MEETING:	**AUDIT COMMITTEE**
DATE:	**27 SEPTEMBER 2010**
TITLE:	**TREASURY MANAGEMENT 2010/11 – MID YEAR REVIEW**
PURPOSE:	**CIPFA's Code of Practice recommends that a report on the Council's actual Treasury Management during the current financial year is produced.**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
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1. INTRODUCTION AND BACKGROUND

The Treasury Management Strategy for 2010/11 has been underpinned by the adoption of CIPFA's Code of Practice on Treasury Management, which includes the requirement for:

- 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.

On 29 March the Pensions Committee requested that the Pension Fund's surplus cash balances still be allowed to be pooled with the Council's general cashflow from 1 April 2010 onwards.

The Code of Practice recommends that members should be informed of Treasury Management activities at least twice a year. This report therefore ensures this authority as well as the Pension Fund is embracing Best Practice in accordance with CIPFA's recommendations. This review ensures that both the Council and the Pension Fund are embracing

2. THE ECONOMY AND EVENTS

The UK continued to emerge from recession but the level of activity remained well below pre-crisis levels. The recovery is as yet fragile and growth is likely to be slow. GDP registered just 0.3% growth in the first calendar quarter of 2010, but had risen to 1.1% during the second quarter.

Consumer price inflation remained well above the Bank of England's 2% target level, with a peak of 3.7% being reached in April. Year-on-year CPI for July 2010 was 3.1% and RPI was 4.8%. Temporary effects are thought to lie behind the elevated rate and inflation is expected to fall over the year due to downward pressure from spare capacity.

The Bank of England's Monetary Policy Committee maintained the Bank Rate at 0.5% and Quantitative Easing at £200bn.

The successful formation of a coalition government dispelled uncertainty surrounding a hung parliament result in May's General Election. The new government's Emergency Budget laid out tough action to address the UK's budget deficit, aiming to eliminate the structural deficit by 2014/15. This is to be achieved through austerity measures – £32bn of spending cuts and £8bn of net tax increases. The expected level of spending cuts and tax rises looks to be enough to extinguish the recent concern about inflation expectations. Therefore, 'rates lower for much longer' remained a relevant message.

The US Federal Reserve kept rates on hold at 0.25% and the European Central Bank maintained rates at 1%. The major ongoing worries in Europe extended from sovereign weakness, to sovereign and corporate debt in Portugal, Italy, Ireland, Greece and Spain, and the risk of contagion extending to other countries.

3. DEBT MANAGEMENT

DEBT	Balance on 01/04/2010 £000s	Less: Debt Maturing £000s	Less: Debt Repaid £000s	Add: New Borrowing £000s	Expected Balance on 30/09/2010 £000s	Decrease in Borrowing £000s
TOTAL BORROWING	**137,532**	4,587	14,118	0	**118,827**	18,705

Large Scale Voluntary Transfer – The Changes in the debt portfolio since 1 April have been as a result of the Council transferring its housing stock to Gwynedd Community Homes on the 12th April 2010. Following the transfer, a portion of the Council's PWLB debt portfolio was repaid on 15 April 2010. This included the repayment of 12% of each of the PWLB loans, (repayment of £14.118m), plus the associated net premium of £3.212m.

4. INVESTMENT ACTIVITY

The Guidance from the Welsh Assembly Government on Local Government Investments gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Investments

	Balance on 01/04/2010 £000s	Add: Investments Made £000s	Less: Investments Repaid £000s	Balance on 31/08/2010 £000s	Increase/ (Decrease) in Investments £000s
Investments in Banks & Building Societies	**55,510**	133,255	135,880	**52,885**	(2,625)
Investments in Money Market Funds	**4,000**	5,000	0	**9,000**	5,000
TOTAL INVESTMENTS	**59,510**	**138,255**	**135,880**	**61,885**	**2,375**

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2010/11. This restricted new investments to the following:

- the Debt Management Office
- Other Local Authorities
- AAA-rated Stable Net Asset Value Money Market Funds
- Deposits with UK Banks and Building Societies systemically important to the UK Banking System and which have minimum long-term ratings of 'A+' or equivalent from Fitch, Moody's and S&P
- Deposits with select non-UK Banks (Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US). These countries, and the Banks within them, have been selected after analysis and careful monitoring of:
    - Credit Ratings (minimum long-term counterparty rating of A+)
    - Credit Default Swaps
    - GDP; Net Debt as a Percentage of GDP
    - Sovereign Support Mechanisms /potential support from a well-resourced parent institution
    - Share Price

Counterparty Update

Following the challenging economic conditions facing Spain, concerns over the effect of rising debt funding costs, and the downgrade of Spain's sovereign rating to AA by Standard and Poor's, the Council has suspended deposits with the Spanish banks since 28 April 2010. The two Spanish banks on our list are Banco Bilbao Vizcaya Argenataria and Banco Santander, and to date they are still suspended.

