

TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

18 June 2012

Report of the Director of Finance

Part 1- Public

Matters for Recommendation to Cabinet - Council Decision

1 TREASURY MANAGEMENT UPDATE

This report provides details of treasury management activity undertaken during April and May of the current (2012/13) financial year within the context of the national economy. The treasury management outturn position for 2011/12 is due to be reported to the June meeting of Cabinet and is also included in this report. Members are invited to endorse the action taken in respect of treasury management activity for April and May 2012 and note the outturn position for 2011/12.

1.1 Introduction

1.1.1 The Chartered Institute for Public Finance and Accountancy (CIPFA) issued a revised Code of Practice for Treasury Management in November 2009. The revised Code was adopted by the Council on 18 February 2010 and suggests that Members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report, therefore, ensures this Council is embracing Best Practice in accordance with CIPFA's revised Code of Practice and subsequent updates.

1.2 Economic Background

1.2.1 Thus far in 2012/13:

- Early estimates UK Gross Domestic Product (GDP) reflected a fall of 0.3% in the first quarter of 2012. If final figures confirm this position the UK economy will be in recession (two successive quarters of negative growth);
- The Monetary Policy Committee (MPC) continued to pause its programme of quantitative easing (QE) and kept official interest rates on hold at 0.5% at its monthly meetings throughout January 2012 to April 2012;
- Consumer Prices Index (CPI) and Retail Prices Index (RPI) inflation indices continue to fall standing at 3.0% and 3.5% in April 2012. Inflation peaked at 5.2% CPI and 5.6% RPI in September 2011.

- In the March 2012 budget the Chancellor revised down growth expectations for 2012 to 0.8% (2.5% in the March 2011 Budget) and revised down the public sector borrowing forecast to £126bn, £1bn lower than the Autumn forecast; and
- Eurozone issues continue with concerns spreading from Greece to the robustness of the Spanish banking system following state intervention in Bankia, Spain's fourth largest bank.

1.2.2 The Monetary Policy Committee voted unanimously to keep official interest rates at a record low of 0.5% in May 2012 and continue to pause QE. The Bank Rate has now remained at this "emergency level" for over 3 years.

1.3 Interest Rate Forecast

1.3.1 The Council's Treasury Advisor, Sector, updated their forecast in May 2012 and anticipate the first rise in the Bank Rate will be delayed a further six months to the quarter ending March 2014.

Rate	Now	Jun-2012	Sep-2012	Dec-2012	Mar-2013	Jun-2013	Sep-2013	Dec-2013	Mar-2014	Jun-2014	Sep-2014	Dec-2014	Mar-2015
	%	%	%	%	%	%	%	%	%	%	%	%	%
Bank Rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.25	1.50
5yr PWLB	1.90	2.00	2.10	2.20	2.20	2.30	2.40	2.50	2.60	2.80	3.00	3.20	3.40
10Yr PWLB	2.90	3.00	3.00	3.20	3.30	3.40	3.50	3.60	3.70	3.80	4.00	4.20	4.40
25yr PWLB	4.10	4.20	4.20	4.30	4.30	4.40	4.50	4.50	4.60	4.70	4.80	4.90	5.00
50yr PWLB	4.20	4.30	4.30	4.40	4.40	4.50	4.60	4.60	4.70	4.80	4.90	5.00	5.10

1.3.2 The forecast is based upon the following assumptions:

- Latest Bank of England Inflation Report (May 2012) indicates a delay in timing of return to trend growth and the rate at which inflation will fall back to the 2% target rate;
- 40% of UK GDP dependent on overseas trade; high correlation of UK growth to US and EU GDP growth means that the UK economy will likely register weak growth in the next two years;
- UK consumers likely to remain focused on paying down debt; weak consumer sentiment, job fears, relatively high inflation and low wage rate increases eroding disposable incomes will all act to suppress consumer expenditure;
- Coalition government hampered in promoting growth by the need to tackle the budget deficit;
- Potential for a further phase of QE keeping gilt yield depressed.

1.4 2012/13 Treasury Management Performance

1.4.1 The Treasury Management Strategy Statement (TMSS) which applies to the 2012/13 financial year was approved by Council on 24 February 2012. The Council's Annual Investment Strategy (AIS), which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity.

1.4.2 The Council will also aim 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 to only invest with highly credit rated financial institutions, using Sector's suggested creditworthiness approach, including sovereign credit rating and credit default swap (CDS) overlay information provided by them.

1.4.3 A full list of investments held on 25 May 2012 and our Internal Lending List of the same date are shown in **[Annexes 1 and 2]** of this report.

