REPORT TO	DATE OF MEETING
Governance Committee	22 September 2010

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SOUTH RIBBLE BOROUGH COUNCIL
forward with South Ribble

SUBJECT	PORTFOLIO	AUTHOR	ITEM
Treasury Management Activity April to June 2010/11	Finance & Resources	G Whitehead	9

This report was submitted to, and noted by, Cabinet on 25 August 2010. It is now submitted for the further information and scrutiny of this committee.

SUMMARY AND LINK TO CORPORATE PRIORITIES

The report advises that, on average, the Council had surplus cash balances of £10.4m on which it received a return of 2.33%% during the first quarter of 2010/11. Investments continue to be made only for short periods and with highly rated institutions. The report also includes the commentary of the Council's treasury advisor on the economic background.

It confirms compliance with the prudential indicators specified in the Treasury Strategy

RECOMMENDATIONS

The Committee is asked to note the report

DETAILS AND REASONING

CIPFA issued the revised Code of Practice for Treasury Management in November 2009, This was adopted by the Council on 10 February 2010.

The revised Code suggests that members should be informed of Treasury Management activities at least twice a year. In fact it is the intention to report more frequently. Members will recall that at the July Cabinet meeting a report was submitted which advised on treasury activity in 200910, and also proposed changes to our treasury strategies pursuant to the change in treasury advisor. This report provides information on first quarter activity, consistent with Best Practice under the revised Code.

ECONOMIC BACKGROUND

A detailed commentary on economic indicators in the first quarter is attached at appendix B. The headlines are as follows:

- The new coalition government enact a fiscal squeeze through its Emergency Budget on the 22nd June;
- Activity indicators suggest that the recovery picked up a little pace in the first quarter;
- High street spending recovered after a weak start to the year;
- The labour market showed some tentative signs of improvement;
- The UK's trade position deteriorated, despite the weak pound;
- CPI inflation remained above target, however the measure of underlying inflation fell;
- The Monetary Policy Committee maintained quantitative easing (QE) and kept Bank Rate on hold at 0.5%;
- The equity rally went into reverse over concerns about the shape of the global recovery;
- The recovery in the US remains fairly strong, but remains weak in the euro-zone.

Economic Forecast

The Council's Treasury Advisers, Sector, have provided the following interest rate forecast:

	As at 30 June %	Dec 2010 %	Mar 2011 %	June 2011 %	Sep 2011 %	Mar 2012 %	June 2012 %	Dec 2012 %	Mar 2013 %
Base rate	0.50	0.50	0.75	1.00	1.50	2.25	2.50	3.50	3.75
5 yr PWLB	2.48	2.95	3.15	3.50	3.50	3.95	4.30	4.70	4.80
10 yr PWLB	3.83	4.40	4.45	4.50	4.60	4.70	4.75	4.95	5.10
25 yr PWLB	4.46	4.75	4.75	4.85	4.90	5.05	5.15	5.25	5.25
50 yr PWLB	4.49	4.75	4.80	4.90	4.95	5.05	5.20	5.25	5.25

- The forecast is based on moderate economic recovery and MPC inflation forecast being below target in two years' time
- The first Bank Rate increase is expected to be in 2011; and to reach 3.75% by March 2013
- Long term PWLB rates are expected to steadily increase to reach 5.25% by early 2013 due to huge gilt issuance, reversal of QE and investor concerns over inflation
- There is considerable uncertainty in all forecasts due to the difficulties of forecasting the timing and amounts of QE reversal, the tough cuts outlined in the Emergency Budget, speed of recovery of banks profitability and balance sheet position, changes in the consumer saving ratio, rebalancing of the UK economy in terms of export and import etc
- The balance of risks is weighted to the downside
- There is still some risk of a "double dip" recession.

Treasury Activity:

The Treasury Management Strategy Statement (TMSS) for 2010/11 was approved by Council on 10 February 2010. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlined the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council also aims to achieve the optimum return (yield) 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.

