DEVON & SOMERSET
FIRE & RESCUE AUTHORITY

REPORT REFERENCE NO.	**RC/11/7**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**22 JULY 2011**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2011/2012**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	That the performance in relation to the treasury management activities of the Authority for 2011/2012 (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. 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 2011.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) Report DSFRA/11/2 – as approved at the meeting of the Devon and Somerset Fire and Rescue Authority held on the 14 February 2011.

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 The adoption of the Code was originally made at the meeting of the DSFRA held on the 16th March 2007.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 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 The preparation of this report demonstrates that the Authority is implementing best practice in accordance with the code.

2. ECONOMIC BACKGROUND

2.1 The quarter ended 30th June 2011 saw the following:

- The economic recovery struggle to regain momentum;
- Conditions on the high street deteriorate;
- Mixed signals on the strength of the labour market recovery;
- Public sector borrowing come out disappointingly high;
- The near term outlook for Consumer price index (CPI) inflation deteriorate further;
- The Monetary Policy Committee (MPC) move away from raising interest rates;
- UK equities staying flat over the quarter with gilt yields falling;
- Economic growth slowing in the US and euro-zone.

2.2 The additional bank holiday for the Royal Wedding pulled down both industrial and services output in April. But the CIPS/Markit business surveys have failed to pick up by much since. An average of the surveys over the last three months point to quarterly Gross Domestic Product (GDP) growth of just 0.3% - less than half its trend.

2.3 The industrial recovery appears to have lost momentum quite quickly. The CIPS/Markit manufacturing survey has fallen to a level consistent with falls in manufacturing output. The output expectations balance of the CBI industrial trends survey has fallen more modestly, but has nonetheless dropped for the past three months in a row.

2.4 Meanwhile, the consumer outlook has darkened. The pick-up in the consumer sector seen during the spring appears to have been only temporary, reflecting the good weather and extra bank holiday. Retail sales volumes fell in May, more than reversing April's increase. The CBI's distributive trades survey fell in June. And a number of well-known retailers have recently fallen into administration.

2.5 Consumers appear to be reacting to the squeeze on their real incomes. Household real disposable incomes fell by 0.8%. Inflation is outpacing average earnings by about 2.5%. Consumer confidence also fell back in June and remains consistent with further falls in consumer spending.

2.6 Meanwhile, the news on the labour market has been mixed. The Workforce Jobs measure of employment rose strongly. But the timelier Labour Force Survey measure flattened off in April and May. And the number of job vacancies continued to fall throughout the quarter. The claimant count measure of unemployment also continued to rise over the last three months. This only partly reflected a rise in the number of lone parents claiming Jobseeker's Allowance due to recent benefit changes.

2.7 The housing market has continued to tread water. The number of mortgage approvals for new house purchase was broadly unchanged over the quarter at a very low level of just 46,000 or so. House prices have also remained broadly flat.

2.8 The trade deficit was unchanged in April compared to March.

2.9 Near-term outlook for inflation has deteriorated further. Although CPI inflation held steady at 4.5% in May, it now looks likely to rise to 5.5% or even higher within the next few months. Food price inflation is likely to rise further. And Scottish Power announced in June a 19% rise in gas prices and 10% rise in electricity prices to take effect in August. Other utility suppliers are likely to follow suit.

2.10 Households' inflation expectations rose sharply in June. But so far, there are no signs of any pick-up in pay growth. The median pay settlement was unchanged at 2.5% in May.

2.11 Most Monetary Policy Committee (MPC)members still think that the rise in inflation will be only temporary and that inflation will fall back sharply next year. So despite the worsening of the near-term inflation outlook, the weakness of the activity data has pushed most members further away from an interest rate rise.

2.12 Some MPC members have even started to discuss the prospect of giving the economy more support. Admittedly, the hurdle for more quantitative easing (QE) will be quite high. However, it is certainly possible if the economy remains as weak as expected.

2.13 At the end of March, financial markets were expecting interest rates to have risen by this July. But now they expect rates to stay on hold until July next year. Meanwhile, sterling was broadly unchanged against the dollar at about $1.60, and fell only a touch against the euro.

