CITY OF PLYMOUTH

Subject:	Treasury Management Strategy 2011/12– Mid year Review
Committee:	Audit Committee
Date:	16 December 2011
Cabinet Member:	Councillor Bowyer
CMT Member:	Director for Corporate Support
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Ref:	djn/audit/071211
Part:	I

Executive Summary:

The Local Government Act 2003 requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. The Council's strategy for 2011/12 was approved by full Council at its budget meeting on 28 February 2011. This report provides an update on the progress and outcomes against the Treasury Management Strategy for the six month period ended 30 September 2011. It is a requirement of the CIPFA Code of Practice on Treasury Management that a full mid year report, as a minimum, should be presented to Full Council.

Corporate Plan 2011-2014:

Effective financial management is fundamental to the delivery of corporate improvement priorities. Treasury Management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is key factor in facilitating the delivery against a number of corporate priorities.

Implications for Medium Term Financial Plan and Resource Implications: Including finance, human, IT and land

Treasury Management affects the Council's budget in terms of borrowing costs and investment returns.

Other Implications: e.g. Section 17 Community Safety, Health and Safety, Risk Management, Equalities Impact Assessment, etc.

The current volatility and uncertainty within the global financial markets has had a substantial effect on Treasury Management activities. The risk in the Council's Investments and Loans will be constantly monitored and acted upon through the Treasury Management Board which meets weekly.

Recommendations & Reasons for recommended action:

1. The report be noted and presented to full Council in accordance with TMP 6

Alternative options considered and reasons for recommended action:

It is Statutory requirement under the Local Government Act 2003 and supporting Regulations to set a an annual treasury strategy for borrowing and prepare an annual investment strategy. Prudential indicators and the MRP policy must be approved by Full Cabinet.

Background papers:

- Treasury Management Strategy Report 2011/12 to Council 28 February 2011
- Treasury Management Practices update for 11-12 reported to Audit committee 27 June 2011
- Treasury Management budget working papers

Sign off:

Finance	Mc1112. 020	Legal	TH0036	HR	n/a	Corp Prop	n/a	IT	n/a	Strat Proc	n/a
Originating SMT Member Malcolm Coe											

Treasury Management Strategy Mid Year Review

1. Introduction

1.1 The Treasury Management Strategy for 2011/12 was approved by full Council at its meeting of the 28 February 2011. The Treasury Management Strategy has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

1.2 Treasury Management is defined as:

"The management of the local authority's investments and 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 responsibility for implementing and monitoring Treasury Management polices and practices and for the execution and administration of Treasury Management decisions is delegated by the Council to its Section 151 Officer – the Director for Corporate Support Services, and is overseen by a Treasury Management Board consisting of senior officers of the Council and the portfolio Member for Finance, Property, People and Governance.

1.4 The day to day operation of the treasury management activity is carried out in accordance with detailed Treasury Management Practices (TMP's). Updates to these practices for 11-12 were approved by the audit Committee on 27th June 2011.

1.5 The Council works closely with its treasury management advisors Arlingclose who assist the Council in formulating views on interest rates, regular updates on economic conditions and interest rate expectations, and advice on specific borrowing and investment decisions.

1.6 This report therefore provides an update on the Council's Treasury Management activity for the period ended 30th September 2011 together with performance against approved Treasury Management Prudential Indicators. In accordance with Treasury Management Practice (TMP) note 6, the report is required to be presented to full Council.

2. Economic Background

2.1 Before reviewing the Council's performance to date it is appropriate to outline the national and economic background within which Council Officers have operated during the first part of the year. The key financial issues are outlined below.

Growth: Global growth prospects deteriorated considerably over the six months to September, moving from an expectation of modest expansion to the risk of a double-dip recession. Q1 2011 GDP in the UK was 0.5% but was just 0.2% in Q2. Even economies like Germany's, which were hitherto seemingly strong, began to flounder with growth registering 0.1% in Q2.

Inflation: Inflation remained stubbornly high. Annual CPI for August was 4.5%; CPI had remained above MPC's 3% upper limit for 20 consecutive months and required the Bank of England's Governor to write his seventh open letter to the Chancellor. The Bank believed the elevated rate of inflation reflected the temporary impact of several factors: the increase in the VAT rate to 20%, past increases in global energy prices and import prices.

Employment / Consumer Confidence: Weakness persisted in the labour market. Job creation was unable to absorb the 90,000 quarterly growth in jobseekers, particularly those in the 16-20 age bracket. Unemployment on the ILO measure rose to 7.9%. High inflation trumping average earnings growth of only 2.9%, scarce availability of credit, stagnant house prices, all combined to lower disposable income, squeeze household spending power and leave consumer confidence fragile.

Central bankers' policies were driven by the feeble growth outlook rather than the upward trend in inflation. The Bank of England's August Inflation Report downgraded the growth forecast even as it acknowledged energy price rises could push CPI to 5% before inflation fell back to the 2% target over the medium-term. The UK's strategy of combining loose monetary policy (the Bank Rate had remained at 0.5% for 2½ years and Quantitative Easing at £200bn) with tight fiscal policy supported the rebalancing of the economy and also commanded support in the markets.

The protracted and unseemly political impasse to resolve the US debt ceiling issue turned a debate into a debacle. A lack of both political governance and measures to address the high debt burden (put off until after the 2012 presidential election), ultimately led Standard & Poor's to downgrade the US Sovereign from AAA to AA+. The country's weak economic and fiscal situation and an unemployment rate of 9.1% left the Federal Reserve little option but to commit to "exceptionally low" interest rates until mid 2013.

The European sovereign debt crisis deepened. The agreement in July to address Greece's fiscal problems and broaden the mandate for the European Financial Stability Facility (EFSF) only bought time for the Eurozone as market pressure increased on Italy and Spain, but did little to address the issue of overburdened sovereign balance sheets.

The European Banking Authority released the results of the second of its stress tests in July. 8 banks (two Greek, one Austrian and five small domestic Spanish banks) out of 91 banks failed the tests. All of the UK and non-UK banks tested by the EBA and which are on the Council's lending list met the 'stressed' Core Tier 1 Ratio of 5%, none were adjudged as 'near-failed'(i.e. having ratios between 5% and 6%).

