authorities would eventually recover 100% of their deposits. However, the value recovered would fluctuate due to currency valuations as the sums are being paid in sterling, US dollars, Euros and Icelandic Kroner, leading to uncertainty about the amount collectible over a prolonged period. Therefore, DDC has now sold at auction the balance of its claim, and the matter is now concluded. DDC has received 97% of the original £1 million deposit and, as the estimated impairment (shortfall) had previously been provided in the statement of accounts to 31st March 2013, there should be no further material adverse impact on the General Fund balances.

Appendices

Appendix 1 – Capita treasury management report for quarter three

Appendix 2 – Investment portfolio as at 31 December 2013

Appendix 3 – Borrowing portfolio as at 31 December 2013

Appendix 4 – Investment portfolio as at 31 January 2014 (Investec) and 28 February 2014 (In-House)

10. **Background Papers**

Medium Term Financial Plan 2013/14 – 2015/16

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