2.14 In the United States, the recovery also appears to have lost a significant amount of momentum. The manufacturing index fell sharply in May and reversed only a fraction of this drop in June. Payrolls employment rose by a disappointing 54,000 in May. Meanwhile, in the euro-zone economy recent falls in most leading indicators suggest that growth is slowing there too. Germany has continued to outperform the rest of the region. The risk of an imminent Greek disaster appears to have eased, but European policymakers' inability to deal with the crisis quickly and effectively is hitting the rest of the periphery.

2.15 Sector, provides the following interest rate forecast:

Sector's Interest Rate View

	NOW	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Sector's Bank Rate View	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.00%	2.25%	2.50%	2.75%	3.00%
5yr PWLB Rate	3.12%	3.55%	3.65%	3.75%	3.90%	4.00%	4.15%	4.25%	4.45%	4.60%	4.65%	4.75%
10yr PWLB View	4.45%	4.75%	4.75%	4.80%	4.95%	4.95%	5.00%	5.05%	5.15%	5.20%	5.25%	5.25%
25yr PWLB View	5.24%	5.40%	5.40%	5.40%	5.40%	5.40%	5.45%	5.50%	5.50%	5.50%	5.60%	5.65%
50yr PWLB Rate	5.20%	5.40%	5.40%	5.40%	5.40%	5.40%	5.45%	5.50%	5.50%	5.50%	5.60%	5.65%

2.16 The Sector forecast is for a November 2011 increase in bank rate but with reservations that it could well slip back in time, unless there is some good news on the UK economic recovery before then.

2.17 Sector has undertaken its normal quarterly review of interest rate forecasts after the issue of the Bank of England's quarterly inflation report. The key Bank of England comments are shown below:

- Mervyn King said after the May Inflation Report was published that 'Bank Rate cannot stay down indefinitely' but this does not equate to saying 'there will be a first increase in Bank Rate in November 2011'. Financial markets have over-reacted to this statement.
- Continuing wage freezes / low pay settlements.
- BoE forecasts for the speed of recovery and of increases in GDP growth rate have consistently been over optimistic since the recession started in 2009.
- CPI will blip up in 2011 due to temporary supply side shock factors but these will drop out within 12 months - as will VAT increases.
- Unless the output gap is closed (unlikely for some considerable time) inflation will eventually fall below target.

2.18 In summary:

- Expect continuing wage freezes /low pay settlements.
- Bank of England forecasts for the speed of recovery and of increase in GDP growth rate have consistently been over optimistic since the recession started in 2009.
- CPI will blip up in 2011 due to temporary supply side shock factors but these will drop out within 12 months – as will VAT increases.
- Unless the output gap is closed (unlikely for some considerable time) inflation will eventually fall below target.
- There has been a significant erosion of the confidence of financial markets in the EU handling of the peripheral debt crisis. There is now a major and escalating risk that the Greek, Irish, Portuguese debt crisis may not be contained and could lead to debt restructurings that could do significant damage to banks which already have weakened balance sheets. It is worth noting that many western governments have already exhausted their capacity to increase government debt to again bail out banks further damaged by any such future events and to counter the dampening of economic growth that would follow.

3. TREASURY MANAGEMENT STRATEGY STATEMENT

Annual Investment Strategy

3.1 The Authority's Annual Investment Strategy, which is incorporated in the Treasury Management Strategy Statement (TMSS) was approved by the Authority on the 14th February 2011. It 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 to cover short term cash flow needs but also to seek out value available in significantly higher rates in periods up to 12 months 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 June 2011 are shown in Appendix A.

3.4 Investment rates available in the market have continued at historically low levels.

3.5 The average level of funds available for investment purposes during the quarter was £16.423m. 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 for quarter
7 day LIBID	0.46%	0.82%	£(14,993)

3.6 As illustrated, the authority outperformed the benchmark by 36 bp. The Authority's budgeted investment return for 2011/12 is £0.100m, and performance so far this year indicates that this figure will be achieved.

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 2011/2012, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to June 2011.

