DEVON & SOMERSET
FIRE & RESCUE AUTHORITY

REPORT REFERENCE NO.	**RC/12/11**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**19 OCTOBER 2012**
SUBJECT OF REPORT	**TREASURY MANAGEMENT PERFORMANCE 2012-2013 – QUARTER 2**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2012-2013 (to September), as set out in this report, 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 RISKS AND BENEFITS ASSESSMENT (ERBA)	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	A. Investments held as at 30 September 2012.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) Report DSFRA/12/3 – as approved at the meeting of the DSFRA meeting held on the 17 February 2012.

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) 2011 Treasury Management in Public Services Code of Practice (the Code) and the CIPFA Prudential Code. The most recent revision of the Code was adopted at the meeting of the DSFRA on the 17th February 2012. 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

Economic performance to date

2.1 Economic sentiment, in respect of the prospects for the UK economy to recover swiftly from recession, suffered a major blow in August when the Bank of England substantially lowered its expectations for the speed of recovery and rate of growth over the coming months and materially amended its forecasts for 2012 and 2013. It was noted that the UK economy is heavily influenced by worldwide economic developments, particularly in the Eurozone, and that on-going negative sentiment in that area would inevitably permeate into the UK's economic performance.

2.2 With regard to the Eurozone, investor confidence remains weak because successive "rescue packages" have first raised, and then disappointed, market expectations. However, the uncertainty created by the continuing Eurozone debt crisis is having a major effect in undermining business and consumer confidence not only in Europe and the UK, but also in America and the Far East/China.

2.3 In the UK, consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on real incomes from high inflation and low pay rises, all taking a toll. Whilst inflation has fallen considerably (CPI @ 2.6% in July), UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession. This means that the UK's recovery from the initial 2008 recession has been the worst and slowest of any G7 country apart from Italy (G7 = US, Japan, Germany, France, Canada, Italy and UK). It is also the slowest recovery from a recession of any of the five UK recessions since 1930 and total GDP is still 4.5% below its peak in 2008.

2.4 This weak recovery has caused social security payments to remain elevated and tax receipts to be depressed. Consequently, the Chancellor's plan to eliminate the annual public sector borrowing deficit has been pushed back further into the future. The Monetary Policy Committee has kept Bank Rate at 0.5% throughout the period while quantitative easing was increased by £50bn to £375bn in July. In addition, in June, the Bank of England and the Government announced schemes to free up banking funds for business and consumers.

2.5 On a positive note, despite all the bad news on the economic front, the UK's sovereign debt remains one of the first ports of call for surplus cash to be invested in and gilt yields, prior to the ECB bond buying announcement in early September, were close to zero for periods out to five years and not that much higher out to ten years.

Outlook for the next six months of 2012/13

2.6 The risks in economic forecasts continue unabated from the previous treasury strategy. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while America is hamstrung by political deadlock which prevents a positive approach to countering weak growth. Whether the presidential election in November will remedy this deadlock is debatable but urgent action will be required early in 2013 to address the US debt position. However, on 13 September the Fed announced an aggressive stimulus programme for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, and this time with no time limit. They also announced that it was unlikely that there would be any increase in interest rates until at least mid-2015.

2.7 Eurozone growth will remain weak as austerity programmes in various countries curtail economic recovery. A crunch situation is rapidly developing in Greece as it has failed yet again to achieve deficit reduction targets and so may require yet another (third) bail out. There is the distinct possibility that some of the northern European countries could push for the ejection of Greece from the Eurozone unless its financial prospects improve, which does not seem likely at this juncture.

2.8 A financial crisis was also rapidly escalating over the situation in Spain. However, in early September the ECB announced that it would purchase unlimited amounts of shorter term bonds of Eurozone countries which have formally agreed the terms for a bailout. Importantly, this support would be subject to conditions (which have yet to be set) and include supervision from the International Monetary Fund. This resulted in a surge in confidence that the Eurozone has at last put in place the framework for adequate defences to protect the Euro. However, it remains to be seen whether the politicians in charge of Spain and Italy will accept such loss of sovereignty in the light of the verdicts that voters have delivered to the politicians in other peripheral countries which have accepted such supervision and austerity programmes. The Eurozone crisis is therefore far from being resolved as yet. The immediate aftermath of this announcement was a rise in bond yields in safe haven countries, including the UK. Nevertheless, this could prove to be as short lived as previous "solutions" to the Eurozone crisis.