Investment activity in the first quarter is summarised in the following table:

	Average Daily investment. £'000	Earnings £	Average Rate %
DMO	88	55	0.25
Clydesdale term deposit	2,901	48,388	6.69
Other fixed term deposits	505	2,319	1.84
Call accounts	5,347	9,769	0.73
Council's own bank	1,573	0	0
	10,414	60,531	2.33

The above table excludes the Icelandic loans. These are commented on below.

A full list of investments held as at 30 June 2010 is shown at Appendix A.

The interest earning benchmark is the LIBID 7 day rate. This was 0.42% during the first quarter. As illustrated, the authority outperformed the benchmark largely due to the deposit with the Clydesdale Bank which matured at the end of the quarter.

The following table compares the budgets for interest payable and receivable against the latest projection.

	Budget for year £'000	Actual for first quarter £'000	Forecast for year £'000
Interest payable	17	5	17
Interest earned			
On current investments	(173)	(60)	(116)
On Icelandic loans	(220)	(53)	(207)
Net cost/(surplus)	(376)	(108)	(306)

The current forecast net surplus is £70k less than the budget. The reasons for this are:

- The budget assumed interest rates would rise more quickly giving an average yield in 2010/11 of 1%. No increase in base rate is now assumed; resulting in a reduction of £34k in interest receipts.
- Forecast average cash balances are currently less than originally estimated.

The above table includes the interest earnings on the Icelandic loans. This may seem strange in as much as the borrowers are in default. However, in writing down (impairing) the value of the investment in the last two years, the receipt of this interest was built into the calculation and it had the effect of inflating the loss charged. This income has therefore to be brought into account this year, and smaller amounts will continue to accrue until the loans are finally redeemed.

Icelandic Loans

There have been no developments in respect of Landsbanki. It is still many months off the court hearing which will decide whether Council investments retain priority status.

In respect of Heritable a further repayment of 6.27p in the £, amounting to £126,407 has been received in mid July. The timing and amount of this repayment is roughly in line with assumptions previously made. The total recovered is now £831,099 or 41.25p in the £. The accounts currently assume that further payments of 45p in the £ will ultimately be received.

New Lending facility

The Council has entered into a banking arrangement with the County Council. It permits the deposit of money on terms similar to those offered on call accounts (i.e. a daily recall facility and interest at 0.2% above base rate). The County is able to offer this facility by virtue of its ability to obtain higher rates (because of size) and to use a wider range of investment opportunities.

Borrowing:

No borrowings have been made in the quarter.

Treasury management training

The Shared Services Team are currently arranging a treasury management training session to be provided by the new Treasury Advisor (Sector). The sessions will be aimed specifically at providing training for the benefit for Members who are involved in scrutinising and approving Treasury Management Strategies and Monitoring Reports. It is intended to hold the training session in partnership with Chorley and Wyre Councils and is planned to take place at South Ribble before the end of September, the actual date very much depending on Member's diary commitments.

Prudential Indicators:

It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits" which were reported in the approved Treasury Management Statement.

The following table shows the approved limits and the current position:

Prudential Indicator	2010/11 Indicator £'000	Quarter 1 Actual £'000
Capital Financing Requirement (CFR)	7,889	5,244
Gross borrowing	472	472
Investments (note 2)	(£5.8m) at year end	(19,528)
Net borrowing/(investments)	(5,800)	(19,056)
Authorised limit for external debt	7,889	7,889
Operational boundary for external debt	7,500	7,500
Limit of fixed interest rates (based on net debt)	9,900	9,900
Limit of variable interest rates (based on net debt)	100% on inv cash	100%
Principal sums invested for periods exceeding 364 days	0	0
Maturity structure of borrowing limits		
Under 12 months	0 to 50%	See note 1
12 months to 2 years	0 to 50%	
2 years to 5 years	0 to 100%	
5 years to 10 years	0 to 100%	
10 years and above	0 to 100%	

Note 1 - the limits on the maturity structure will only be applicable if the Council were to take further borrowings to finance capital expenditure associated with the changes to the waste collection/recycling service.

Note 2 - The prudential indicators assumed investments, inclusive of Icelandic loans, falling from £8.4m at 1/4/10 to £5.8m at 1/4/11. The actual value at 30 June 2010 far exceeds this at £19.5m. The average cash balances in the first quarter have been £10.4m (as above) plus £3.3m Icelandic loans.

