DEVON & SOMERSET
FIRE & RESCUE AUTHORITY

REPORT REFERENCE NO.	**RC/10/12**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**16 JULY 2010**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2010/2011**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	That the performance in relation to the treasury management activities of the Authority for 2010/2011 (to June) be noted;
EXECUTIVE SUMMARY	The Chartered Institute of Public Finance and Accountancy (CIPFA) issued the revised Code of Practice for Treasury Management in November 2009, following consultation with Local Authorities during the summer. The revised Code 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 revised Code of Practice.
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 June 2010.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) Report DSFRA/10/3Policy – as approved at the meeting of the DSFRA meeting held on the 19 February 2010.

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 The adoption of the Code was originally made at the meeting of the DSFRA held on the 16th March 2007. A revised Code of Practice has recently been issued which was adopted by the authority at the budget meeting held on 19 February 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 The report provides information on the performance so far in the current financial year, based upon the position at the end of June 2009.

2. THE ECONOMY

2.1 The first quarter of 2010/11 saw:

- The new coalition government enact a fiscal squeeze set to be the most severe since the end of the Second World War;
- Activity indicators suggest that the recovery picked up a little pace in the first quarter;
- High street spending recovered after a weak start to the year;
- The labour market showed some tentative signs of improvement;
- The UK's trade position deteriorated, despite the weak pound;
- CPI inflation remained above target, however the measure of underlying inflation fell;
- The Monetary Policy Committee maintained QE and kept Bank Rate on hold at 0.5%;
- The equity rally went into reverse over concerns about the shape of the global recovery;
- The recovery in the US remains fairly strong, but remains weak in the euro-zone.

2.2 The key development of the first quarter was the emergency Budget with plans unveiled by the new Chancellor to severely tighten fiscal policy. According to the new (and independent) Office for Budget Responsibility, cyclically adjusted net borrowing – the portion of borrowing that will not disappear with economic growth – will now fall from 8.7% of GDP in the fiscal year just gone to 0.8% in 2014-15.

2.3 The Budget directed the bulk of the fiscal tightening at households instead of firms. Key measures within the Budget included a rise in the standard rate of VAT from 17.5% to 20%, to take effect in January 2011. Plans for social security payments were also scaled back. However, the burden on lower income households was partly offset by an increase in the income tax personal allowance by £1,000 to £7,475 from April 2011 from which high earners will not benefit.

2.4 Meanwhile, activity surveys suggested that the recovery gathered pace in the first quarter after the economy's 0.3% expansion. On the face of it, the weighted average of the activity balances of the CIPS/Markit reports of manufacturing, construction and services in April and May suggest that the economy expanded at a quarterly rate of around 0.7% in the first quarter. However, given that the surveys have often been too upbeat, this seems likely to be an over-estimate.

2.5 Encouragingly, the labour market has shown some tentative signs of improvement. The number of people claiming unemployment benefit fell by 32,000 in April and 31,000 in May, leaving the total at 1.48m. Employment also rose by 5,000 in the three months to April. However, the workforce increased at a faster rate, so that the total number of unemployed according to the wider ILO measure still rose by 23,000 in the three months to April.

2.6 The UK's trade position continued to deteriorate, despite the support provided by the lower pound. The trade in goods and services deficit widened from £3.2bn to £3.3bn in April. Exported goods volumes fell again, this time by a monthly 0.5%. However, the export orders balances of the activity surveys continued to suggest that volumes would pick up soon.

2.7 Inflationary pressures have finally begun to ease. CPI inflation rose from 3.4% to a recent peak of 3.7% in April before falling back to 3.4% in May. Temporary factors, such as the rise in the rate of VAT to 17.5% in January and the rise in oil prices last year, continued to support above-target inflation.

2.8 The Monetary Policy Committee (MPC) continued to keep Bank Rate on hold at 0.5% and to maintain its stock of asset purchases. The Bank of England's quarterly Inflation Report in May also projected inflation to be below the 2% target at the two year horizon, suggesting that rates will remain on hold for a considerable period. Some MPC members expressed concern that the recent bout of high inflation could lead to a permanent shift in inflation expectations if it persisted much longer.

Economic Forecast

2.9 The Council's Treasury Advisers, Sector, provides the following forecast:

Sector's Interest Rate View	NOW	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Sector's Bank Rate View	0.50%	0.50%	0.50%	0.75%	1.00%	1.50%	1.75%	2.25%	2.50%	3.00%	3.50%	3.75%
5yr PWLB Rate	2.48%	2.95%	2.95%	3.15%	3.30%	3.50%	3.60%	3.95%	4.30%	4.55%	4.70%	4.80%
10yr PWLB View	3.83%	4.30%	4.40%	4.45%	4.55%	4.60%	4.65%	4.70%	4.75%	4.90%	4.95%	5.10%
25yr PWLB View	4.46%	4.70%	4.75%	4.75%	4.85%	4.90%	5.00%	5.05%	5.15%	5.20%	5.25%	5.25%
50yr PWLB Rate	4.49%	4.70%	4.75%	4.80%	4.90%	4.95%	5.05%	5.05%	5.20%	5.25%	5.25%	5.25%

- The forecast is based on moderate economic recovery and MPC inflation forecast being below target in two years' time
- The first Bank Rate increase is expected to be in 2011; and to reach 3.75% by March 2013
- Long term PWLB rates are expected to steadily increase to reach 5.25% by early 2013 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 tough cuts outlined in the emergency Budget, 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
- The balance of risks is weighted to the downside
- There is still some risk of a "double dip" recession.