Gilt yields and money market rates: The economic uncertainty resulted in analysts postponing the likelihood of an increase in the UK Bank Rate until mid 2012. Gilts were considered a safe haven and benefited from market turmoil. Gilt yields fell to their lowest levels in five years. 5-year gilt yields fell to 1.25%, 10-year yields to 2.2% and 20-year yields to 3.05%.

PWLB borrowing rates fell commensurately (the Board maintained the +0.90% margin above the equivalent gilt yield for new borrowing).

There was very little change to Libor and Libid rates as at 30/09/2011, the differential between 0.1% to 0.2% for maturities up to 12 months.

Money market data and PWLB rate movements over the first half of 2011/12 are attached as Appendix 1 to this report.

3. The Council's Strategy for 2011/12

3.1 The Council's Treasury Management Strategy was approved by full Council on 28th February 2011. As an overriding principle, the strategy proposed that in the current financial climate the Council would continue to minimise risk contained within its current debt and investment portfolios by establishing an integrated debt management and investment policy which balanced certainty and security, with liquidity and yield. The Council would continue to make use of short term variable rate borrowing, whilst at the same time seeking to balance its investments across a range of investment instruments.

3.2 Where possible the Council would continue to reduce the underlying level of long-term debt with the borrowing strategy for 2011/12 to meet the capital financing requirement from short-term fixed rate borrowing or variable rate borrowing where rates were lower than those available to the Council on its investments. Where borrowing rates were higher than investment rates internal resources would be used in lieu of borrowing with borrowing only taken to cover short-term cash flow requirements. Capital expenditure levels, market conditions and interest rate levels would be monitored during the year in order to minimise borrowing costs over the medium to longer term.

4. Review of the Council's Performance April – September 2011

4.1 Table 1 shows the Council's overall treasury portfolio at 30th September 2011 compared to the position at the start of the year.

Table 1

01/04/2011 £m	Average Interest rate %		30/9/2011 £m	Average Interest rate %
		External Borrowing Long-term:		
61.315	5.4001	PWLB	61.315	5.4001
130.000	4.4202	Market	130.000	4.4202
0.083	1.1660	Bonds	0.083	1.1660
94.985	0.4801	Temporary Borrowing	22.200	0.3025
286.383	**3.3222**	**Total PCC Borrowing**	**213.598**	**4.2782**
		Long-term liabilities		
31.753	8.7300	PFI Schemes	31.753	8.7300
3.263	n/a	Finance Leases	3.263	n/a
321.399		**Total External Debt**	**248.614**	
(165.801)	1.5871	**Total Investments**	**(95.930)**	1.7551
155.598		**Net Borrowing/(Net Investment) Position**	**152.684**	

Borrowing

4.2 Under Section 3 of the Local Government Act 2003 and supporting regulations the Council must determine and keep under review how much it can afford to borrow. The Council is required to set two limits:

- The Authorised Limit
- The Operational Boundary

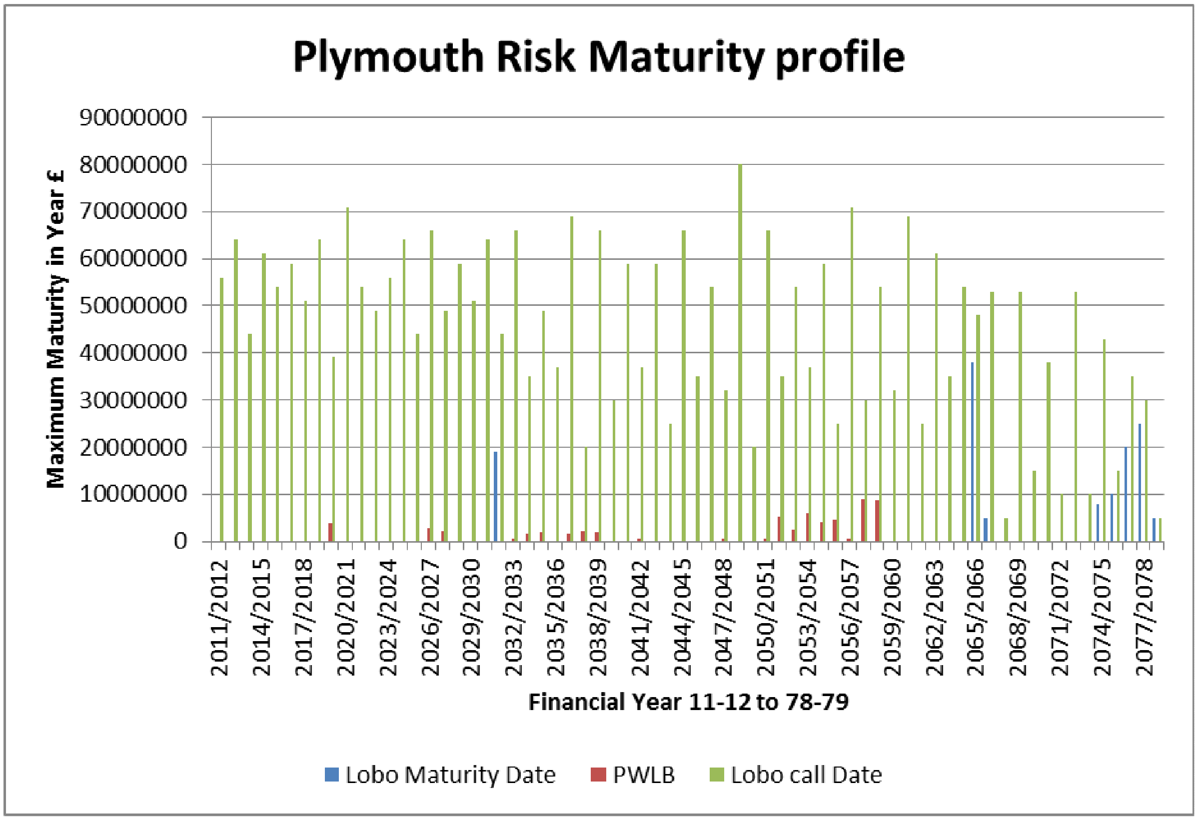
4.3 The external debt limits for 2010/11, as approved by Council in February 2011, are as follows:

- Authorised limits £368m
- Operational Boundary £343m

4.4 The maximum borrowing outstanding during the period was £327.4m on 11th April 2011 (including £36.419m for the PFI scheme and finance leases). This was within both the authorised limit and the operational boundary. At 30th September 2011 total external debt had fallen to £248.6m with external borrowing excluding PFI and Finance leases at £213.6m due to the strategy to reduce short-term borrowing and call account deposits to reduce credit risk resulting from the Eurozone debt crisis.