1.4.4 As illustrated in the economic background section above, investment rates available in the market are at an historical low point. The average level of cash flow funds available for investment purposes to the end of May 2012 was £8.3m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme. The Authority holds £18.9m of core cash balances for investment purposes which are managed by our external fund manager. These funds are for the most part available to invest for more than one year, albeit some funds will need to be recalled during March 2013 to top up our daily cash balances.

1.4.5 As at the end of May 2012 funds invested and interest earned is set out in the table below:

	Funds invested at 25 May 2012	Average duration to maturity	Gross annualised return to 25 May 2012	7 day LIBID benchmark	Interest earned to 25 May 2012
	£m	Yrs	%	%	£
In-house cash flow – excl Landsbanki	5.4	0.33	1.20	0.52	15,100
Externally managed core funds	18.9	0.30	1.54	0.52	49,350
Total	24.3	0.31	1.45	0.52	64,450

1.4.6 The authority outperformed the benchmark by 93 basis points. Interest earned of £64,450 is £20,250 better than our profiled budget for the same period.

1.4.7 **In-house Managed Cash Flow.** Our daily cash flow balances for the year ahead are modelled at the start of the financial year. That cash flow model is then updated daily and reviewed on a regular basis. The majority of our cash flow surpluses are invested overnight in bank deposit accounts and money market funds to ensure sufficient short term liquidity to meet payment obligations. However, when cash surpluses permit, fixed term investments are undertaken to take advantage of the higher yields available. In mid-April the following fixed term investments were made:

£m	Bank / Building Society	Duration	Rate	Period
1.0	Bank of Scotland	12 Months	3.00%	11/04/12 – 11/04/13
1.0	Lloyds TSB	12 Months	3.00%	11/04/12 – 11/04/13

1.4.8 If cash flow surpluses permit, further fixed term Investments will be undertaken as the year progresses. However, the current cash flow forecast **[Annex 3]** indicates little scope exits at the present time.

1.4.9 Whilst we always report performance against the 7-Day LIBID benchmark we have not previously been able to show performance relative to other local authorities. Our external advisors, Sector, have recently expanded the services that they provide and introduced a benchmarking facility. Tonbridge & Malling joined the Kent benchmarking group in April 2012 and the inaugural meeting of that group was held in May 2012.

1.4.10 Attached at **[Annex 4]** is a scatter graph that plots the return and the credit / duration risk associated with an authority's portfolio against a model. The scatter graph shows that as at the end of March 2012 the return being generated by our overnight deposits of 0.81%, whilst low relative to other authorities, was inline with the model prediction. The same March data for all other authorities is used in **[Annex 5]** but Tonbridge and Malling's position on the graph updated to reflect the fixed term investments that were undertaken in April. Members will note the significant uplift in return of 1.45% was broadly inline with the average for all authorities (vertical scale). However, this performance was generated at significantly less than the average credit / duration risk for other authorities (horizontal scale). The overall result for our in-house portfolio at the end of April was outperformance against the model. The scatter graphs are only prepared on a quarterly basis by Sector so it is not possible to provide a direct comparison between Tonbridge and Malling's April data with that of other authorities, Nevertheless, **[Annex 5]** is believed to give a good indication of our return and associated credit / duration risk relative to others.

- 1.4.11 **Externally Managed Core Funds.** All of the Council's core funds are now being managed by our external fund manager. The fund manager anticipates the return for the 2012/13 financial year as a whole will be between 1.00% and 2.00%. The annualised return at the end of May of 1.54% accords with the fund manager's central case view of 1.50% for the year as a whole.
- 1.4.12 Following downgrades by the rating agencies to the credit rating of a significant number of financial institutions, our revisions to the Treasury Management Strategy Statement and Annual Investment Strategy 2012/13 included a reduction in the minimum counterparty credit quality. To offset the Council's increased credit risk exposure the maximum percentage of funds that could be invested with individual counterparties or groups of related counterparty was reduced from 25% to 20% (Audit Committee 23 January 2012). Current investments with Nationwide and Rabobank [**Annex 1**] preceded the introduction of these lower exposure limits. Treasury Management Team has reviewed these investments and is content that they should be allowed to run to maturity. Exposure to Nationwide will comply with our lower 20% limit following a maturity on 1 June 2012. Exposure to Rabobank will comply with our lower 20% limit following a maturity on 10 August 2012.