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 June 2010 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 first quarter of 2010/11 was £9.395m. 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	0.42%	0.81%	£10,484

3.5 As illustrated, the authority outperformed the benchmark by 39 bp**.** The Authority's budgeted investment return for 2010/11 is £0.070m, and performance so far this year indicates that this figure will be achieved.

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.

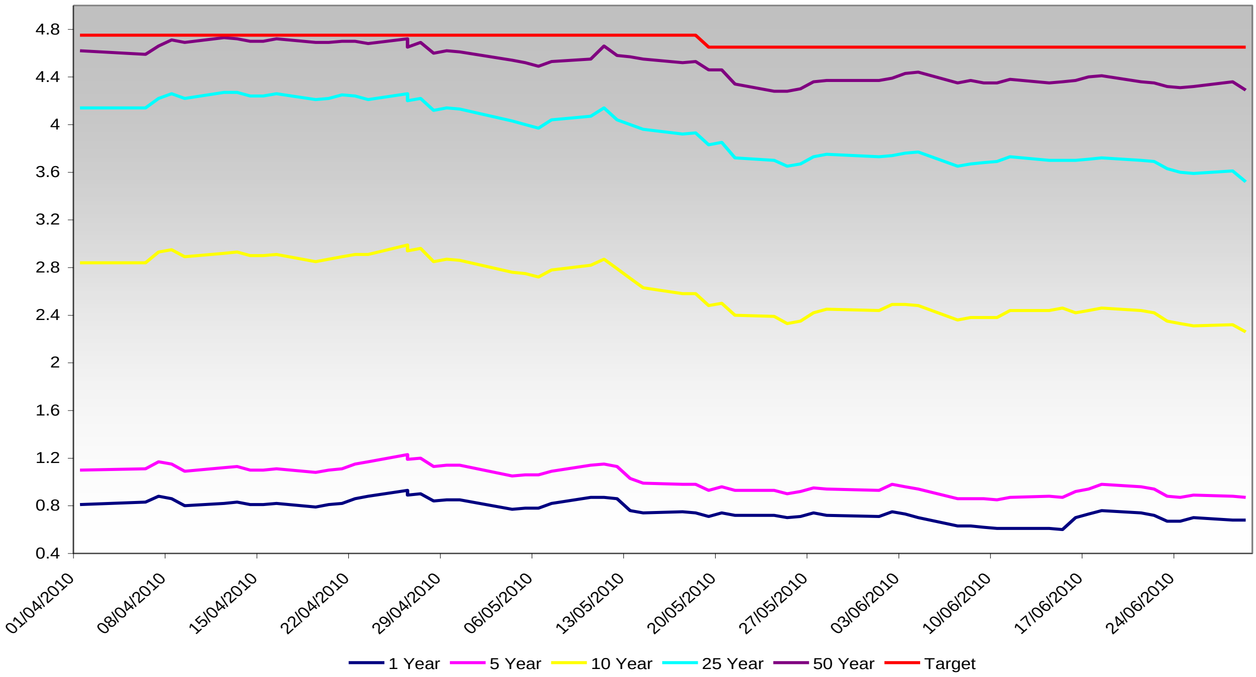
3.7 A full list of the approved limits (as amended) are included in the Financial Performance Report 2010/2011, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to June 2010.

3.8 Sector's target rate for new long term borrowing for the first quarter of 2010/11 was in the range of 4.65% to 4.75%. As at the end of June 2010, due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new external borrowing of £3.0m was undertaken from the PWLB at the rates indicated in the table below.

Date of Loan	Amount £m	Life (Years)	Interest Rate
25/05/2010	0.500	16.5	4.20%
25/05/2010	0.500	33.5	4.29%
25/05/2010	0.500	34.5	4.28%
25/05/2010	0.500	35.5	4.29%
25/05/2010	0.500	36.5	4.29%
25/05/2010	0.500	49.5	4.29%

3.9 As illustrated below, interest rates have gradually increased during the quarter across all bands, with the low points in June for 1, 5, 10, 25 and 50 year PWLB loans. The high points were in April for 1, 5, 10, 25 and 50 year PWLB loans.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.60	0.85	2.26	3.52	4.28
Date	15/06/2010	10/06/2010	29/06/2010	29/06/2010	24/05/2010
High	0.93	1.23	2.99	4.27	4.73
Date	26/04/2010	26/04/2010	26/04/2010	12/04/2010	12/04/2010
Average	0.76	1.02	2.63	3.93	4.50



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 for the first quarter of 2010/2011. 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 so far, 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 June 2010

Counterparty	Maximum to be invested (£m)	Total amount invested (£m)	Call or Term	Interest rate(s)
Santander	5.0	1.387	C	0.70%
Bank of Scotland	5.0	1.000	T	1.15%
		1.500	T	1.35%
Norwich & Peterborough B/S	1.5	1.000	T	0.90%
Principality B/S	1.5	1.000	T	0.72%
Stroud & Swindon B/S	1.5	1.500	T	0.68%
West Bromwich B/S	1.5	1.500	T	0.68%
Total invested as at 30th June		**8.887**		