4.5 The following graph shows the maturity profile of the Council's external debt:

Figure 1



4.6 The debt portfolio currently includes £130m of LOBO loans. These loans have various option call dates where the banks have the ability to amend the loan terms and at which point the Council could choose to repay the loan if the terms are changed adversely. This is reflected within the maturity profile shown above (in green) to enable officers to risk manage the Council's cashflows. To 30th September 2011 £34m of loans had reached their call option dates. No options were exercised and these loans will continue at fixed rates until the next option dates in 2 to 5 years time.

4.7 Table 2 shows the movement in the borrowing portfolio during the year.

Table 2

	Balance on 01/04/2011 £000s	**Debt Maturing £000s**	**Debt Repaid £000s**	**New Borrowing £000s**	**Balance on 30/09/2011 £000s**	**Increase/ (Decrease) in Borrowing**
Short Term Borrowing	94,985	(635,345)	0	562,560	22,200	(72,785)
Long Term Borrowing	191,398	0	0	0	191,398	0
TOTAL BORROWING	**286,383**	**(635,345)**	**0**	**562,560**	**213.598**	**(72,785)**

4.8 New borrowing in year

The use of short-term borrowing has been the most cost effective means of financing of capital expenditure and cashflow requirements. By matching any short-term borrowing with the available of liquid deposits held in bank call accounts this has lowered overall treasury risk by allowing flexibility of reducing debt and investment levels at short notice when credit conditions deteriorated.

The Council started the year with £94.985m of short–term loans with £635.345m of new loans taken and £562.560m of loans maturing in 11/12. The average period of new loans taken in the period 1st April 2011 to 30th September 2011 was 24.5 days at an average rate of 0.3661% which mitigate the impact of changes in variable rates on the Council's overall treasury portfolio (the Council's investments are deemed to be variable rate investments due to their short-term nature). Short-term fixed/variable rate borrowing is expected to remain attractive for some time as the Bank of England maintains the base rate at historically low levels. However with credit conditions deteriating with sovereign debt problems in the Eurozone the strategy has changed to a greater emphasis on internal borrowing reducing external borrowing and investments further reducing the credit risk of the Council's investment portfolio. This strategy will be constantly reviewed reacting to any changes in credit conditions.

4.9 Debt Rescheduling

There has been no debt rescheduling in the period due to falling interest rates making the repayment of any PWLB loans more expensive. Officers along with our advisers Arlingclose will monitor PWLB interest rates looking for opportunities to repay any debt maximising the savings achieved whilst maintaining a balances maturity profile.

4.10 Overall Debt performance for the first part of the year

All new debt taken in 11-12 has been in short-term borrowing to meet cashflow/capital financing requirements. Over the period total loan debt has reduced by £72.785m as a result of a reduction in short-term borrowing to reduce credit risk in the first half of the year increasing internal borrowing. The reduction in short-term borrowing has resulted in an increase in the average rate on external borrowing from 3.322% on 1st April 2011to 4.2872% on 30th September 2011.

Investment Activity

4.11 Managing Investment Risk

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

4.11.2 Security of capital remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2011/12. This restricted new investments to the following:

- Deposits with the Debt Management Office (DMADF)
- Treasury Bills
- Other Local Authorities
- AAA-rated Stable Net Asset Value Money Market Funds (not currently in use)
- Deposits with UK Banks and Building Societies systemically important to the UK banking system and deposits with select non-UK Banks (Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the USA). Counterparty credit quality is 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; Sovereign Support Mechanisms /potential support from a well-resourced parent institution; Share Price.
- Bonds issued by Multilateral Development Banks, such as the European Investment Bank (not currently in use).

4.11.3 Figure 2 below shows the split of split of deposits over country/sector as at 30 September 2011. In terms of risk management, the majority of the investment portfolio is now held in UK institutions. These institutions are of systemic importance to the UK economy and as such would in probability receive state support should they have difficulty in operating due to adverse credit conditions. Table 3 provides more detail of the actual deposits by counterparty group.

