DEVON & SOMERSET
FIRE & RESCUE AUTHORITY

REPORT REFERENCE NO.	**RC/10/16**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**21 OCTOBER 2010**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2010/2011 (TO SEPTEMBER 2010)**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	That the performance in relation to the treasury management activities of the Authority for 2010/2011 (to September) 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 Sept 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 The adoption of the Code was originally made at the meeting of the DSFRA held on the 16th March 2007.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 full Authority of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during 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 This mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2010/11
- A review of the Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy
- A review of the Council's investment portfolio for 2010/11
- A review of the Council's borrowing strategy for 2010/11
- A review of any debt rescheduling undertaken during 2010/11
- A review of compliance with Treasury and Prudential Limits for 2010/11

2. ECONOMIC UPDATE

2.1 Global Economy

- The sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit. However, any default or write down of Greek debt would have substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May.

- Growth in the US, UK and the Euro zone in quarter 2 of 2010 was particularly driven by strong growth in the construction sector catching up from inclement weather earlier in the year and is unlikely to be repeated; general expectations are for much more subdued figures for the remainder of 2010. Market expectations for all three sectors of the economy is that these have all peaked and are pointing downwards, though not necessarily in to negative territory.

2.2 **UK Economy**

- Following the general election in May 2010, the coalition government has put in place an austerity plan to carry out correction of the public sector deficit over the next five years. The inevitable result of fiscal contraction will be major job losses during this period, in particular in public sector services. This will have a knock on effect on consumer and business confidence. House prices have started a negative trend during the summer and mortgage approvals are at very weak levels and also declining.
- **Economic Growth** – GDP growth is likely to have peaked at 1.2% in quarter 2 of 2010.
- **Unemployment** – the trend of falling unemployment (on the benefit claimant count) has now been replaced since July with small increases which are likely to be the start of a new trend of rising unemployment.
- **Inflation and Bank Rate** – CPI has remained high so far during 2010. It peaked at 3.7% in April and has fallen back to 3.1% in August. RPI remains high, at 4.7% in August. Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back under the target over the next two years. The last quarterly Inflation Report in August showed a significant undershoot after the end of 2011.
- The Bank of England finished its programme of quantitative easing with a total of £200bn in November 2009 (although there is currently some increase in expectations that there might be a second round of quantitative easing).

2.3 It is the Authority's Treasury advisers, Sector's, view is that there is unlikely to be any increase in Bank Rate until the middle of 2011.

- **AAA rating** – prior to the general election, credit rating agencies had been issuing repeated warnings that unless there was a major fiscal contraction, then the AAA sovereign rating was at significant risk of being downgraded. Sterling was also under major pressure during the first half of the year. However, after the Chancellor's budget on 22 June, Sterling has strengthened against the US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors now view UK government gilts as being a safe haven from EU government debt. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and PWLB rates.

Economic Forecast

2.4 Sector provides the following forecast:

	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Bank rate	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.50%	3.00%	3.25%
5yr PWLB rate	2.20%	2.20%	2.20%	2.40%	2.60%	2.80%	3.00%	3.30%	3.60%	3.80%	4.10%	4.40%
10yr PWLB rate	3.30%	3.30%	3.30%	3.40%	3.70%	3.90%	4.00%	4.30%	4.40%	4.60%	4.60%	4.90%
25yr PWLB rate	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.70%	4.70%	4.80%	5.00%	5.00%	5.00%
50yr PWLB rate	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.70%	4.70%	4.80%	5.00%	5.00%	5.00%

2.5 It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be, and there are a range of views in the market. Sector has adopted a moderate view. There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:

- the speed of economic recovery in the US and EU
- the degree to which government austerity programmes will dampen economic growth
- the speed of rebalancing of the UK economy towards exporting and substituting imports
- changes in the consumer savings ratio
- the potential for more quantitative easing, and the timing of this in both the UK and US
- the speed of recovery of banks' profitability and balance sheet imbalances
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy

2.6 The overall balance of risks is weighted to the downside and there is some risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, although this is currently viewed as being a small risk.

2.7 Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

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 2010 are shown in Appendix A.

3.4 Borrowing rates have been at historically low rates during the first six months of the 2010/11 financial year. As outlined in Section 2 above, there is still considerable uncertainty and volatility in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy is still fit for purpose in the current economic climate.

3.5 The average level of funds available for investment purposes in the first quarter of 2010/11 was £17.217m. 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	0.43%	0.81%	£18,692

3.6 As illustrated, the authority outperformed the benchmark by 38 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 exceeded.

