AUDIT COMMITTEE – 8 FEBRUARY 2013

E

TREASURY MANAGEMENT PERFORMANCE REPORT – 1 APRIL 2012 TO 31 DECEMBER 2012

1. INTRODUCTION

1.1 This is one of the regular reports on the Council's borrowing and investment activities that are submitted in accordance with the Treasury Management Code of Practice which the Council has adopted and applies its principles to all investment activity.

1.2 This report covers the period 1 April 2012 to 31 December 2012 for the Council's treasury management activities.

1.3 A glossary is attached as Appendix 1.

2. STRATEGY FOR 2012/13

2.1 The Council approved the Treasury Management Strategy for 2012/13 in February 2012. This strategy is monitored by Council Staff on a daily basis.

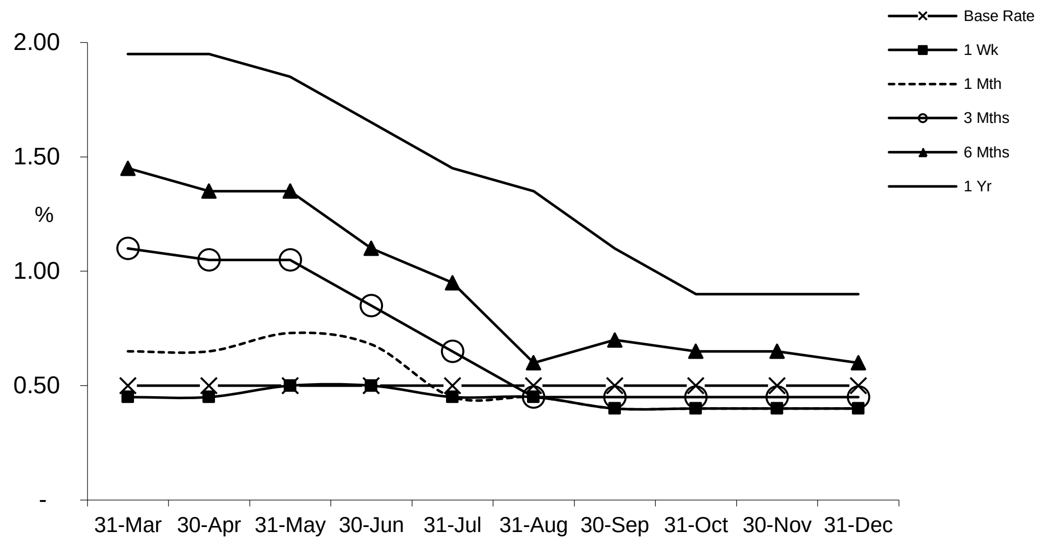
2.2 All financial advice provided by the Council's Treasury Consultants is given full consideration.

3. SUMMARY OF INTEREST RATES - to 31 December 2012

3.1 Investment Rates

3.1.1 Since April 2012, money market investment rates for one week to one year have varied between 0.40% and 1.95%.

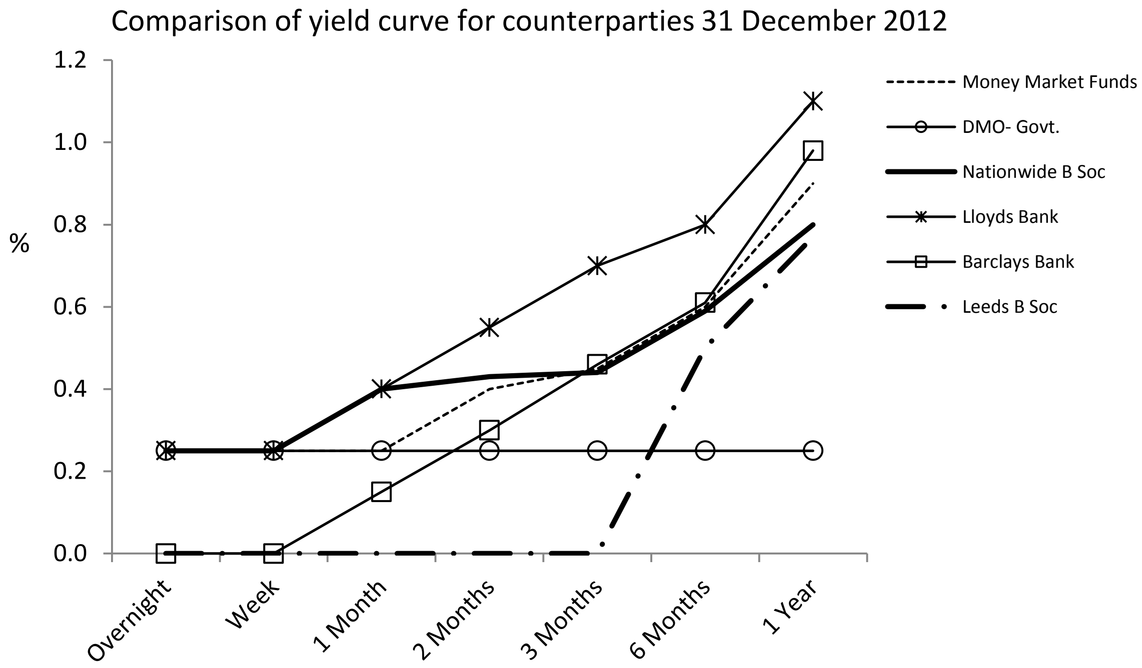
Money Market Interest Rates 1/4/12 to 31/12/12



