TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

8 April 2013

Report of the Director of Finance and Transformation

Part 1- Public

Delegated

1 TREASURY MANAGEMENT UPDATE

This report provides an update of treasury management activity undertaken during the 2012/13 financial year within the context of the national economy and invites Members to endorse the action taken by Officers and to note the treasury management position at 1 March 2013.

1.1 Introduction

1.1.1 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 activity 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 its subsequent updates.

1.2 Economic Background

- The Bank of England (BoE) introduced a further round of quantitative easing some 12 month ago (February 2012) to help stimulate the economy. This brought the total package of asset purchases to £375bn since 2009. A further stimulus measure was introduced summer 2012 in the form of Funding for Lending. Under the scheme, banks are provided with funds at a low rate of interest to lend on to business and individuals. Despite the measure lending actually declined in the last three months of 2012.

- The UK economy grew by only 0.2% in 2012 with three out of four quarters (Q1, Q2 & Q4) registering contraction. Output in Q1 of 2013 is expected to be positive avoiding a treble-dip recession. The most recent Office for Budget Responsibility (OBR) growth forecast for 2013 is for GDP to rise by 0.6%. This is down from the OBR's autumn 2012 forecast of 1.2%.

- Inflation as measured by the consumer price index (CPI) has continued to rise from its low point of 2.4% in September 2012 and in February 2013 stood at 2.8% (RPI for February 2013 was 3.2%). The OBR expects Inflation to decline back to the target figure of 2.0% by 2016.

- Moody's downgraded the UK from AAA to Aa1 (equivalent to Fitch AA+) in February 2013 with a stable outlook. Key drivers to the rating action were continuing weakness in the UK's medium-term growth outlook and deterioration in the government's balance sheet caused by a high and rising debt burden.

- The Chancellor in his 2013 budget confirmed the government would stick firmly to its current austerity policy to tackle the deficit but acknowledged that the national debt would continue to rise over the coming years to 85% of GDP before beginning to fall in 2017/18. Two years later than originally envisaged when the coalition came to office.

- The Chancellor's budget introduced a number of initiatives intended to help stimulate economic growth including: a reduction in corporation tax and employers national insurance contributions; loans to support home buyers to acquire new-build properties; and additional funding for infrastructure projects. In addition the remit of the Monetary Policy Committee (MPC) would be updated to allow it to use "unconventional monetary instruments" to support the economy while keeping inflation stable. The existing remit will be changed to focus on growth as well as inflation.

- Market concerns over the Euro zone eased in the latter part of 2012 following the announcement that the European Central Bank (ECB) would purchase unlimited quantities of sovereign bonds via its "Outright Money Transactions" programme. However, market reaction to the inconclusive outcome of the Italian elections in February 2013 and the Cyprus bank deposit saga in March 2013 are a reminder that the fundamental issues relating to the Euro zone debt crisis have yet to be resolved.

1.3 Interest Rate Forecast

1.3.1 The Bank Rate has remained at an emergency level of 0.5% for the last 4 years. Sector's latest forecast, updated in February 2013, anticipates the Bank Rate will remain at this level for a further 2 years before rising in the first quarter of 2015.

Rate	Now	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
	%	%	%	%	%	%	%	%	%	%	%	%	%
Bank Rate	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**
5yr PWLB	**1.90**	**1.80**	**1.80**	**1.80**	**1.80**	**1.90**	**2.00**	**2.10**	**2.20**	**2.40**	**2.50**	**2.60**	**2.80**
10Yr PWLB	**3.10**	**2.90**	**2.90**	**2.90**	**2.90**	**3.00**	**3.10**	**3.20**	**3.30**	**3.50**	**3.60**	**3.80**	**3.90**
25yr PWLB	**4.20**	**4.10**	**4.10**	**4.10**	**4.10**	**4.20**	**4.20**	**4.30**	**4.40**	**4.60**	**4.60**	**4.80**	**4.90**
50yr PWLB	**4.40**	**4.20**	**4.20**	**4.20**	**4.20**	**4.40**	**4.40**	**4.50**	**4.60**	**4.70**	**4.80**	**4.90**	**5.00**

1.4 Investment Performance

1.4.1 In accordance with the CIPFA Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. We find ourselves in a very difficult investment market with low yields reflecting the 0.5% Bank Rate.

