DEVON & SOMERSET
FIRE & RESCUE AUTHORITY

REPORT REFERENCE NO.	**RC/09/11**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**16 NOVEMBER 2009**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2009/10**
LEAD OFFICER	**Treasurer**
RECOMMENDATIONS	That the performance in relation to the treasury management activities of the authority for 2009/2010 (to September) be noted;
EXECUTIVE SUMMARY	The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management, requires that the authority receives a report in respect of borrowing and investment activities during the year, and compares this performance against the treasury management strategy adopted. The report includes a performance report relating to the current financial year, as at September 2009.
RESOURCE IMPLICATIONS	As indicated within the report.
EQUALITY IMPACT ASSESSMENT	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	Appendix A – Investments held as at 30 September 2009.
LIST OF BACKGROUND PAPERS	Treasury Management Policy – as approved at the meeting of the Shadow DSFRA meeting held on the 16 March 2007. Revision to the Treasury Management Policy, as approved at the DSFRA meeting held on the 31 March 2009.

1. INTRODUCTION

1.1 The Treasury Management Strategy for Devon and Somerset FRA had been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2001. The adoption of the Code was originally made at the meeting of the DSFRA held on the 16th March 2007, with the most recent revision being agreed at the meeting of the DSFRA on the 31st March 2009. The Authority fully complies with the primary requirements of the Code, which includes:

- The creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Authority's treasury management activities.
- The creation and maintenance of Treasury Management Practices, which set out the manner in which the Authority will seek to achieve those policies and objectives.
- The receipt by the Authority of an annual strategy report for the year ahead and an annual review report of the previous year.
- The delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.2 Treasury management in this context is defined as:

"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

1.3 CIPFA issued an interim Treasury Management guidance document in March 2009, highlighting Best Practice recommendations for Local Authorities to follow. The document suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This report therefore ensures this Authority is embracing Best Practice in accordance with CIPFA's recommendations. It is expected that CIPFA will issue an updated Treasury Management Code of Practice in the autumn of 2009, following consultations with Local Authorities during the summer. The report provides information on the performance so far in the current financial year, based upon the position at the end of September 2009.

2. THE ECONOMY

2.1 The second quarter of the financial year of 2009 saw:

- There are some signs of recovery in the market, with some sectors showing growth
- Concerns remain about the fragile state of any recovery with the impact of rising unemployment, therefore bank rate/investment rates expected to stay lower for longer
- House prices rise at the fastest rate in over five years;
- An extension of the Bank of England's quantitative easing programme...
- ...but have limited success in boosting credit or money supply growth;
- Unemployment continue to rise and pay growth weaken further;

- Inflationary pressures in the economy ease further, but more slowly than had been expected;
- Conditions in financial markets improve further, and equity prices rally strongly;
- The pound fall back, yielding much of the gains made in the first quarter;
- Other major economies exit the recession, including the US.

2.2 At its meeting in August, the Monetary Policy Committee (MPC) increased the amount of asset purchases under the Bank's quantitative easing (QE) programme by £50bn to £175bn.

2.3 Net lending to businesses increased in August for the first month since March, however, the household sector as a whole reduced unsecured debt in August. Banks are likely to remain reluctant to lend while conditions in the labour market are still deteriorating. The claimant count rose by 25,200 in July and 24,400 in August. While these were smaller rises than in the first quarter, they were enough to take the claimant count above 1.6m, the highest level since Q2 1997.

2.4 Inflationary pressures in the economy eased further in the quarter, although at a slower rate than in the previous quarter, and more slowly than many expected. CPI inflation fell from 1.8% in June to 1.6% in August, largely as a result of falls in the annual rate of food and utility price inflation. However, core inflation rose from 1.6% in June to 1.8% in August – a higher rate than in other advanced economies. The rise most likely reflects the lagged impact of the pound's depreciation last year, and so should prove temporary.

2.5 The most upbeat news was from the housing market. The Nationwide house price index rose 3.8% in Q2, the largest quarterly rise since Q2 2004. House prices by this measure are now only 13.5% below their peak. And while the Halifax measure remained more downbeat, it too posted increases in the quarter. However, the rise in house prices appeared to be largely driven by the scarcity of homeowners putting their homes up for sale, suggesting that the rises may therefore only be temporary.

Economic Forecast

2.6 The authority Treasury Advisers, Sector, have provided the following forecast;

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Bank rate	0.50%	0.50%	0.50%	0.75%	1.25%	1.75%	2.50%	3.00%	3.75%	4.00%	4.25%	4.50%	4.50%	4.50%
5yr PWLB rate	2.80%	2.90%	3.10%	3.20%	3.30%	3.55%	3.85%	4.15%	4.55%	4.60%	4.80%	4.80%	4.85%	4.85%
10yr PWLB rate	3.75%	3.80%	3.90%	4.00%	4.15%	4.30%	4.55%	4.75%	4.95%	5.00%	5.10%	5.15%	5.15%	5.15%
25yr PWLB rate	4.35%	4.45%	4.55%	4.60%	4.70%	4.90%	5.00%	5.00%	5.10%	5.20%	5.30%	5.30%	5.35%	5.35%
50yr PWLB rate	4.50%	4.55%	4.70%	4.75%	4.90%	5.00%	5.15%	5.15%	5.20%	5.25%	5.40%	5.40%	5.45%	5.45%