Figure 2

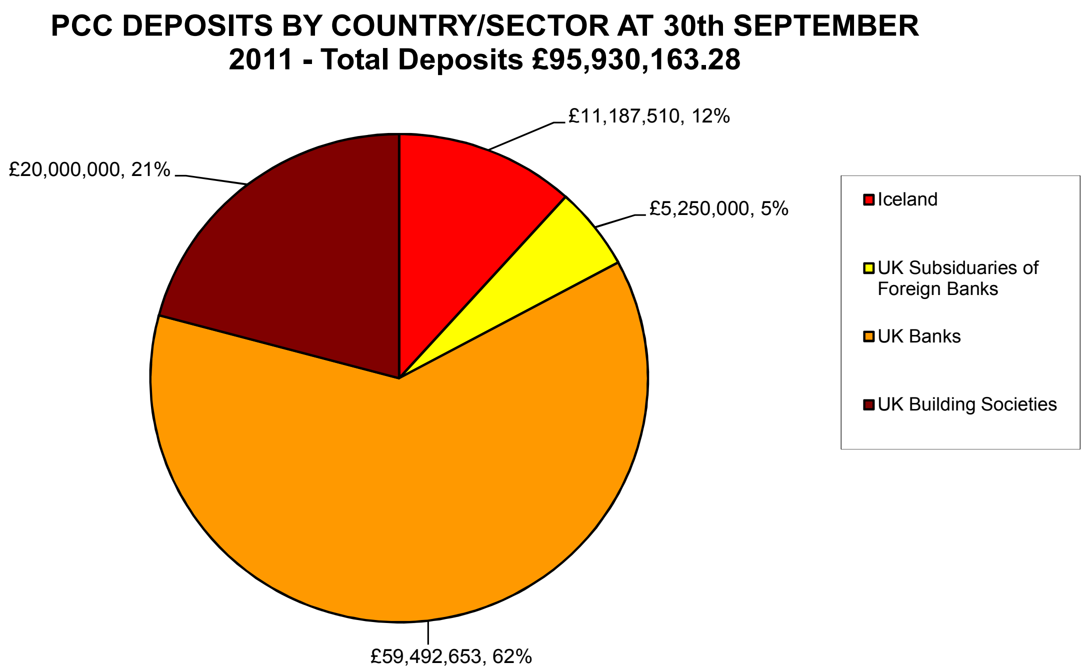
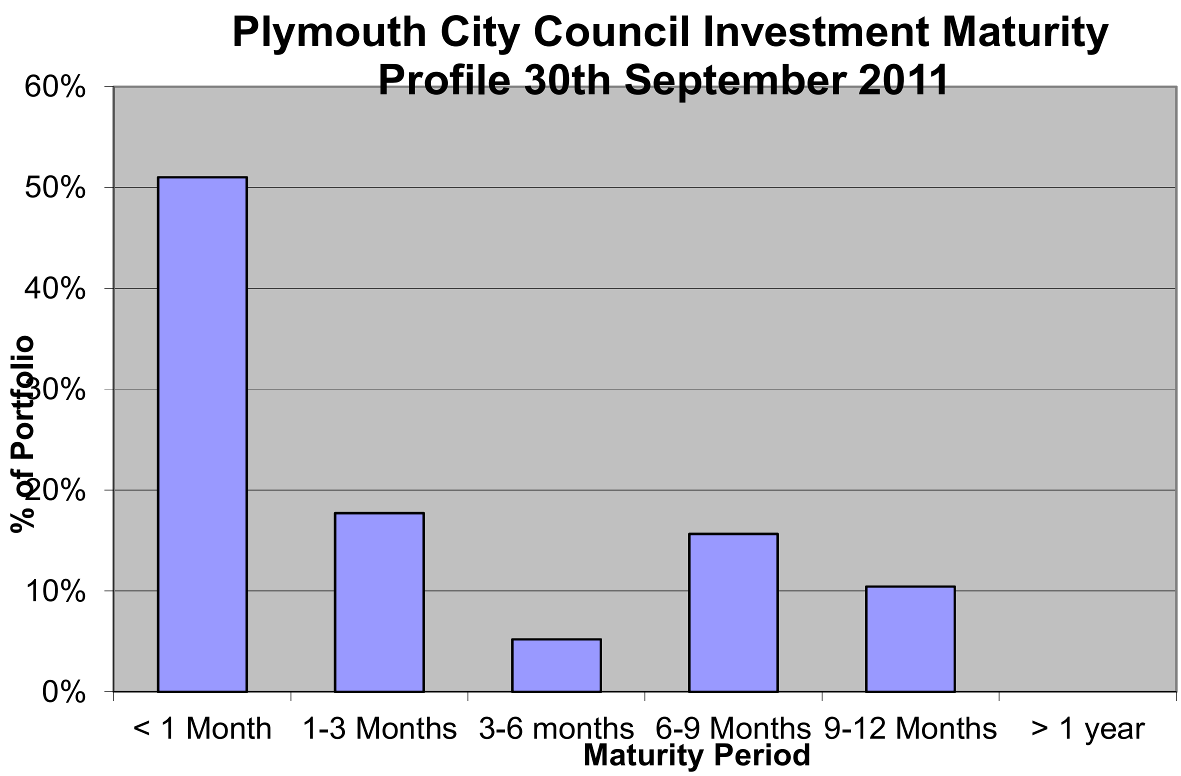


Table 3

Counter party	Total
	£m
Iceland	11.187
Banco Santander	
Santander UK (was Abbey National)	5.250
Lloyds Banking Group	
Bank of Scotland	20.000
Barclays	9.500
Royal Bank of Scotland (RBS)	
RBS	24.993
Ulster Bank	5.000
Nationwide	20.000
Total	**95.930**

4.11.4 The maturity profile of the Councils deposits is represented in figure 3. This shows a large proportion of deposits maturing in less than one month reflecting the deposits in call accounts giving the liquidity requirement to meet cashflow requirements and the ability to react to further adverse changes in market conditions.

Figure 3



4.12 Icelandic Bank Update

4.12.1 The Council continues to receive regular dividend payments in respect of its investment in Heritable bank with the following dividends received in the period April – September 2011:

	Principal £000	Interest £000	Total £000
April 2011	187	10	197
July 2011	122	6	128

Further, we can confirm the receipt of the next dividend at the end of October 2011:

October 2011	126	6	132

This brings the total amount recovered to date to £2.037m (64.6%)

4.12.2 Investments in Landsbanki (£4m) and Glitnir (£6m) remain subject to court proceedings. The Council is expecting its claim to be heard by the Icelandic Courts in September 2011, with a decision likely either late October or early

November 2011. If the outcome is known after publication of this report, an update will be given in a timely manner to Council as appropriate.

Based on the test case hearings, the Council is hopeful that its claims will receive priority creditor status and 100% of monies in Glitnir will be recovered, with recovery of money in Landsbanki at 95%.

The Council continues to work with Bevan Brittan solicitors and the LGA continues to actively pursue the recovery of its total investments.

4.13 Credit Risk

4.13.1 The Treasury Management Strategy report to Audit Committee in February 2010 outlined a recommendation that Officers work to develop a set of benchmarking criteria against which the Council's investment risk could be measured. The Council's treasury advisors, Arlingclose, as a result developed the following matrix to score the credit risk of an authority's investment portfolio. This continues to be used in 11-12:

Scoring:
-Value weighted average reflects the credit quality of investments according to the size of the deposit
-Time weighted average reflects the credit quality of investments according to the maturity of the deposit
-AAA = highest credit quality = 1
- D = lowest credit quality = 15
-Aim = A+ or higher credit rating, with a score of 5 or lower, to reflect current investment approach with main focus on security

4.13.2 Table 3 shows the rating currently attached to the Council's portfolio and its movement during the year.

Table 3

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/2011	4.20	AA-	4.75	A+
30/06/2011	4.24	AA-	4.58	A+
30/09/2011	4.37	AA-	4.68	A+

Note: These scores exclude any deposits with Icelandic banks.

