Report to:

South Oxfordshire District Council

Listening Learning Leading

Cabinet

Council

Audit and Corporate Governance Committee

AGENDA ITEM NO 6

Report of Head of Finance

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To: Audit and Corporate Governance Committee on: 29 January 2013
To: Cabinet on: 14 February 2013
To: Council on: 21 February 2013

Treasury management mid year monitoring report 2012/13

Recommendations

That Audit and Corporate Governance committee:

1. notes the treasury management mid year monitoring report 2012/13, and
2. is satisfied that the treasury activities are carried out in accordance with the treasury management strategy and policy.

That Cabinet:

2. Considers any comments from Audit and Corporate Governance committee and recommends council to approve the report.

Purpose of report

1. The report fulfils the legislative requirements to ensure the adequate monitoring of the treasury management activities and that the council's prudential indicators are reported to council mid year. The report provides details of the treasury activities for the first six months of 2012/13 and an update on the current economic conditions with a view to the remainder of the year.

Strategic objectives

2. An effective treasury management strategy is required in order to meet our strategic objective of managing our business effectively. Managing the finances of the authority in accordance with the treasury management strategy will help to ensure that resources are available to deliver its services and meet the council's other strategic objectives.

Background

3. The council's treasury activities are strictly regulated by legislation. The CIPFA Prudential Code and CIPFA Treasury Management Code of Practice requires a monitoring report to be provided mid year to council. The report covers the treasury activity for the period 1 April to 30 September,

4. The 2012/13 treasury management strategy was approved by council on 22 February 2012. This report provides details on the treasury activity and performance for the first six months of 2012/13 against prudential indicators and benchmarks set for the year. It is also an opportunity to review and revise the limits if required. Full council is required to approve this report.

The economy and interest rates

5. An update on the economic conditions and interest rate forecasts is in appendix A.

Icelandic banks – Kaupthing Singer & Friedlander

6. The council has now received £1,999,767 in respect of the claim for £2.6 million (£2.5 million investment plus interest) from the investment made with the failed Icelandic bank Kaupthing Singer & Friedlander (KSF).

7. The administrators intend to make further payments at regular intervals. The latest information states that it is the administrators' current intention to pay the tenth dividend in approximately six months' time. The estimated total amount to be recovered is forecast to be in the range of 81p to 86p in the pound. This equates to between £2,130,975 and £2,262,517

Investments

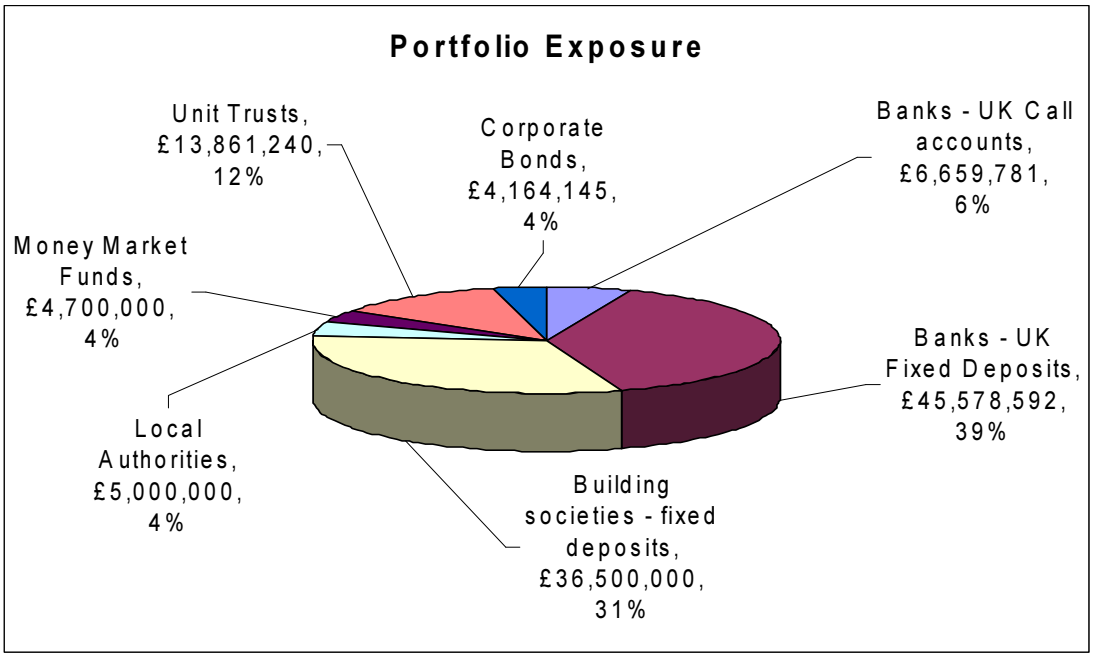
8. In accordance with the Code the council's investment position as at 30 September 2012 is shown in table 1 below.