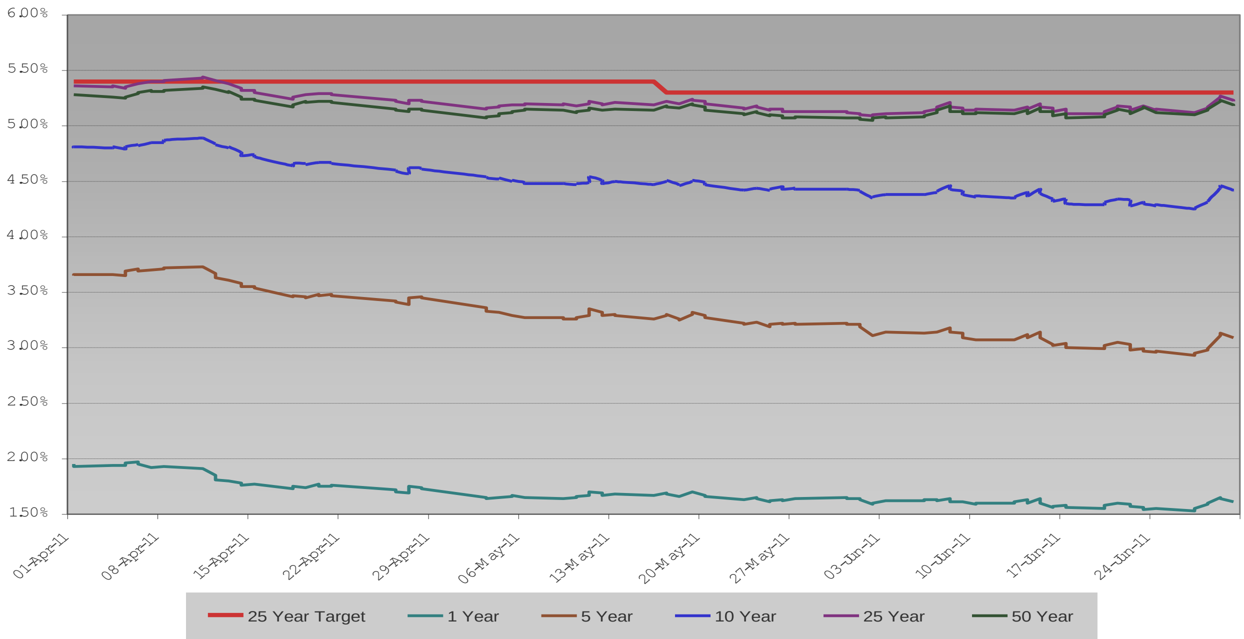
3.9 Sector's 25 year target rate for new long term borrowing for the quarter started at 5.40% and ended at 5.30%. No new borrowing was taken during this quarter of the year.

3.10 No debt rescheduling was undertaken during this quarter of the year.

3.11 As shown below, most interest rates have generally been on a slightly positive trend during the quarter across all bands.

PWLB rates quarter ended 30.06.2011

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.53%	2.93%	4.25%	5.09%	5.05%
Date	27/06/11	27/06/11	27/06/11	02/06/11	02/06/11
High	1.97%	3.73%	4.89%	5.44%	5.35%
Date	06/04/11	11/04/11	11/04/11	11/04/11	11/04/11
Average	1.69%	3.29%	4.51%	5.22%	5.16%



3.12 In line with the paper that went to Resources committee in May 2011, it is anticipated that internal borrowing and available grants will reduce the call on borrowing. However if capital spend is in line with programme levels then borrowing will be undertaken during the financial year.

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 2011/2012. 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 are still low 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 2011

% of total investments	Counterparty	Maximum to be invested (£m)	Total amount invested (£m)	Call or Term	Date if Term	Interest Rate
31.25%	Santander UK & Cater Allen	5.0	1.500	T	01/08/2011	1.41%
			1.500	T	17/10/2011	1.32%
			1.500	T	21/12/2011	1.35%
20.14%	Bank of Scotland	5.0	1.000	T	15/07/2011	2.00%
			1.901	C		0.75%
13.89%	Barclays	10.0	2.000	T	22/07/2011	0.76%
6.94%	Kent Reliance B/S	1.5	1.000	T	11/07/2011	0.95%
6.94%	Newcastle B/S	1.5	1.000	T	01/07/2011	0.90%
10.42%	Nottingham B/S	1.5	1.500	T	30/12/2011	1.80%
10.42%	Principality B/S	1.5	1.500	T	18/07/2011	0.80%
			14.401			