Based on the scoring methodology, the Council's Counterparty credit quality has been largely maintained throughout the year with the Council reacting to rating downgrades by reducing deposits and suspending counterparties from the council's lending list.

4.13.3 Arlingclose have used the scoring matrix to compare Plymouth's investment risk against other unitary authorities who use Arlingclose as their advisors. The results are shown in section 5.

4.14 Counterparty Update

4.14.1 Maturity Limits

The lack of real progress in resolving the sovereign debt crisis in Europe began to affect even the stronger Eurozone nations and their banking systems. Market volatility, as measured by the VIX index, spiked sharply in August, banks' share prices fell sharply. Having reviewed all credit indicators the Council, advised by Arlingclose, believed that there were no solvency issues with the banks on the recommended lending list. Nevertheless the share price moves were too sharp to ignore and a prudent response to the tensions and negativity in the markets was required.

The Council responded to the growing stress by scaling back maturities for new investments on the advice of the Council's treasury advisors. Limits for UK banks, Nationwide BS and Australian, Canadian and US banks were reduced to 6 months (Santander UK plc restricted to 3 months). Limits for European banks were reduced to 1 month. French institutions were suspended for new investments in response to concerns over funding and their sovereign exposure to peripheral European nations.

4.14.2 On 28th September Clydesdale Bank was suspended from the lending list following the bank's downgrade to A2 by Moody's, which falls below the Council's minimum criteria of A+ or equivalent. All previously held deposits with Clydesdale were held in call/notice accounts and these were withdrawn fallowing the rating downgrade. At 30th September 2011 the Council had no deposits with Clydesdale Bank.

4.15 Investment activity during the year

4.15.1 Investments are made short term to cover cash flow and liquidity requirements and longer term to maximise and guarantee future income. In line with our investment strategy for 2011/12 the following longer term deposits were taken in the period 1t April 2011 to 30 September 2011.

Amount	Start Date	End Date	Term (days)	Rate %
£1.0m	15/04/11	14/10/11	182	1.42

£1.0m	09/05/11	09/11/11	184	1.41
£5.0m	13/05/11	27/07/12	441	2.65
£5.0m	02/06/11	02/12/11	183	1.03
£5.0m	02/06/11	31/05/12	364	1.41
£1.0m	08/06/11	08/12/11	183	1.41
£5.0m	14/06/11	12/06/12	364	1.53
£5.0m	04/08/11	06/02/12	186	1.04
£5.0m	04/08/11	02/08/12	364	1.42

4.15.2 The above deposits have been taken above target rates and increased the forecast return on investments in 2011/12. However current market conditions continue to put pressure on the Council's treasury management activity. In line with cash flow requirements to year end deposits for the remainder of the year will be made in shorter period maturities and call accounts at rates below target.

5. Benchmarking

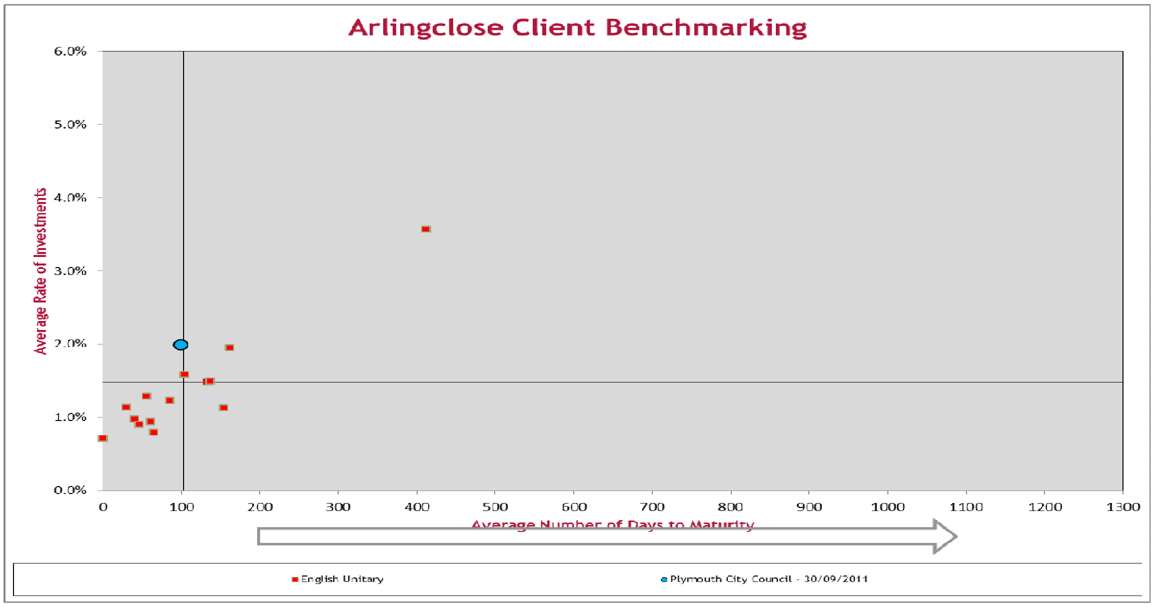
5.1 The Council's performance on investments is measured against a benchmark of the 7 day libid rate. For the period to 30 September 2011 the return on investments made in 2011/12 was 1.0379% against the average 7 day Libid for the period of 0.533%. Including investment made in previous years at higher rates the average return on all deposits taken to 30 September 2011 was 2.0181%.

5.2 As outlined above, Arlingclose have developed a set of benchmarking criteria to enable comparisons on performance to be made on data provided by all their clients. To compare like with like the following graphs compare our performance with other Unitary authorities. This is based on data provided to 30 September 2011.