- The forecast is based on moderate economic recovery and moderate MPC concerns about inflation looking 2 years ahead
- The first Bank Rate increase is expected to be in Q2 of 2010/11
- Bank Rate to reach 4.5% in Q2 of 2012/13
- Long term PWLB rates to steadily increase to reach 5.45% by the end of 2012 due to high gilt issuance, reversal of QE and investor concerns over inflation

- There is a high level of uncertainties in all the above forecasts. This is due to the difficulties of forecasting the timing and amounts of QE reversal, fiscal contraction after the general election expected by May 2010, speed of recovery of banks' profitability and balance sheet positions, changes in the consumer saving ratio and rebalancing of the UK economy towards exports.

3. TREASURY MANAGEMENT STRATEGY STATEMENT

Annual Investment Strategy

3.1 The authority's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Authority's investment priorities as follows:

- Security of Capital
- Liquidity

3.2 The Authority will also aim to achieve the optimum return 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 using the Sector suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information provided by Sector.

3.3 A full list of investments held as at 30 September 2009 are shown in Appendix A.

3.4 As illustrated in the economic background section above, investment rates available in the market are at an historical low point. The average level of funds available for investment purposes in the second quarter of 2009/10 was £9.287m. 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.

Benchmark	Benchmark Return	Authority Performance	Investment Interest Earned
7 day	0.62%	0.47%	£14,515

3.5 As illustrated, the authority outperformed the benchmark by 6 bp**.** The authority's budgeted investment return for 2009/10 is £0.105m, and performance for the year to date indicates that this figure will not be achieved, as a consequence of the fall in interest rates since the budget was originally set.

Borrowing Strategy

Prudential Indicators:

3.6 It is a statutory duty for the Authority to determine and keep under review the "Affordable Borrowing Limits". The Authority's' approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.

3.7 A full list of the approved limits are included in the budget monitoring report, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to September 2009.

3.8 Sector's target rate for new long term borrowing for the first quarter of 2009/10 was 4.50%. As at the end of September 2009, due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new external borrowing of £3.5m was undertaken at the rates indicated in the table below. It is likely that the authority will need to seek new external borrowing during the remainder of the year, the timing of which will be dependent on the cash flow position of the authority, and predictions relating to movements in PWLB/market rates.

Date of Loan	**Amount £m**	**Life (Years)**	**Interest Rate**
19/08/2009	0.500	38.5	4.36%
19/08/2009	0.500	39.5	4.36%
19/08/2009	0.500	41.5	4.36%
30/09/2009	0.500	20.0	3.82%
30/09/2009	0.500	21.0	3.87%
30/09/2009	0.500	22.0	3.91%
30/09/2009	0.500	23.0	3.95%

3.9 As outlined below, interest rates have gradually decreased during the quarter across all bands, with the low points during August / September and the high points in July. PWLB rates are currently below Sector's new borrowing targets in some maturity bands.

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	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.68	2.7	3.69	4.19	4.2
Date	16/09/2009	26/08/2009	27/08/2009	01/09/2009	18/08/2009
High	1.16	3.29	4.15	4.77	4.74
Date	02/07/2009	28/07/2009	24/07/2009	24/07/2009	24/07/2009
Average	0.94	2.98	3.89	4.43	4.46

4. SUMMARY

4.1 In compliance with the requirements of the CIPFA Code of Practice of Treasury Management, this report provides members with a summary report of the treasury management activities during 2009/2010. As is indicated in this report, none of the Prudential Indicators have been breached, and a prudent approach has been taken in relation to investment decisions taken during the year, with priority being given to liquidity and security over yield. Whilst investment returns have reduced from the previous year, as a consequence of the fall in interest rates, the authority is still achieving returns above the LIBID 7 day rate, which is the benchmark return for this type of short term investments.

KEVIN WOODWARD
Treasurer

Investments as at 30th September 2009				
Counterparty	Maximum to be invested	Total amount invested	Call or Term	Interest rate(s)
	£m	£m		
Abbey	5.0	1.9	C	0.80%
Alliance & Leicester	5.0	1.21	C	0.64%
Barclays Bank	6.0	1.0	T	0.67%
Bank of Scotland	5.0	0.01	C	0.51%
Clydesdale Bank	5.0	2.2	T	0.46%
Kent Reliance B/S	1.0	1.0	T	1.40%
Norwich & Peterborough B/S	1.0	1.0	T	1.00%
Nottingham B/S	1.0	1.0	T	1.05%
Principality B/S	1.0	1.0	T	1.45%
Skipton B/S	1.0	1.0	T	0.75%
West Bromwich B/S	1.0	1.0	T	1.42%
Total invested as at 30th September 2009		**12.32m**		