Table 1: maturity structure of investments at 30 September 2012:	Total £000's	% holding
Cash deposits:		
Call accounts	5,172	4%
Notice account	1,487	1%
Up to 1 month	7,000	6%
2 Month	9,000	8%
3 Month	1,000	1%
4 Month	2,000	2%
5-6 Month	19,500	17%
7-12 Month	25,500	22%
1 -2 Year	17,500	15%
2-5Year	5,000	4%
Kaupthing Singer & Friedlander	579	1%
Total cash deposits	**93,738**	**81%**
Equities	13,861	12%
Corporate bonds	4,164	3%
Money market funds	4,700	4%
Total investments	**116,465**	**100%**

Note: £116.465 million does not represent uncommitted resource the council has at its disposal. This amount includes council tax receipts held prior to forwarding to Oxfordshire County Council and Thames Valley Police, business rate receipts prior to payment to the government and committed capital and revenue balances. Details of the council's uncommitted balances are provided in the annual budget and council tax setting report.

9. The council currently holds a significant proportion of its investments in the form of cash deposits, the majority of which have been placed for fixed terms with a fixed investment return. Six per cent of the entire investment portfolio is held on call or in notice accounts, with 81 per cent of the total investment portfolio held in cash deposits.

10. The chart below shows in percentage terms how the portfolio is spread across the types of investments.



11. Total investment income is forecast to be around £2.6 million in 2012/13 against a budget of £2.5 million. Table 2 shows the interest earned for the first six months.

Table 2: Investment interest earned by investment type

Investment type	Interest Earned Apr - Sep 2012			
	Annual Budget £000's	Actual To date £000's	Profiled Budget £000's	Variation £000's
Call accounts	43	44	21.5	23
cash deposits < 1 yr	1,057	254	528.5	(275)
Cash deposits > 1 yr	705	643	352.5	291
MMF	30	20	15	5
Corporate bonds	411	198	205.5	(8)
Transferred Debt	10	0	5	(5)
Equities	250	212	125	87
Total Interest	**2,506**	**1,371**	**1,253**	**118**

Treasury activity

12. It has been difficult to place investments during the first six months of the year because of the continued financial uncertainty. At the start of the year some good rates were achieved which have contributed to the increase in investment income for the first half of the year. During May through to July deposits were placed mainly at rates which ranged between 1.50 per cent and 1.82 per cent. Since the end of August rates have dropped considerably.

13. Re-investment opportunities are not nearly as attractive as six months ago, one year rates have dropped by over 1.25 per cent. There is currently little incentive to reinvest longer term periods. Cash deposits are being held short term with a view to re-investing for longer periods as the medium term rates improve. The governments Funding to Lending Scheme has lowered bank funding costs and has been extended to building societies. This access to cheaper borrowing is a key factor in the fall in market rates now available.

14. The weighted average maturity period has decreased to 231 days. As a result of the many banking downgrades there are now fewer financial institutions meeting the council's investment criteria. When it is possible investments will be placed with highly rated institutions with a view to increase the weighted average maturity of the portfolio.