WIDER IMPLICATIONS

In the preparation of this report, consideration has been given to the impact of its proposals in all the areas listed below, and the table shows any implications in respect of each of these. The risk assessment which has been carried out forms part of the background papers to the report.

FINANCIAL	The financial implications are outlined within the report.
LEGAL	Compliance with various Regulations and statutory Codes of Practice

RISK	The Council's treasury management strategy and policies are designed to ensure the effective control and management of the risks associated with such activities.

OTHER (see below)	

Asset Management	*Corporate Plans and Policies*	*Crime and Disorder*	*Efficiency Savings/Value for Money*
Equality, Diversity and Community Cohesion	*Freedom of Information/ Data Protection*	*Health and Safety*	*Health Inequalities*
Human Rights Act 1998	*Implementing Electronic Government*	*Staffing, Training and Development*	*Sustainability*

BACKGROUND DOCUMENTS

Financial Strategy/Budget and Council Tax 2010/11
Treasury Management in the Public Services: Code of Practice
CIPFA Prudential Code for Capital Finance in Local Authorities

Appendix A

Investments held as at 30 June 2010:

Counterparty	Amount	Rate	Period	Sector recommended time limit
	£'000	%		
Call Account – Bank of Scotland	1,000	0.75	Overnight	12 months
Call Account – Santander	3,000	0.75	Overnight	6 months
Call Account – Royal Bank of Scotland	3,000	0.70	Overnight	12 months
Debt Management Office	4,000	0.25	1 week	Not applicable
Term Deposit – Bank of Scotland	2,000	1.84	1 year	12 months
HSBC current account	3,221	0	Overnight	12 months
	16,221			

Sector's time limit recommendation is based on the credit rating of an institution adjusted for any outlook warnings, and also takes account of the "spread" on credit default swap transactions (effectively the rate charged by the market to underwrite borrowings and thus a good and early indicator of market perception of risk).

Appendix B

Economic Background

The key development of the first quarter was the Emergency Budget delivered on the 22nd June which unveiled plans by the new Chancellor to severely tighten fiscal policy. According to the new (and independent) Office for Budget Responsibility, cyclically adjusted net borrowing – the portion of borrowing that will not disappear with economic growth – will now fall from 8.7% of GDP in the fiscal year just gone to 0.8% in 2014-15.

The Budget directed the bulk of the fiscal tightening at households and the public sector instead of private companies. Key measures within the Budget included a rise in the standard rate of VAT from 17.5% to 20%, to take effect in January 2011. Plans for social security payments were also scaled back. However, the burden on lower income households was partly offset by an increase in the income tax personal allowance by £1,000 to £7,475 from April 2011 from which high earners will not benefit.

Meanwhile, activity surveys suggested that the recovery gathered pace in the first quarter after the economy's 0.3% expansion. Encouragingly, the labour market has shown some tentative signs of improvement. The number of people claiming unemployment benefit fell by 32,000 in April and 31,000 in May, leaving the total at 1.48m. Employment also rose by 5,000 in the three months to April. However, the workforce increased at a faster rate, so that the total number of unemployed according to the wider ILO measure still rose by 23,000 in the three months to April.

The UK's trade position continued to deteriorate, despite the support provided by the lower pound. The trade in goods and services deficit widened from £3.2bn to £3.3bn in April. Exported goods volumes fell again, this time by a monthly 0.5%. However, the export orders balances of the activity surveys continued to suggest that volumes would pick up soon.

Inflationary pressures have finally begun to ease. CPI inflation rose from 3.4% to a recent peak of 3.7% in April before falling back to 3.4% in May. Temporary factors, such as the rise in the rate of VAT to 17.5% in January and the rise in oil prices last year, continued to support above-target inflation.

The Monetary Policy Committee (MPC) continued to keep Bank Rate on hold at 0.5% and to maintain its stock of asset purchases. The Bank of England's quarterly Inflation Report in May also projected inflation to be below the 2% target at the two year horizon, suggesting that rates will remain on hold for a considerable period. Some MPC members expressed concern that the recent bout of high inflation could lead to a permanent shift in inflation expectations if it persisted much longer.