The 4 graphs used for comparison are:

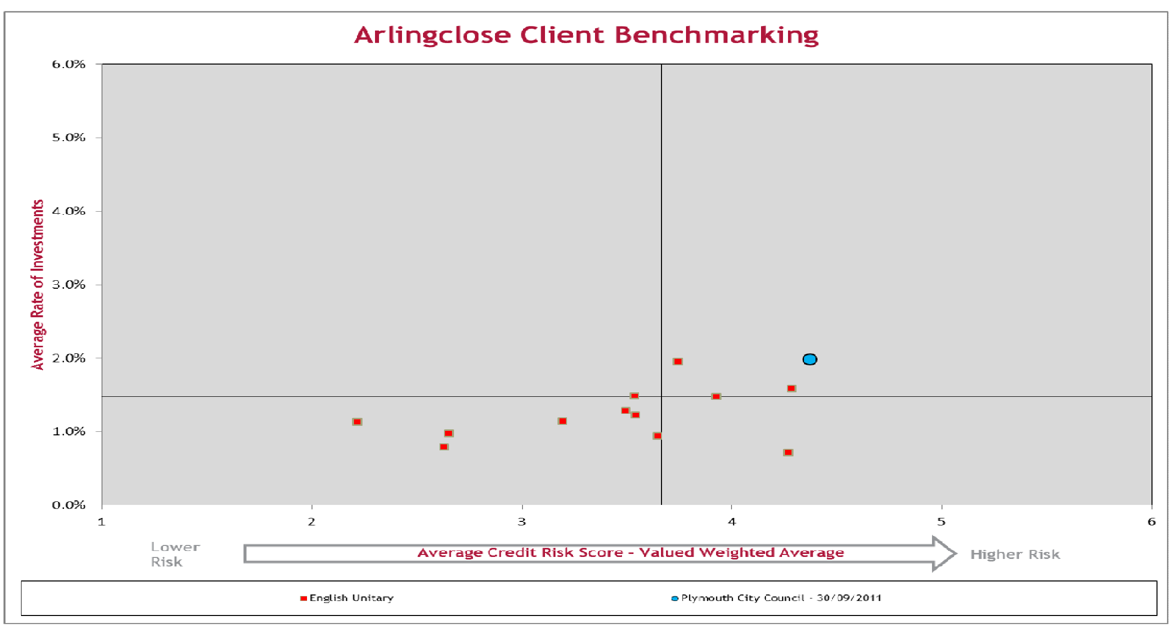
1. Average rate of investment against average maturity period
2. Average rate of investment against value weighted average credit risk score
3. Average rate of investment against time weighted average credit risk score

Graph 1 Average Number of days to Maturity V Return



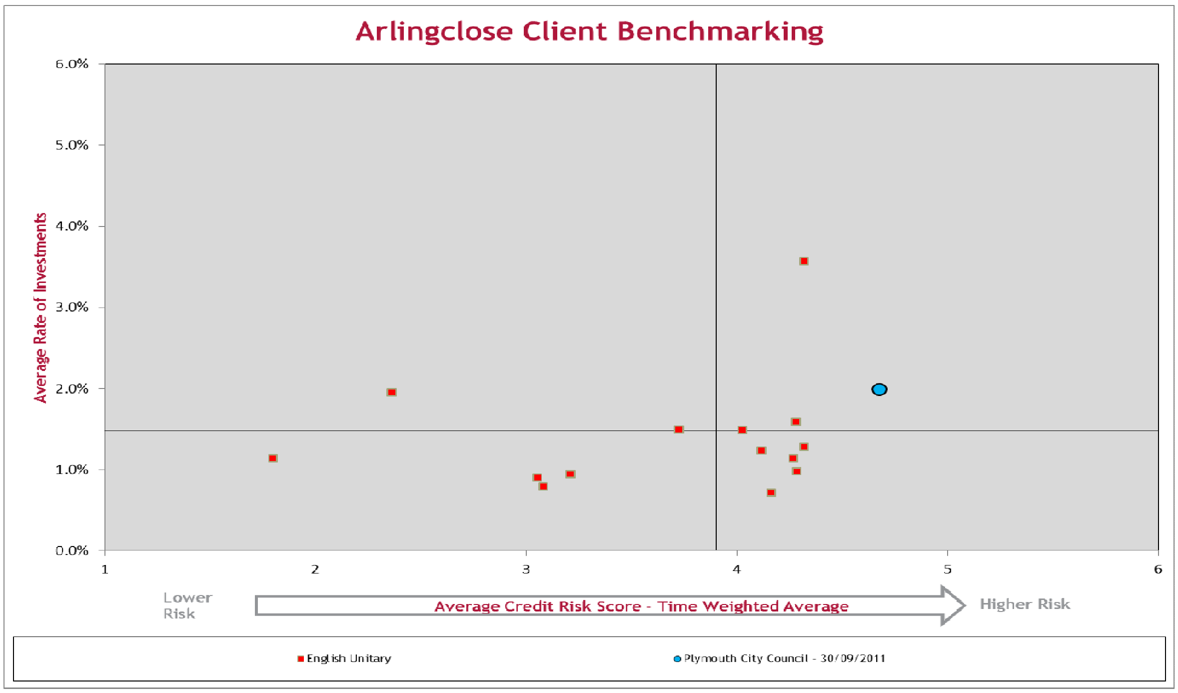
This graph shows the duration of investments against return. It shows the Council's investments have performed well against other unitary authorities reflecting the higher rates negotiated on call accounts and the legacy investments in Ulster Bank (a subsidiary of the RBS group) which are high rate but due to mature in the next few months.

Graph 2. Value Weighted Average V Return



As a general rule to aim should be to convert a grater average length of portfolio duration into a greater than average return. There should be a positive correlation between duration and return. However this chart should not be viewed in isolation from other measured parameters and it should be noted that a high average number of days to maturity does not necessarily mean a higher risk, in fact the reverse may be considered true in some cases. As can be seen from the above graph Plymouth City council are converting duration into a higher return than the majority of our peer group..

Graph 3 Time weighted Average V Return



Longer term investments with banks are inherently more risky. Ideally authorities should move towards the top left hand corner of the above graph. Therefore it is preferable to see risk taken converted into return at a greater than average rate. This should be seen as a longer term goal within Plymouth city council's portfolio which is currently affected by a number of rating downgrades ion legacy investments increasing the credit risk score. This is the case with our Ulster Bank deposits where the rating has been lowered but there are still see as an important bank within the RBS group which is 84% owned by the UK taxpayer.