Borrowing Strategy

Prudential Indicators:

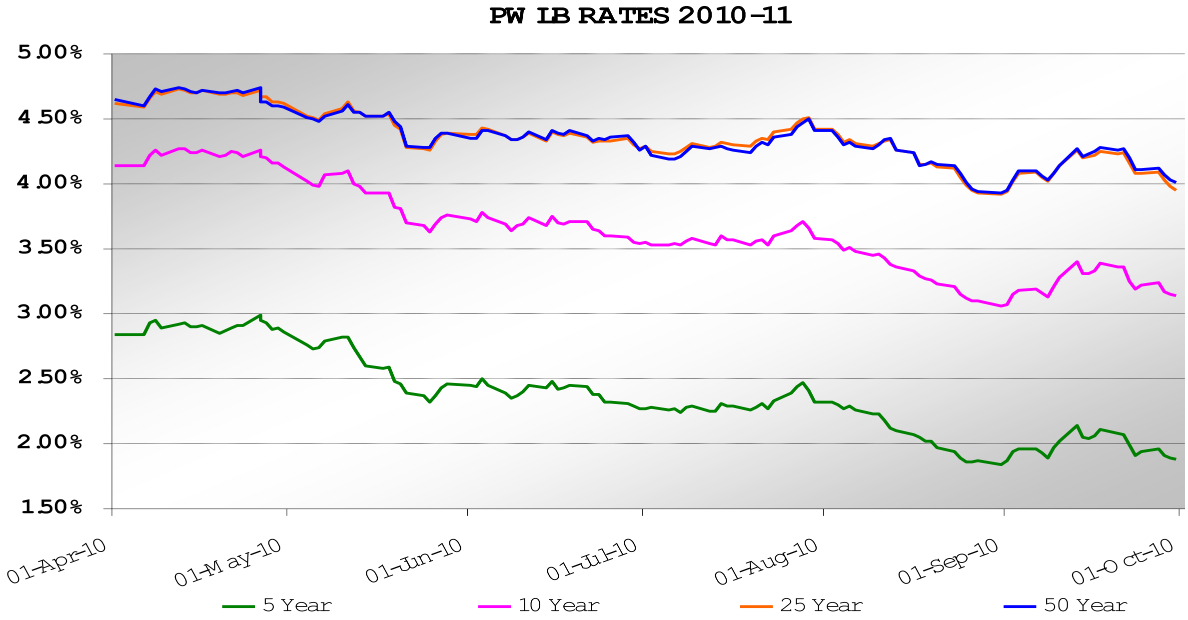
3.7 It is a statutory duty for the Authority to determine and keep under review the "Affordable Borrowing Limits". The Authority's' approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.

3.8 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 September 2010.

3.9 No new borrowing was taken during the second quarter of the year.

3.10 No debt rescheduling has been undertaken during the second quarter of the year.

3.11 Sector's central target rate for new external long term borrowing (25 years) for the first six months of 2010/11 started at 4.65% and fell progressively to 4.20%. The general trend has been a reduction in interest rates during the six months, across all bands, with the low points occurring in the middle to end of August. The high points were in early to mid April. The graph and table below show the movement in PWLB rates for the first six months of the year and provide benchmarking data showing high and low points.



PWLB BORROWING RATES 2010/11 for 1 to 50 years

	1	2	3	4	5	10	25	50
1. 4.2010	**0.81%**	**1.37%**	**1.91%**	**2.40%**	**2.84%**	**4.14%**	**4.62%**	**4.65%**
30.9.2010	**0.64%**	**0.91%**	**1.22%**	**1.55%**	**1.88%**	**3.14%**	**3.95%**	**4.01%**
HIGH	**0.93%**	**1.52%**	**2.07%**	**2.56%**	**2.99%**	**4.27%**	**4.73%**	**4.74%**
LOW	**0.60%**	**0.89%**	**1.20%**	**1.52%**	**1.84%**	**3.06%**	**3.92%**	**3.93%**
spread	**0.33%**	**0.63%**	**0.87%**	**1.04%**	**1.15%**	**1.21%**	**0.81%**	**0.81%**
average	**0.73%**	**1.15%**	**1.58%**	**1.99%**	**2.37%**	**3.65%**	**4.35%**	**4.35%**
high date	26/04/2010	26/04/2010	26/04/2010	26/04/2010	26/04/2010	12/04/2010	12/04/2010	26/04/2010
low date	15/06/2010	24/08/2010	25/08/2010	31/08/2010	31/08/2010	31/08/2010	31/08/2010	31/08/2010

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 second 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

APPENDIX A

Investments as at 30th September 2010

% of total investments	Counterparty	Maximum to be invested (£m)	Total amount invested (£)	Call or Term	Date if Term	Interest Rate
16.95%	Santander UK & Cater Allen	5.0	1.000	T	17/01/2011	1.32%
			1.500	T	01/02/2011	1.33%
			0.245	C		0.80%
28.71%	Bank of Scotland	5.0	1.500	T	29/10/2010	1.35%
			1.000	T	15/07/2011	2.00%
			2.150	C		0.75%
9.26%	Barclays	10.0	1.500	T	17/01/2011	0.98%
9.26%	Kent Reliance B/S	1.5	1.500	T	15/10/2010	0.75%
8.03%	Newcastle B/S	1.5	1.300	T	30/11/2010	0.83%
9.26%	Skipton B/S	1.5	1.500	T	15/10/2010	0.70%
9.26%	Stroud & Swindon B/S	1.5	1.500	T	29/10/2010	0.63%
9.26%	West Bromwich B/S	1.5	1.500	T	01/11/2010	0.77%
			16.195			