Santander UK Plc is a wholly owned subsidiary of Banco Santander. It is however a UK incorporated bank with its own separate banking licence, and also remains a UK authorised institution. While ArlingClose our advisers do not have any outstanding credit concerns about Santander UK plc, they advised us on 28 April 2010, as a prudent measure to limit investments with Santander UK plc to one month. However, since then there has been an improvement in Banco Santander's creditworthiness indicators. On the 24 August, ArlingClose advised us that they believed a prudent increase in the maturity limit for Santander UK plc was warranted. As a result they advised us that the maturity limit for Santander UK plc should be increased from one month to six months. They are still monitoring the improvement in Santander UK plc's creditworthiness indicators, and if they are maintained over the next three months, they will reinstate the 12 month maturity limit. The last deposit we made with Santander UK plc matured on 31 March 2010.

The Council has no current investments with non-uk banks.

The Council's current counterparty list, as updated on 6 September 2010 is attached as information in Appendix A.

5. Compliance with Prudential Indicators

The Council can confirm that it has complied with the majority of its Prudential Indicators for 2010/11, which were set in February 2010 as part of the Council's Treasury Management Strategy Statement. Details can be found in Appendix B.

6. Outlook

At the time of writing this quarterly activity report in September 2010, the outlook for interest rates was as follows:

Official Bank Rate	Sep 2010	Dec 2010	Mar 2011	Jun 2011	Sep 2011	Dec 2011	Mar 2012	Jun 2012	Sep 2012	Dec 2012	Mar 2013
Upside Risk	-	-	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50
Central Case	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50	2.00	2.50	2.75
Downside Risk	-	-	-	-	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

The recovery in growth is likely to be slow and uneven.

The path of base rates reflects the fragile state of the recovering economy and the significantly greater fiscal tightening of the emergency budget. With growth and underlying inflation likely to remain subdued, the Bank will stick to its lower for longer stance on policy rates.

Gilts will remain volatile, more so in the election's aftermath.

The potential for downgrades to UK sovereign ratings has receded, but the negative outlook (S&P) will remain for now.

7. Summary

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first half of 2010/11. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

8. Other Information

WAG Investment Guidance – The revised guidance came into effect on 1st April 2010. The guidance reiterated the need to focus on security and liquidity, rather than yield. It also recommended that strategies include details of assessing credit risk, reasons for borrowing in advance of need and the use of treasury advisers.

PWLB Intraday Rate Setting – On 26th April 2010 the PWLB introduced twice daily rate settings at 9:30 and 12:30. This was set out in Circular 143. It was also announced that the DMO/PWLB plans to increase the number of regular intra-daily re-sets to three times a day in the near future. A further announcement on this is expected in due course.

APPENDIX A

GWYNEDD COUNCIL'S LIST OF AUTHORISED COUNTERPARTIES (as updated 06/09/10)