15. The value of the unit trusts has moved from £13.4 million at the start of April up to £13.9 million at the end of September. This movement is expected in the current volatile markets where investors are moving between safer havens such as gilts and moving back into equities when the markets look calmer.

Performance measurement

16. A list of investments as at 30 September is shown in appendix B. All investments were with approved counterparties. The average level of investments held was £113 million and the average return on these investments is shown below in table 3. This shows in summary the performance of the council's investments against the benchmarks set out in the Treasury Management Strategy. These benchmarks are used to assess and monitor the council's investment performance for each type of investment.

Table 3: investment returns achieved against benchmark

	Benchmark return %	Actual return %	Growth (below)/above benchmark %	Benchmarks
Bank & building society deposits - non-managed	0.73%	2.27%	1.54%	3 Month LIBID
Equities	0.75%	1.43%	0.68%	FTSE all shares index
Corporate bonds	0.50%	5.68%	5.18%	BoE base rate

Note: the benchmark return for equities reflects the movement in capital value. All other benchmarks reflect earnings of investment income.

Treasury management limits on activity

17. The council is required by the Prudential Code to report on the limits set each year in the Treasury Management Strategy. The purpose of these limits is to ensure that the activity of the treasury function remains within certain parameters, thereby mitigating risk and reducing the impact of an adverse movement in interest rates. However, if

these limits are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The limits are shown in appendix C.

Debt activity during 2012/13

18. During the first six months of 2012/13 there has been no need for the council to borrow. The council will continue to take a prudent approach to its debt strategy. The prudential indicators and limits set out in appendix C provide the scope and flexibility for the council to borrow in the short-term up to the maximum limits, if such a need arose within the cash flow management activities of the authority, for the achievement of its service objectives.

Recommended changes to the treasury management strategy

19. Council approved the 2012/13 treasury management strategy on 24 February 2012. There are no proposed changes to the strategy for 2012/13 at this time.

Financial implications

20. This time last year forecasts were that inflationary pressures would mean that interest rates would have to start rising towards the end of 2012. This hasn't happened and the current outlook for growth for the UK economy means interest rates are very low and likely to remain so. Investments made early in 2012 should ensure that the interest earned on investments for 2012-13 is around £2.6 million. However from 2013 income may reduce for a year or so until market rates rise. This will be reflected in the council's medium term financial plan .

21. Investments including working capital, are projected to fall to approximately £90 million by 2015/16. Should investment rates recover to three percent then annual returns will be around £3 million.

Legal implications

22. There are no significant legal implications as a result of the recommendations in this report. Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services, the ODPM Local Government Investment Guidance provides assurance that the council's investments are, and will continue to be, within its legal powers.

Conclusion

23. This report provides details of the treasury management activities for the period 1 April 2012 to 30 September 2012 and the mid year prudential indicators to council.

24. These details confirm that treasury activities have operated within the agreed parameters set out in the approved treasury management strategy, and provides the monitoring information for audit and corporate governance committee to fulfil the role of scrutinising treasury management activity.

Background papers

- CIPFA Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes
- CIPFA Prudential Code for Capital Finance in Local Authorities
- Various committee reports, principally:-

  I. Treasury Management Policy Statement, Treasury Management Practices (cabinet 7 March 2002)
  II. Recommendation of amendment to delegated authority (council 28 October 2004)
  III. Treasury Management Investment Strategy 2012/13(cabinet 14 February 2012, council 24 February 2012)

[1] Chartered Institute of Public Finance and Accounting (CIPFA)

Appendices

A – Economic update and interest rates
B – List of investments as at 30.9.12
C – Prudential Indicators

Economic Update and interest rates

A1. The Bank of England lowered its expectations for the speed of recovery and rate of growth in August. The growth in the UK economy remains weak and forecasts for growth have been reduced for the next two years. Forty percent of the UK output depends on overseas trade. The euro zone (EZ) economies remain weak and concerns persist that some EZ countries are falling into negative growth.