2.9 The Bank of England Quarterly Inflation Report in August pushed back the timing of the return to trend growth and also lowered its inflation expectations. Nevertheless, concern remains that the Bank's forecasts of a weaker and delayed robust recovery may still prove to be over optimistic given the world headwinds the UK economy faces. Weak export markets will remain a drag on the economy and consumer expenditure will continue to be depressed due to a focus on paying down debt, negative economic sentiment and job fears. The Coalition Government, meanwhile, is likely to be hampered in promoting growth by the requirement of maintaining austerity measures to tackle the budget deficit.

2.10 The overall balance of risks is, therefore, weighted to the downside:

- We expect low growth in the UK to continue, with Bank Rate unlikely to rise in the next 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB borrowing rates is for them to eventually rise, primarily due to the need for a high volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries. However, the current safe haven status of the UK may continue for some time, tempering any increases in yield.
- This interest rate forecast is based on an assumption that growth starts to recover in the next three years to a near trend rate (2.5%). However, if the Eurozone debt crisis worsens as a result of one or more countries having to leave the Euro, or low growth in the UK continues longer, then Bank Rate is likely to be depressed for even longer than in this forecast.

Sector's interest rate forecast

2.11 The Sector forecasts below for PWLB rates incorporate the introduction of the **PWLB certainty rate** in November 2012 which will reduce PWLB borrowing rates by 0.20% for this authority.

	as at 17/9/12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank Rate	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.75%**	**1.00%**
3 Month Libid	**0.55%**	**0.60%**	**0.60%**	**0.60%**	**0.60%**	**0.60%**	**0.60%**	**0.70%**	**0.90%**	**1.10%**	**1.40%**
6 Month Libid	**0.85%**	**0.85%**	**0.85%**	**0.85%**	**0.85%**	**0.85%**	**1.00%**	**1.10%**	**1.30%**	**1.50%**	**1.80%**
12 Month Libid	**1.30%**	**1.30%**	**1.30%**	**1.30%**	**1.40%**	**1.50%**	**1.70%**	**1.90%**	**2.10%**	**2.30%**	**2.60%**
5 yr PWLB Rate	**1.89%**	**1.50%**	**1.50%**	**1.50%**	**1.60%**	**1.70%**	**1.80%**	**1.90%**	**2.00%**	**2.10%**	**2.30%**
10 yr PWLB Rate	**2.91%**	**2.50%**	**2.50%**	**2.50%**	**2.60%**	**2.70%**	**2.80%**	**2.90%**	**3.00%**	**3.20%**	**3.30%**
25 yr PWLB Rate	**4.15%**	**3.70%**	**3.70%**	**3.70%**	**3.80%**	**3.80%**	**3.90%**	**4.00%**	**4.10%**	**4.20%**	**4.30%**
50 yr PWLB Rate	**4.32%**	**3.90%**	**3.90%**	**3.90%**	**4.00%**	**4.00%**	**4.10%**	**4.20%**	**4.30%**	**4.40%**	**4.50%**

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 17th February 2012. 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 a significant proportion of 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 There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

3.4 A full list of investments held as at 30 September 2012 are shown in Appendix A.

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

3.6 The average level of funds available for investment purposes during the quarter was £25.048m (£17.980m in previous quarter). 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
3 Month LIBID	0.60%	0.67%	£77,658

3.7 As illustrated above, the authority has outperformed the 3 month LIBID benchmark by 0.07 bp**.** It is anticipated that the budgeted investment return for the year of £0.100m will be overachieved. Our performance so far indicates that the figure will be overachieved by £0.127m.

