# DEVON & SOMERSET
# FIRE & RESCUE AUTHORITY

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| **REPORT REFERENCE NO.** | **RC/10/1** |
| **MEETING** | **RESOURCES COMMITTEE** |
| **DATE OF MEETING** | **8 FEBRUARY 2010** |
| **SUBJECT OF REPORT** | **TREASURY MANAGEMENT PERFORMANCE 2009/2010** |
| **LEAD OFFICER** | **TREASURER** |
| **RECOMMENDATIONS** | That the performance in relation to the treasury management activities of the Authority for 2009/2010 (to December 2009) 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.<br>The report includes a performance report relating to the current financial year, as at December 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 31 December 2009. |
| **LIST OF BACKGROUND PAPERS** | Treasury Management Policy – as approved at the meeting of the Shadow DSFRA meeting held on the 16 March 2007.<br>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 The adoption of the Code was originally made at the meeting of the DSFRA held on the 16th March 2007, with the most recent revision being agreed at the meeting of the DSFRA on the 31st March 2009. A revised Code of Practice has recently been issued, to be adopted by the authority prior to 31 March 2010. 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 December 2009.

## 2. THE ECONOMY

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

- Activity indicators suggesting that the economy is finally exiting the recession;
- Household spending grow at its fastest rate since early 2008;
- The deterioration of the labour market slowing considerably;
- Little improvement in the UK's trade position;
- Monetary policy loosened again...
- ...but with only limited effect on asset markets and the growth of the money supply;
- Inflation rise as higher energy costs pushed up the annual comparison;
- Financial markets make further gains, but at a much slower pace;

2.2 Monetary policy was loosened further in the third quarter. At its meeting in November, the Monetary Policy Committee (MPC) increased the amount of asset purchases under the Bank's Quantitative Easing (QE) programme by £25bn to £200bn. However, QE continued to have a relatively limited effect, and there were only tentative signs of a positive impact outside of financial markets.

2.3 Household spending in Q3 looks set to have grown at its fastest rate since early 2008. The annual growth in retail sales was the highest in nearly eighteen months in October. Retail sales should have received at least some support towards the end of the year as consumers brought forward spending before the reinstatement of the standard rate of VAT on the 1st January. High street spending appears to have been stronger too. New private car registrations were 86% higher in October and 141% higher in November than a year ago, partly as a result of the Government's car scrappage scheme.

2.4 Q3 also saw the rate of deterioration in the labour market slow considerably. Unemployment claimant count rose by 5,900 in October but *fell* by 6,300 in November 2009. The improvement in the labour market no doubt supported the housing market, which continued to recover in the third quarter, albeit at a slightly slower rate than in Q2. The Nationwide house price index finished the quarter 1.5% higher than at the end of the previous quarter. The Halifax measure, which had been a little less buoyant in Q2, also posted decent rises. However, the rise in house prices continued to be largely driven by the shortage of homeowners putting their homes up for sale, suggesting that the rises may prove to be temporary.

2.5 Consumer Price Inflation (CPI) rose in the third quarter, from 1.1% in September to 1.5% in October and 1.9% in November, while RPI inflation returned to positive territory. Much of the rise in inflation was the result of energy price inflation turning from negative to positive.

2.6 The third quarter saw the global recovery continue to take hold. Once again, the recovery appeared to be strongest in the US. In the euro-zone, the output balance of the composite PMI index rose over the quarter to be consistent with quarterly growth in euro-zone GDP of around 0.5%. The recovery looked set to be strongest in France and Germany. But, like in the US, there were concerns that households in all countries remained reticent to spend.

Economic Forecast

2.7 The Authority's Treasury Advisers, Sector, have provided the following forecast;

| | 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% | 0.75% | 1.00% | 1.50% | 2.25% | 2.75% | 3.25% | 3.50% | 3.75% | 4.25% | 4.25% | 4.50% |
| **5yr PWLB rate** | 3.05% | 3.20% | 3.30% | 3.40% | 3.60% | 3.85% | 4.15% | 4.55% | 4.60% | 4.80% | 4.80% | 4.85% | 4.85% |
| **10yr PWLB rate** | 4.00% | 4.05% | 4.15% | 4.30% | 4.45% | 4.60% | 4.80% | 4.90% | 5.00% | 5.10% | 5.10% | 5.15% | 5.15% |
| **25yr PWLB rate** | 4.55% | 4.65% | 4.70% | 4.80% | 4.90% | 5.00% | 5.05% | 5.10% | 5.20% | 5.30% | 5.30% | 5.35% | 5.35% |
| **50yr PWLB rate** | 4.60% | 4.70% | 4.75% | 4.90% | 5.00% | 5.10% | 5.15% | 5.20% | 5.30% | 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 expected to be in the quarter ending September 2010; and is expected to reach 4.5% by the end of March 2013
- Long term PWLB rates are expected to steadily increase to reach 5.45% by end of 2012 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 fiscal effect of a general election, 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.

## 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 31 December 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 third quarter of 2009/10 was £14.040m. 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 LIBID | 0.44% | 0.84% | £29,760 |

3.5 As illustrated, the authority outperformed the benchmark by 40 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 December 2009.

3.8 Sector's target rate for new long term borrowing for the third quarter of 2009/10 was 4.45%. As at the end of December 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 £2.7m was undertaken at the rates indicated in the table below. It is unlikely that the authority will seek new external borrowing during the remainder of the year, although this is 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** |
|---|---|---|---|
| 13/10/2009 | 0.700 | 29.5 | 4.09% |
| 13/10/2009 | 0.500 | 30.5 | 4.13% |
| 13/10/2009 | 0.500 | 31.5 | 4.13% |
| 13/10/2009 | 0.500 | 48.5 | 4.19% |
| 13/10/2009 | 0.500 | 49.5 | 4.18% |

3.9 As outlined below, interest rates have gradually increased during the quarter across all bands, with the low points in October and the high points at the end of December.

| | 1 Year | 5 Year | 10 Year | 25 Year | 50 Year |
|---|---|---|---|---|---|
| Low | 0.73 | 2.46 | 3.55 | 4.07 | 4.18 |
| Date | 09/10/2009 | 30/10/2009 | 09/10/2009 | 09/10/2009 | 09/10/2009 |
| High | 0.97 | 3.12 | 4.3 | 4.64 | 4.57 |
| Date | 22/10/2009 | 30/12/2009 | 30/12/2009 | 30/12/2009 | 30/12/2009 |
| Average | 0.83 | 2.82 | 3.90 | 4.34 | 4.35 |

## 4. <u>SUMMARY</u>

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 31st December 2009 – Appendix A** | | | | |
|---|---|---|---|---|
| Counterparty | Maximum to be invested | Total amount invested | Call or Term | Interest rate(s) |
| | £m | £m | | |
| Abbey | 5.0 | 4.96 | C | 0.80% |
| Barclays Bank | 6.0 | 2.0 | T | 0.70% |
| Chelsea B/S | 1.5 | 1.0 | T | 0.95% |
| Newcastle B/S | | 1.0 | T | 1.00% |
| Norwich & Peterborough B/S | 1.5 | 1.0 | T | 1.55% |
| Nottingham B/S | 1.5 | 1.0 | T | 0.80% |
| Stroud & Swindon B/S | 1.5 | 1.0 | T | 0.75% |
| Total invested as at 31st December 2009 | | **11.96m** | | |