A2. Higher unemployment, job fears, high inflation eroding disposable incomes, small or no pay increases are all factors contributing to consumers ability to spend and overall living standards have fallen in real terms due to the sharp price rises relative to wages. Average real wages have fallen every month since June 2008. The squeeze on households' income will remain a critical factor in the economy over the next few years. Inflation is the main cause and will continue to have the greatest impact on living standards as real income will continue to decline. The weak recovery has meant that social security payments remain high and tax income is low.

A3. Looking ahead the EZ crisis is far from resolved as Greece has failed to achieve the deficit reduction targets so a third bail out may be required. Northern EU countries may not agree to support this. Economic growth is forecast to remain low for the next 24 months and the base rate will not be increased whilst growth is low. This means that investment returns will also remain low.

A4. The government Funding for Lending Scheme has been introduced to improve access to mortgages at lower rates. This has affected lenders need to borrow and money market rates have fallen considerably as a result. There will be a need to increase interest rates and reverse the government bond purchases at some stage, but it is unlikely to happen in the next 12 to 24 months.

A5. Investor demand in UK gilts as a 'safe haven' continues to keep yield increases down. Long term rates will eventually rise, mainly due to the fact that high volumes of gilts have been issued already in the UK and also in other major western countries.

A6. The interest rate forecast is based on the assumption that growth starts to recover in the next three years. If the EZ crisis worsens or low growth in the UK continues the base rate is likely to remain low for longer than this forecast.

A7. Concerns over investment counterparty risk remain because of the volatile economic conditions. However the council's current treasury management policy manages this risk down to a low level.

Interest rates

A8. The Bank of England changed its forecast significantly in the August Inflation report and reduced growth to 1% in 2013 and 2% in 2014.

A9. **Bank rate** - remained unchanged at 0.5% throughout the first half of 2012/13. The earlier forecast of a rate rise in September 2013 has been postponed until Q4 in 2014.

Bank rate

	Now	Previously
Q1 2013	0.50%	0.50%
Q1 2014	0.50%	0.50%
Q1 2015	0.75%	1.00%

A10. **Deposits rates** have fluctuated in a very narrow range during the first six months of the financial year. Investment rates have remained flat with a range between 0.5 per cent to around 1.5 per cent for up to a year's maturity. This has dropped significantly as banks and building societies were offered further cheap cash supply . The short term rates from one month to six months offer very little differential with six month rates ranging between 0.37 percent and 0.63 percent.

A11. Sector's forecast of the expected movement in medium term interest rates:

Sector's interest rate forecast

	Now	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Bank base rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%
3m LIBID	0.50%	0.50%	0.60%	0.50%	0.50%	0.50%	0.50%	0.60%	0.60%	0.70%	0.80%	1.10%
6m LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.10%	1.30%
12m LIBID	0.70%	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.10%	1.20%	1.30%	1.30%	1.50%
5 yr PWLB rate	1.60%	1.50%	1.50%	1.50%	1.60%	1.60%	1.70%	1.70%	1.80%	2.00%	2.20%	2.30%
10 yr PWLB rate	2.50%	2.50%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	3.00%	3.20%	3.30%
25 yr PWLB rate	3.80%	3.70%	3.80%	3.80%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.30%	4.40%
50yr PWLB rate	3.90%	3.90%	4.00%	4.00%	4.00%	4.00%	4.10%	4.10%	4.20%	4.30%	4.50%	4.60%