Borrowing Strategy

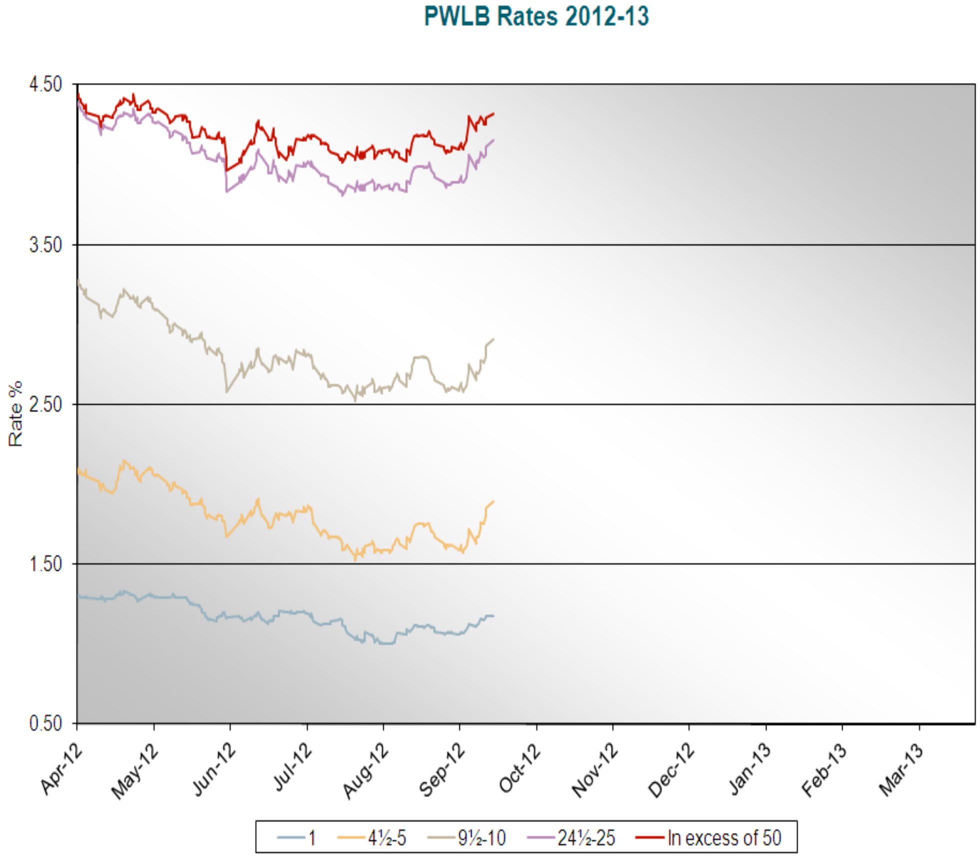
Prudential Indicators:

3.8 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.

3.9 A full list of the approved limits (as amended) are included in the Financial Performance Report 2012-2013, considered elsewhere on the agenda, which confirms that no breaches of the Prudential Indicators were made in the period to September 2012 and that there are no concerns that they will be breached during the financial year.

3.10 Total external borrowing as at 30 September 2012 stood at £28.637m, compared to a figure as at 30 June 2012 of £29.066m. No new borrowing was taken out during the quarter with an amount of £0.699m being repaid. No debt rescheduling was taken out during the quarter.

3.11 The graph and table below show the movement in PWLB rates for the first six months of the year (to 10.9.12): It is anticipated that internal borrowing and available grants will reduce the call on any further borrowing and therefore it is unlikely that any further borrowing will be undertaken this 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 second quarter report of the treasury management activities for 2012-2013. 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 anticipating that the investment returns will be greater than originally budgeted.

KEVIN WOODWARD
Treasurer

Investments as at 30th September 2012

% of total investments	Counterparty	Maximum to be invested (£m)	Total amount invested (£m)	Call or Term	Date if Term	Interest Rate
19.64%	Bank of Scotland	5.0	1.500	T	04/07/2013	3.00%
			1.500	T	04/07/2013	3.00%
			2.000	T	01/02/2013	2.00%
30.44%	Barclays	10.0	2.000	T	30/11/2012	1.24%
			1.750	T	07/12/2012	1.19%
			1.500	T	12/12/2012	0.52%
			2.500	T	16/10/2012	0.76%
19.64%	Ignis Money Market Fund	5.0	5.000	C		Variable
16.54%	Black Rock	5.0	4.210	C		Variable
5.89%	Nationwide B/S	1.5	1.500	T	29/11/2012	0.54%
7.86%	Local Authority	1.5	2.000	T	15/07/2013	0.34%
			25.460			