1.5 Compliance with 2012/13 TMSS and AIS

- 1.5.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits" by way of the Prudential Indicators (affordability limits) set out in the approved Treasury Management Strategy Statement. In this regard it is confirmed that no borrowing was undertaken in the period April to May 2012.
- 1.5.2 During the financial year to date the Council has operated within the treasury limits and prudential indicators set out in the Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators will be included for review as part of the Treasury Management Update report to the Audit Committee meeting in October 2012.
- 1.5.3 Throughout the period April to May 2012 all of the requirements contained in the 2012/13 Annual Investment Strategy intended to limit the Council's exposure to investment risks (minimum sovereign and counterparty credit rating; durational limits; exposure limits in respect of counterparties, groups of related counterparty and sovereigns; and specified and non-specified investment limits) have been fully complied with in respect of any **new** investments undertaken since 1 April 2012.

1.6 2011/12 Treasury Management Outturn

- 1.6.1 A detailed report covering treasury management activity for the whole of 2011/12 is being submitted to Cabinet on 20 June 2012 as part of the Revenue and Capital Outturn report for 2011/12. The Treasury Management Annual Report for 2011/12, included within that report, is appended at [**Annex 6**].

- 1.6.2 The investment performance for the three parts of our portfolio summarised in the annual report are as follows:

2011/12 Financial Year	Average investment £m	Interest Earned £	Gross rate of return %	Benchmark return (7 day LIBID) %
Internally managed cash flow (excluding Landsbanki)	10.3	95,550	0.92	0.55
Internally managed core funds	0.4	23,950	6.25	0.55
Externally managed core funds (excluding year end valuation gains / losses)	20.4	331,800	1.63	0.55
Total	31.1	451,300	1.45	0.55

- 1.6.3 Total investment income of £451,300 better the 2011/12 revised estimate by £60,300. CIPFA undertook a national treasury management risk study **[Annex 7]**. Our return of 1.45% better the expected 1.30% quoted on page 3 of the report.
- 1.6.4 All investment undertaken during 2011/12, both in-house and those executed by our external fund manager were undertaken in full compliance with the requirements of the Treasury Management Strategy Statement and Annual Investment Strategy for 2011/12, approved by Full Council on 17 February 2011.

1.7 Legal Implications

- 1.7.1 In respect of our “defaulted” £1m investment with Landsbanki the Landsbanki test case appeal hearings took place in the Supreme Court of Iceland on 14 and 15 September 2011. We are delighted the Icelandic Supreme Court has found in favour of UK local authorities and other UK wholesale depositors. This judgement means that UK local authorities’ claims have been recognised as deposits with priority status over other creditors’ claims.
- 1.7.2 Agreement to the Council’s settlement was approved by the Icelandic District Court in May 2012 and payment of our first distribution of funds is now imminent.
- 1.7.3 Subject to exchange rates, we anticipate that we will recover all of the £1m we had on deposit with Landsbanki together with the interest that was due had the deposit been repaid on time. The way in which the LGA and our legal advisors have co-ordinated the legal action with other local authorities has minimised legal costs whilst enabling us to advance the strongest possible arguments to secure this excellent result. The cost of the litigation to date amounts to less than 1 per cent of the amount we expect to recover.

1.8 Financial and Value for Money Considerations

- 1.8.1 Interest earned to the end of May 2012 of £64,450 bettered our 2012/13 original estimate by £20,250. At the present time, the full year estimate for 2012/13 of £296,000 is expected to be achieved.
- 1.8.2 The performance of our fund manager is monitored against all of the players in the public sector cash management market place using data provided by Sector Treasury Services. In addition, the performances of both externally and internally managed investments are monitored against relevant benchmarks.

1.9 Risk Assessment

- 1.9.1 The application of best practice, including the regular reporting and scrutiny of treasury management activity, as identified by the CIPFA Code is considered to be the most effective way of mitigating the risks associated with treasury management.

1.10 Equality Impact Assessment

- 1.10.1 See 'Screening for equality impacts' table at end of report.

1.11 Recommendations

- 1.11.1 Members are invited to **RECOMMEND** that Cabinet :

- 1) endorse the action taken by officers in respect of treasury management activity for the period April to May 2012
- 2) endorses Officers decision not to call for the disposal of investments held by our external fund manager with Nationwide and Rabobank; and
- 3) note the 2011/12 outturn position.

Background papers:

contact: Mike Withey

Nil

Sharon Shelton
Director of Finance

Screening for equality impacts:		
Question	Answer	Explanation of impacts
a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against	No	N/A

Screening for equality impacts:		
Question	Answer	Explanation of impacts
different groups in the community?		
b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality?	No	N/A
c. What steps are you taking to mitigate, reduce, avoid or minimise the impacts identified above?		N/A

In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above.