1.4.2 Cash flow funds are available on a temporary basis and their amount varies from month to month and during the course of each month depending on the timing of receipts (council tax, business rates, grants and other sources of income) and payments (precepts, NNDR pool contributions, benefits, staff and suppliers). The authority presently has £17.7m of core cash balances for investment purposes which are managed by our external fund manager. These funds which comprise our revenue and capital reserves are for the most part available to invest for more than one year.

1.4.3 As at the beginning of March 2013, funds invested and interest earned is set out in the table below.

	Funds invested on 1 March 2013 £m	Average duration to maturity Days	Gross annualised return to 1 March 2013 %	7 day Libid benchmark (compounded) %	Interest earned to 1 March 2013 £
In-house cash flow – excluding Landsbanki	9.7	15.7	1.06	0.46	109,400
Externally managed core funds	17.7	59.5	1.17	0.46	196,700
Total	27.4	44.0	1.13	0.46	306,100

1.4.4 The authority out-performed the benchmark by 67 basis points. In cash terms investment income is some £31,400 better than expected when compared to our profiled 2012/13 original estimates (£300 less than expected when measured against the revised 2012/13 estimates).

In-house Managed Cash Flow and Core Fund Investments

1.4.5 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. During the 2012/13 financial year the following fixed term investments were made:

£m	Bank / Building Society	Duration	Rate	Period
1.0	Bank of Scotland	12	3.00%	11/04/12 – 11/04/13
1.0	Lloyds TSB	12	3.00%	11/04/12 – 11/04/13
0.5	Lloyds TSB	4	1.20%	22/11/12 – 22/03/13
1.0	Nationwide (CD)	3	0.44%	11/12/12 – 11/03/13

1.4.6 In addition to term deposits the opportunity to generate additional yield is also achieved by utilising notice accounts. At 1 March 2013 £2m was deposited in a National Westminster 95 day notice account at a rate of 1.20% per annum and £0.5m in a 35 day notice account with Handelsbanken at 0.48% per annum.

Externally Managed Core Funds

1.4.7 Our external fund manager is currently performing just below the level anticipated in our 2012/13 Annual Investment Strategy. Annualised gross return at the beginning of March was 1.17% vs. an expectation of 1.25%.

Current Investments

1.4.8 A full list of investments held on 1 March 2013 and our Internal Lending List of the same date are provided at **[Annexes 1 and 2]**. The yield on the total sum invested of £27.4m, exclusive of Landsbanki, is 0.76% and comprises internally managed investments of £9.7m at 1.16% and externally managed investments of £17.7m at 0.53%. Our external fund manager is expected to be able to enhance this return by taking capital profits on Gilt trades when the opportunities present themselves.

1.5 Borrowing

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 1 April 2012 to 1 March 2013.

1.6 Legal Implications

1.6.1 The Council invested £1m in a three month fixed term deposit with the Icelandic bank, Landsbanki. The bank went into administration a few days prior to the investments intended maturity in October 2008. The Council has participated in a joint action, co-ordinated by the Local Government Association, to recover the investment and associated interest. In April 2011 the Icelandic District Court ruled that such deposits have **priority status**. Following an appeal, this ruling was upheld by the Icelandic Supreme Court in September 2011. Agreement to the Council’s settlement was approved by the Icelandic District court in May 2012 and payment of our first distribution of funds received in June 2012. A further distribution of funds was made in October 2012 bringing the total recovery to date to just under £491,000.

1.6.2 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. In addition, this Council was one of a limited number of authorities who submitted a demand for repayment. The validity of our demand has been recognised by the award of additional interest (gap interest for the period October 2008 to April 2009). 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.

1.7 Financial and Value for Money Considerations

1.7.1 Despite the Bank Rate remaining at a historical low (0.5%) throughout the financial year investment income has thus far exceeded expectations. Investment income is currently £31,400 better than expected against our original 2012/13 estimates (£300 less than expected against our revised estimates for 2012/13).

1.7.2 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.

1.8 Risk Assessment

1.8.1 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.

1.9 Equality Impact Assessment

1.9.1 See ‘Screening for equality impacts’ table at end of report.

1.10 Recommendations

1.10.1 Members are **RECOMMENDED** to:

1) Endorse the action taken by officers in respect of treasury management activity; and to

2) Note the treasury management position as at 1 March 2013.

Background papers: contact: Michael Withey

Forecasts provided by Sector Treasury Services.

Sharon Shelton
Director of Finance and Transformation

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 different groups in the community?	No	N/A
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.