

MEETING: **PENSIONS COMMITTEE**

DATE: **25 NOVEMBER 2011**

TITLE: **TREASURY MANAGEMENT 2010/11**

PURPOSE: **CIPFA's Code of Practice requires that a report on the results of the Council's actual treasury management is produced.**

RECOMMENDATION: **RECEIVE THE REPORT FOR INFORMATION**

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1. Introduction and Background

CIPFA's revised Code of Practice on Treasury Management was adopted by the Council on 1st March 2011 and the Council fully complies with its requirements. The Code requires that I report on the results of the Council's actual treasury management in the previous financial year against that which was expected.

In accordance with the Welsh Assembly Government's Statutory Guidance on Local Government Investments, which requires an authority to produce an Annual Investment Strategy, it was considered best practice for the Gwynedd Pension Fund (the "Fund") to adopt Gwynedd Council's Treasury Management Strategy Statement (TMSS) for 2010/11, as amended for the purpose of the Pension Fund. The Pensions Committee approved the TMSS at its meeting on 29 March 2010. As a result, I am required to report on the results of the actual treasury management in 2010/11 against that which was expected. The report looks at:

- the economic background;
- investment activity.

2. Economic Background

At the time of determining the strategy for 2010/11, interest rates were expected to remain low in response to the fragile state of the UK economy. Spending cuts and tax increases seemed inevitable post the General Election. The outlook for growth was uncertain due to consumers and corporates trimming their spending and financial institutions exercising restraint in new lending.

The economy's two headline indicators moved in opposite directions – growth was lacklustre whilst inflation spiked sharply higher. The economy grew by just 1.3% in calendar year 2010; the forecast for 2011 was revised down to 1.7% by the Office of Budget Responsibility in March. Higher commodity, energy and food prices and the increase in VAT to 20% pushed the February 2011 annual inflation figure to 4.4%. The Bank Rate was held at 0.5% as the economy grappled with uneven growth and the austerity measures set out in the coalition government's Comprehensive Spending Review. Significant cuts were made to public expenditure, in particular local government funding.

The US Federal Reserve kept rates on hold at 0.25% following a slowdown in American growth. The European Central Bank maintained rates at 1%, with the markets expecting a rate rise in early Spring.

The credit crisis migrated from banks to European sovereigns. The ratings of Ireland and Portugal were downgraded to the ‘triple-B’ category whilst the rating of Greece was downgraded to sub-investment (or ‘junk’) grade. The sovereign rating of Spain was also downgraded but remained in the ‘double-A’ category.

During the year money market rates increased marginally at the shorter end (overnight to 3 months). 6 - 12 month rates increased between 0.25% to 0.30% over the 12 month period reflecting the expectation that the Bank Rate would be raised later in 2011.

3. Investment Activity

The Welsh Assembly Government’s (WAG’s) revised Investment Guidance came into effect on 1st April 2010 and 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.

Pension Fund Balances	Balance on 31/03/2010 £m	Balance on 31/03/2011 £m
Balances	8.9	8.0

Over the course of the year the pension fund’s balances ranged from £1.1m to £15.5m.

As requested by the Pensions Committee on 29 March 2010, the pension fund’s money was pooled with the Council’s general cashflow. The table below shows a summary of where this pooled money was invested.

Investments	Balance on 31/3/2010 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/03/2011 £m
Short Term Investments	55.5	305.8	323.2	38.1
Long Term Investments		25.0		25.0
Investments in Money Market Funds	4.0	5.0	4.0	5.0
TOTAL INVESTMENTS	59.5	335.8	327.2	68.1
Increase/ (Decrease) in Investments £m				8.6

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. Investments during the year included:

- Deposits with other Local Authorities;
- Investments in AAA-rated Money Market Funds;
- Call accounts and deposits with Banks and Building Societies systemically important to that country’s banking system (UK, Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US).

Credit Risk: Counterparty credit quality was assessed and monitored with reference to credit ratings (Council’s minimum long-term counterparty rating of A+ across all three rating agencies, Fitch, S&P and Moody’s); credit default swaps; GDP of the country in which the institution operates; the country’s net debt as a percentage of GDP; any potential support mechanisms and share price. Counterparty credit quality has progressively strengthened as demonstrated by the Credit Score Analysis summarised below. The table in Appendix 1 explains the credit score.

Date	Value Weighted Average Credit Risk Score	Value Weighted Average Credit Rating	Time Weighted Average Credit Risk Score	Time Weighted Average Credit Rating	Average Life (days)
31/03/2010	4.10	AA-	4.20	AA-	104
30/06/2010	4.08	AA-	4.24	AA-	43
30/09/2010	3.93	AA-	3.94	AA-	86
31/12/2010	3.88	AA-	4.15	AA-	169
31/03/2011	3.69	AA-	2.26	AA+	109

Liquidity: In keeping with the WAG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds, overnight deposits and the use of call accounts.

Yield: The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% through the year. Short term money market rates remained at very low levels which had a significant impact on investment income.

Update on our Investments with the Heritable Bank

Following guidance from CIPFA, issued in September 2010, and further developments within the financial year, the following is now known.

It is now expected that 85p/£ will be recovered overall. Repayments in 2010/11 were 6.27% in July, 4.14% in October and 4.72% in January. In total, 50.11% was repaid by 31 March 2011.

Credit Score Analysis

Scoring:

Long-Term Credit Rating	Score
AAA	1
AA+	2
AA	3
AA-	4
A+	5
A	6
A-	7
BBB+	8
BBB	9
BBB-	10
Not rated	11
BB	12
CCC	13
C	14
D	15

The value weighted average reflects the credit quality of investments according to the size of the deposit. The time weighted average reflects the credit quality of investments according to the maturity of the deposit.

The Council aims to achieve a score of 5 or lower, to reflect the Council's overriding priority of security of monies invested and the minimum credit rating of threshold of A+ for investment counterparties.