3.1.2 The chart above reflects the average published money market rates that have been available over the period.

3.1.3 Money market investment rates have reduced over the period reflecting ongoing gloomy forecasts in economic growth and budgetary difficulties experienced globally.

3.1.4 Until recently there has been a large variation between one type of counterparty and another. However, these yields have converged over the last few months so that the difference has been greatly diminished. Examples of the current money market yield curves for different organisations are shown below. Some organisations are not borrowing at all in the very short–term.



3.1.5 There has been no change in the Bank of England base rate during the year to date:

Date	**Bank Base Rate**
At 1 April 2012	0.50%
31 December 2012	0.50%

4. ECONOMIC UPDATE

4.1 Global economy

The relief of the markets at the avoidance of the $600bn US ‘fiscal cliff’ was palpable. But the deal that was agreed failed to address some of the other major issues that will crop up in the US over the next few months.

The two most prominent events will be the passage of the Federal budget through Congress and the required lifting of the Federal Debt ceiling, due in late February.

The most worrying will be the negotiations over the Federal debt ceiling. When this was reviewed two years ago the deadline was broken and the US went into technical default. Another technical default seems a strong possibility.

The euro-zone has been relatively quiet in recent months. However, discontent over the severity of austerity measures could trigger a return to more turbulent conditions even before the Italian election.

4.2 UK economy

In the UK the Chancellor delivered the Autumn Statement which confirmed the expectation of further weak prospects for 2013.

The data item likely to attract the most attention will be the National Institute's estimate of GDP growth in the quarter to the end of December.

While this is not a perfect measure, it will give an indication of the economy's performance during the final stages of 2012. The hope is that the slow down following the third quarter of 2012 did not push the UK back into negative territory. If that can be avoided, some of the gloom over a triple dip recession might lift.

The meetings of the MPC are not expected to deliver any alterations to monetary policies in the UK. Further easing is expected in the UK at some stage, but any dramatic change may have to wait until the new governor of the Bank of England, Mark Carney, is in charge.

4.3 Outlook for the next six months of 2012/13

There remain huge uncertainties in economic forecasts due to the following major difficulties:

- the increase in risk that the economy of the UK, US and EU will not grow substantially, or at all,
- the outcome of the US budget negotiations,
- the potential for further EU sovereign debt problems which would impact financial markets and the global and UK economies,
- central UK government decisions are likely to continue to restrain funding and consumer growth.

The overall balance of risks is pessimistic:

- Low growth in the UK is expected to continue. The forecast increase in the bank base rate is not now anticipated before 2015. However, the previous forecast from some economists that the base rate would reduce prior to increasing again has now been rescinded.

4.4 Interest rate forecast

The following table reflects the forecast of Sector Treasury Services who are the Council's treasury advisors.

Year	Base Rate	Money Market Rate		Borrowing Rate		
	%	3 Month %	1 Year %	10 year %	25-year %	50-year %
2012/13	0.5	0.5	1.0	2.5	3.8	4.0
2013/14	0.5	0.5	1.1	2.6	3.8	4.0
2014/15	0.5	0.8	1.3	3.0	4.0	4.3

5. LONG TERM BORROWING

5.1 The balance of long-term debt outstanding was £142.7m at 31 December 2012. None of this debt is scheduled to be repaid for the next 5 years.

5.2 The debt is running at an average annual percentage rate of 3.13%. A six monthly Interest payment of £2.2m is due on 28 March 2013.

6. TEMPORARY BORROWING AND INVESTMENT (SEE GLOSSARY)

6.1 Borrowing

6.1.1 Temporary borrowing is raised for cash flow purposes during the year.

6.1.2 However, no temporary borrowing has been raised during the year to date.

6.2 Temporary Investment

6.2.1 The original estimate, for 2012/13, for interest receivable on temporary investments, was £390,000 based on an anticipated average earnings forecast of 1.20% for the year. The revised forecast is £589,000 based on a revised average earnings forecast of 1.46% for the full financial year.