Term Deposits / Call Accounts

Country	Counterparty	Maximum Limit of Investments £m	Maximum Length of Loans
UK	DMADF, DMO	No limit	No limit
UK	UK Local Authorities	£10m	1 year
UK	**Santander (previously known as Abbey) Part of the Banco Santander Group**	**£20m**	**6 MONTHS**
UK	Bank of Scotland/Lloyds	£20m	**keep to 1 year**
UK	Barclays	£20m	**keep to 1 year**
UK	Clydesdale (part of the National Australia Bank Group)	£20m	**keep to 1 year**
UK	HSBC	£20m	**keep to 1 year**
UK	Nationwide	£20m	**keep to 1 year**
UK	Royal Bank of Scotland	£20m	**keep to 1 year**
Australia	Australia and NZ Banking Group	£5m	1 year
Australia	Commonwealth Bank of Australia	£5m	1 year
Australia	National Australia Bank Ltd (part of the National Australia Bank Group)	£5m	1 year
Australia	Westpac Banking Corp	£5m	1 year
Canada	Bank of Montreal	£5m	1 year
Canada	Bank of Nova Scotia	£5m	1 year
Canada	Canadian Imperial Bank of Commerce	£5m	1 year
Canada	Royal Bank of Canada	£5m	1 year
Canada	Toronto-Dominion Bank	£5m	1 year
Finland	Nordea Bank Finland	£5m	1 year
France	BNP Paribas	£5m	1 year
France	Calyon (Credit Agricole Group)	£5m	1 year
France	Credit Agricole SA	£5m	1 year
Germany	Deutsche Bank A	£5m	1 year
Netherlands	Rabobank	£5m	1 year
Spain	**Banco Bilbao Vizcaya Argentaria**	**£5m**	**Temporarily Suspended**
Spain	**Banco Santander SA (part of the Banco Santander Group)**	**£5m**	**Temporarily Suspended**
Switzerland	Credit Suisse	£5m	1 year
US	JP Morgan	£5m	1 year

1) **There is a limit of £20m on banks within the same banking group.**
2) **Investments in Non-UK banks will be restricted to a maximum limit of 40% of the portfolio, with a £10m country limit.**

Money Market Funds

Country	Counterparty	Maximum Limit of Investments £m	Maximum Length of Loans
UK/Ireland	BlackRock	£5m	Daily Liquidity
UK/Ireland	Henderson	£5m	Daily Liquidity
UK/Ireland	Invesco	£5m	Daily Liquidity
UK/Ireland	Prime-Rate	£5m	Daily Liquidity
UK/Ireland	Henderson	£5m	Daily Liquidity

APPENDIX B

Capital Financing Requirement

Estimates of the Council's cumulative maximum external borrowing requirement for 2010/11 to 2012/13 are shown in the table below:

	31/3/2010 Actual £000s	31/3/2011 Estimate £000s	31/3/2012 Estimate £000s	31/3/2013 Estimate £000s
Capital Financing Requirement	162.0	150.3	157.0	158.2
Less: Existing Profile of Borrowing and Other Long Term Liabilities	137.5	118.7	113.9	112.6
Cumulative Maximum External Borrowing Requirement	**24.5**	**31.6**	**43.1**	**45.6**

Balances and Reserves

Estimates of the Council's level of Balances and Reserves for 2010/11 to 2012/13 are as follows:

	31/3/2010 Actual £000s	31/3/2011 Estimate £000s	31/3/2012 Estimate £000s	31/3/2013 Estimate £000s
Balances and Reserves	**44,411**	**39,400**	**36,300**	**33,300**

Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Authorised Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Council's Authorised Borrowing Limit was set at £160m for 2010/11.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The Operational Boundary for 2010/11 was set at £135m.

There were no breaches to the Authorised Limit during the period to 30/09/10.

However, the operational boundary of £135m was breached between 1 April and 15 April 2010, when borrowing was £137.5m. This breach occurred as a result of the delay in the housing stock transfer. The strategy for 2010/11 was based on the assumption that the transfer would happen on 29 March 2010, and that £14.1m of the PWLB loans would have been repaid by 31 March 2010. Had this happened our borrowing on the 1 April would have been £123.4m and we would have been within the limit. Unfortunately as the transfer was delayed then we were inevitably over our limit until the transfer happened and the £14.1m debt was repaid on the 15 April and subsequently we have operated within the operational boundary as set.

(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2010/11 %
Upper Limit for Fixed Rate Exposure	100%
Compliance with Limits:	Yes
Upper Limit for Variable Rate Exposure	50%
Compliance with Limits:	Yes

(c) Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	**Upper Limit**	**Lower Limit**	**Estimated % Fixed Rate Borrowing as at 30/09/10**	**Compliance with Set Limits?**
under 12 months	25%	0%	3.72%	Yes
12 months and within 24 months	25%	0%	0.72%	Yes
24 months and within 5 years	50%	0%	16.20%	Yes
5 years and within 10 years	75%	0%	5.85%	Yes
10 years and above	100%	0%	73.51%	Yes

(d) Total principal sums invested for periods longer than 364 days

- This indicator allows the Council to manage the risk inherent in investments longer than 364 days.
- The limit for 2010/11 was set at £40m.
- The Council's policy is to keep investment maturities up to a maximum of 24 months. No investments were made for a period greater than 364 days during this period.