6. Revenue Implications of Treasury Management

6.1 The expenditure arising from the Council's borrowing and lending accrues to the revenue accounts. This includes interest payable and receivable, the minimum revenue provision (for debt repayment), and premiums and discounts written out to revenue from previous debt rescheduling. Some of the interest receivable is passed on to specific accounts where this interest has accrued from the investment of surplus balances for these services. The balance (net cost) is met by the General Fund. The table below shows the monitoring positions against budget arising from these transactions in 2010/11 to 30 September 2010. Due to the reduction in higher interest fixed- term deposits and the increased use of internal borrowing as an alternative to lower rate short-term borrowing

Summary of Capital Financing Costs 2010/11

	2011/12 Budget £000	**Forecast 2010/11 Outturn £000**	**Variance £000**
External Interest payments	8,871	9,188	317
External Interest received	(1,743)	(1,657)	86
Interest transferred to other accounts	200	220	20
Premiums / Discounts written out to Revenue	(189)	(189)	0
Debt Management Expenses	130	130	0
Treasury Management Cost	**7,269**	**7,692**	**423**
Minimum Revenue Provision	7,285	7,018	(267)
Recharges for unsupported borrowing	(1,588)	(1.508)	80
Recovered from trading Accounts	(3,331)	(3,331)	0
Net Cost to General Fund	**9,635**	**9,871**	**236**

7 Compliance with Prudential Indicators

7.1 Under the arrangements set out in the Prudential Code for Capital Finance in Local Authorities, individual authorities are responsible for deciding the level of their affordable borrowing, having regard to the Code, and for establishing a range of prudential indicators covering borrowing limits and other treasury management measures. The prudential Indicators for 2010/11 were approved by Council on 28th February 2011.

The performance to 30 September 2011 against these limits are set out below:

(a) Authorised Limit and Operational Boundary for External Debt

- The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. It is measured on a daily basis against all external borrowing items on the balance sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). It is consistent with the Council's existing commitments, its proposal for capital expenditure and its approved treasury management policy/strategy.

- The Council's Affordable (Authorised) Borrowing Limit was set at £368m for 2011/12 including a limit for other long term liabilities of £31m to cover PFI.

- 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. It is a focus for the day to day Treasury Management and a means by which the authority manages its external debt within the self imposed Authorised limit. The operational Boundary may be breached at certain times during the year due to short-term cashflow requirements

- The Operational Boundary for 2011/12 was set at £343m.

- There were no breaches to the Authorised Limit or Operational Boundary to 30th September 2011 with the total external debt (including PFi and finance leases) reaching its maximum level of £325.96m.

(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	200
Maximum exposure in 11-12	222.91
Compliance with Limits:	No
Upper Limit for Variable Rate Exposure	85
Maximum exposure in 10-11	-12.82
Compliance with Limits:	Yes

For 5 days in during June and July the upper limit for fixed rate exposure exceeded the 200% limit. This was due to cashflow receipts increasing balances held in call accounts reducing net variable debt and increasing the proportion held in net fixed rate debt. This was also a consequence of reducing the maturity period of deposits. By the end of September the exposure to net fixed rate date had fallen back to 141.34% with net variable rate debt at -41.34%, both well within the limits set.

(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. And is designed to protect against excessive exposure to interest rate changes.

- It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment. The repayment of the majority of PWLB loans over the last 2 years has resulted in a high proportion of Lobo (lenders Option, Borrowers Option) loans which may be subject to rate change or repayment at specified intervals. On specified dates the Lender has the option to vary the rate. If the option is taken the Council (Borrower) has the option to repay the loan. Therefore the loan may be subject to repayment on a number of occasions throughout the life of the loan. These repayment possibilities are included in the limits set for the maturity of fixed rate borrowing and the monitoring of actuals against these limits. The following table shows the performance against limits during the year.

Maturity Structure of Fixed Rate Borrowing	**Upper Limit %**	**Lower Limit %**	**Highest % of Actual Fixed Rate Borrowing during 11-12**	**Lowest % of Actual Fixed Rate Borrowing during 11-12**	**Compliance with Set Limits?**
under 12 months	50	0	26.69	13.11	Yes
12 months and within 24 months	70	0	48.59	33.44	Yes
24 months and within 5 years	35	0	15.15	5.22	Yes
5 years and within 10 years	25	0	4.56	1.94	Yes
10 years and within 20 years	25	0	2.50	2.50	Yes
20 years and with 30 years	25	0	5.37	5.37	Yes
30 years and within 40 years	25	0	0.72	0.72	Yes
40 years and within 50 years	30	0	21.50	21.50	Yes
50 tears and above	50	0	0	0	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 2011/12 was set at £25m.
- The Council's strategy for 11-12 started with maximum deposit maturity limits out to 2 years policy. However due to adverse changes in credit conditions only one deposit was made for more than 12 months in the period to 30th September 2011. On 1st April 2011 deposits with maturity periods greater than 364 days was at a peak for the year of £5m due to deposits taken in previous years with in excess of 12 months left to maturity. As these maturities fell below 12 months a £5m deposit was taken with Bank of Scotland for 441 days bringing the level of deposits invested for periods longer than 364 days back up to £5m.

7. Outlook for Q3-Q4

7.1 At the time of writing this activity report in November 2011, the outlook for interest rates was as follows:

	Dec-10	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Official Bank Rate													
Upside risk	-	-	-	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.50	1.75	1.75
Central case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	-	-	-	-	-	-	-	-	-	-	-	-	-

- Momentum in economic growth is scarce.

- Conventional monetary policy has become largely redundant; the Bank of England and the US Federal Reserve have signaled their respective official interest rates will be on hold through to end of 2012. It could be 2016 before official interest rates rise putting pressure on investment returns over the next five years.

- The bank of England's Monetary Policy committee has returned to unconventional monetary policy and embarked on a further round of Quantitative easing. It is likely that there will be more to come. Gilts will remain volatile as the growth versus headline inflation debate escalates.