Appendix B

Investments as at 30 September 2012

Counterparty	Deposit Type	Principal	Rate
Furness Building Society	Fixed	1,000,000	1.60%
Furness Building Society	Fixed	2,000,000	1.60%
Nottingham Building Society	Fixed	3,000,000	1.50%
Furness Building Society	Fixed	1,000,000	1.50%
Barclays Bank plc	Fixed	5,000,000	1.75%
Nottingham Building Society	Fixed	2,000,000	1.85%
Hinkley & Rugby Building Society	Fixed	2,000,000	1.50%
Market Harborough	Fixed	1,000,000	1.70%
Furness Building Society	Fixed	2,000,000	1.40%
National Counties Building Society	Fixed	1,500,000	1.70%
Nationwide	Fixed	3,000,000	1.52%
Nottingham Building Society	Fixed	1,000,000	1.74%
Nottingham Building Society	Fixed	2,000,000	1.70%
Bank of Scotland	Fixed	2,000,000	3.10%
National Counties Building Society	Fixed	2,500,000	1.55%
Barclays Bank plc	Fixed	1,500,000	1.56%
National Counties Building Society	Fixed	2,000,000	1.80%
Nottingham Building Society	Fixed	2,000,000	1.82%
Newcastle Building Society	Fixed	2,000,000	1.75%
National Counties Building Society	Fixed	1,000,000	1.40%
Bank of Scotland	Fixed	1,000,000	2.55%
Brentwood Borough Council	Fixed	2,000,000	2.16%
National Counties Building Society	Fixed	1,500,000	1.80%
Nottingham Building Society	Fixed	2,000,000	1.75%
Saffron Building Society	Fixed	2,000,000	1.65%
Lloyds TSB	Fixed	5,000,000	2.80%
Lloyds TSB	Fixed	4,000,000	2.85%
Doncaster MBC	Fixed	2,000,000	1.05%
Lloyds TSB	Fixed	5,000,000	2.80%
Barclays Bank plc	Fixed	2,000,000	2.60%
Bank of Scotland	Fixed	3,000,000	2.80%
Barclays Bank plc	Fixed	3,000,000	2.75%
Royal Bank of Scotland	Fixed	5,000,000	2.82%
Royal Bank of Scotland	Fixed	1,500,000	3.25%
Royal Bank of Scotland	Fixed	1,500,000	3.10%
Barclays Bank plc	Fixed	1,500,000	2.60%
Barclays Bank plc	Fixed	2,000,000	3.75%
Kingston upon Hull City Council	Fixed	1,000,000	1.90%
HSBC	Fixed	2,000,000	1.90%
Santander	Call	5,170,000	0.90%
Alliance & Leicester 30 Day Notice A/c	Call	1,487,493	0.90%
Royal Bank of Scotland	Call	2,288	0.85%
Goldman Sachs	MMF	1,210,000	Variable
Deutsche Bank	MMF	3,000,000	Variable
Blackrock	MMF	490,000	Variable
L&G Equities	Unit Trust	13,861,240	Variable
Royal Bank of Scotland	Corporate Bond	1,666,800.00	9.63%
Halifax	Corporate Bond	2,183,200.00	11.50%
Santander	Corporate Bond	314,145.00	11.50%
GRAND TOTAL		**116,463,758**	

Prudential indicators as at 30th September 2012

	2012/13 Original Estimate £m	Actual as at 30-Sep £m
Debt		
Authorised limit for external debt		
Borrowing	5	0
Other long term liabilities	5	0
	10	**0**
Operational boundary for external debt		
Borrowing	2	0
Other long term liabilities	3	0
	5	**0**
Interest rate exposures		
Maximum fixed rate borrowing	10	**0**
Maximum variable rate borrowing	10	**0**
Investments		
Interest rate exposures		
Limits on fixed interest rates	100	89
Limits on variable interest rates	30	5
Principal sums invested > 364 days		
Upper limit for principal sums invested >364 days	70	23
Limit to be placed on investments to maturity:		
1 - 2 years	70	18
2-5 years	50	5
5 years+	50	0
Investment portfolio spread		
Supranational bonds	15	0
Gilts	15	0
Equities*	10	14
Corporate bonds	10	4
Money market funds	20	5
Pooled bond fund	5	0
Property - direct investments	30	16
Property related pooled funds	10	0
External fund manager	20	0
Cash and certificates of deposit	85%	81%
Debt management account deposit facility	100%	0%

*Limit at time of purchase - Equities include accumulated dividends

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