9. Summary

9.1 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 2011/12. As indicated in this report the only Prudential Indicator to have been breached in the period was the fixed rate exposure limit due to the impact of peaks in cashflow receipts invested in call accounts. A prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

Appendix 1

Money Market Data and PWLB Rates

The average, low and high rates correspond to the rates during the financial year and rather than those in the tables below

Table 1: Bank Rate, Money Market Rates

Date		Bank Rate		O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
01/04/2011		0.50		0.40	0.54	0.54	0.69	1.12	1.59	1.89	2.36	3.00
30/04/2011		0.50		0.50	0.40	0.49	0.69	1.05	1.52	1.62	2.07	2.74
31/05/2011		0.50		0.40	0.40	0.52	0.69	1.08	1.56	1.53	1.89	2.54
30/06/2011		0.50		0.50	0.40	0.50	0.77	1.06	1.54	1.44	1.82	2.50
30/07/2011		0.50		0.40	0.40	0.50	0.78	1.07	1.55	1.29	1.53	2.09
31/08/2011		0.50		0.40	0.40	0.56	0.86	1.15	1.63	1.27	1.43	1.92
30/09/2011		0.50		0.60	0.60	0.54	0.92	1.21	1.69	1.25	1.38	1.75
Average		**0.50**		0.41	0.43	0.53	0.77	1.10	1.58	1.42	1.71	2.29
Maximum		**0.50**		0.60	0.60	0.58	0.92	1.21	1.69	1.95	2.42	3.07
Minimum		**0.50**		0.40	0.35	0.49	0.68	1.01	1.40	1.08	1.23	1.60
Spread		**0.00**		0.20	0.25	0.09	0.24	0.20	0.29	0.87	1.19	1.46

Table 2: PWLB Borrowing Rates – Fixed Rate, Maturity Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2011	128/11	1.93	3.66	4.81	5.33	5.35	5.31	5.28
28/04/2011	162/11	1.73	3.45	4.61	5.18	5.21	5.17	5.14
31/05/2011	202/11	1.64	3.21	4.43	5.08	5.12	5.09	5.07
30/06/2011	246/11	1.61	3.09	4.42	5.17	5.21	5.20	5.18
29/07/2011	288/11	1.52	2.75	4.06	4.97	5.07	5.06	5.04
31/08/2011	332/11	1.48	2.50	3.71	4.66	4.84	4.87	4.85
30/09/2011	375/11	1.49	2.41	3.49	4.36	4.62	4.70	4.70
	Low	1.42	2.18	3.31	4.24	4.49	4.55	4.54
	Average	1.59	2.92	4.15	4.94	5.04	5.04	5.01
	High	1.97	3.73	4.89	5.41	5.42	5.39	5.35

Table 3: PWLB Repayment Rates - Fixed Rate, Maturity Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2011	128/11	0.82	2.37	3.62	4.21	4.24	4.16	4.10
28/04/2011	162/11	0.62	2.16	3.42	4.06	4.10	4.02	3.96
31/05/2011	202/11	0.53	1.93	3.23	3.97	4.01	3.94	3.90
30/06/2011	246/11	0.50	1.80	3.22	4.05	4.10	4.05	4.01
29/07/2011	288/11	0.41	1.48	2.86	3.84	3.95	3.91	3.87
31/08/2011	332/11	0.37	1.25	2.50	3.53	3.73	3.72	3.68
30/09/2011	375/11	0.38	1.17	2.30	3.23	3.51	3.55	3.53
	Low	0.31	0.95	2.10	3.10	3.37	3.40	3.37
	Average	0.48	1.65	2.95	3.82	3.93	3.89	3.84
	High	0.86	2.44	3.71	4.29	4.31	4.23	4.18

Table 4: PWLB Borrowing Rates – Fixed Rate, Equal Instalment of Principal (EIP) Loans

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2011	128/11	2.76	3.74	4.84	5.22	5.33	5.36
28/04/2011	162/11	2.55	3.53	4.64	5.05	5.18	5.22
31/05/2011	202/11	2.37	3.30	4.46	4.93	5.09	5.12
30/06/2011	246/11	2.25	3.17	4.46	4.99	5.17	5.22
29/07/2011	288/11	2.01	2.83	4.11	4.73	4.97	5.06
31/08/2011	332/11	1.88	2.57	3.75	4.38	4.67	4.80
30/09/2011	375/11	1.84	2.48	3.53	4.08	4.37	4.54
	Low	1.67	2.24	3.35	3.93	4.25	4.41
	Average	2.17	3.00	4.19	4.73	4.95	5.02
	High	2.82	3.82	4.92	5.30	5.41	5.44

Table 5: PWLB Repayment Rates – Equal Instalment of Principal (EIP) Loans

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2011	128/11	1.54	2.55	3.70	4.10	4.22	4.25
28/04/2011	162/11	1.33	2.34	3.50	3.91	4.07	4.11
31/05/2011	202/11	1.16	2.10	3.32	3.81	3.97	4.01
30/06/2011	246/11	1.04	1.98	3.31	3.87	4.06	4.11
29/07/2011	288/11	0.82	1.64	2.95	3.60	3.86	3.94
31/08/2011	332/11	0.70	1.39	2.60	3.25	3.55	3.68
30/09/2011	375/11	0.67	1.30	2.38	2.95	3.25	3.42
	Low	0.51	1.07	2.20	2.80	3.13	3.30
	Average	0.97	1.81	3.04	3.60	3.83	3.91
	High	1.59	2.62	3.78	4.18	4.30	4.33

Table 6: PWLB Variable Rates

	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR	**Pre-CSR**	**Pre-CSR**	**Post-CSR**	**Post-CSR**	**Post-CSR**
01/04/2011	0.67	0.77	0.89	1.57	1.67	1.79
28/04/2011	0.67	0.71	0.79	1.57	1.61	1.69
31/05/2011	0.66	0.70	0.76	1.56	1.60	1.66
30/06/2011	0.65	0.68	0.71	1.55	1.58	1.61
30/07/2011	0.65	0.67	0.69	1.55	1.57	1.59
31/08/2011	0.65	0.66	0.68	1.55	1.56	1.58
30/09/2011	0.65	0.65	0.66	1.55	1.55	1.56
Low	0.65	0.65	0.65	1.55	1.55	1.55
Average	0.66	0.69	0.72	1.56	1.59	1.62
High	0.69	0.79	0.91	1.59	1.69	1.81