6.2.2 The interest earned on temporary investments for the period to 31 December 2012 was equivalent to an annual rate of return of 1.53%. This is likely to decrease as the year progresses as interest rates generally have reduced.

6.2.3 Funds of £17m which represents the Council's core funds, and is made up of reserves that are unlikely to be needed for expenditure during the rest of the year, have been invested in 12 month deposits. These earn a higher rate of interest than do deposits made for shorter periods.

6.2.4 Additional investments will be mainly for cash flow purposes and necessarily of shorter duration and hence will have lower rates of return.

6.2.6 A list of temporary investments at 31 December 2012 is shown at Appendix 2.

7. INVESTMENT BENCHMARK

7.1 In order to measure the performance of the Council's investments it is necessary to compare the earnings to a benchmark. The benchmark is established by taking a daily figure published by the money markets and averaging this over the year to establish an annual benchmark return.

7.2 Formerly these reports have compared the interest rate paid for 7 day money at the London Interbank Bid (LIBID) rate averaged over one year. The LIBID rate is the rate that major UK banks will pay for money deposits on the London Interbank market.

7.3 Because the Council invests over different periods the use of the 7 day benchmark, although widely used in comparisons, masks the performance of different ranges of investments.

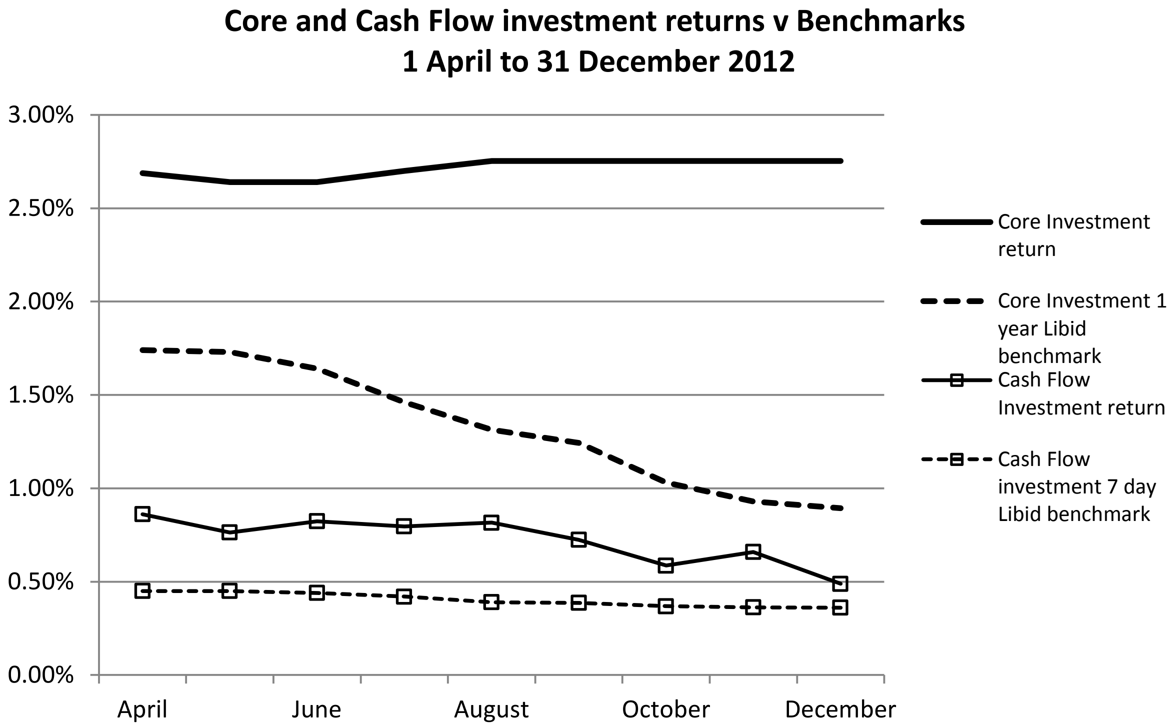
8. INVESTMENT CATEGORIES

8.1 In order to more accurately appreciate the rate of return on investments it should be appreciated that there are two categories. One is for "core" investments. These are made from the Council's cash reserves which are unlikely to be used during the next 12 month period. These funds can be invested within the Treasury Strategy but with a mind to placing longer term deposits and therefore achieving a higher rate of interest.

8.2 The other category is for "cash flow" investments. These are the funds that are collected on behalf of the New Forest District Council, Hampshire County Council, Hampshire Police Authority and Hampshire Fire & Rescue. Some of these are paid out again in the form of a precept within a few weeks; some are used over a period of months. All will be used within the financial year and are not therefore available for strategic investment. Cash flow investments can be deposited in either short term deposits or instant access Money Market Funds.

8.3 These categories can be compared to alternative benchmarks to help identify the investment returns.

8.4 The following graph compares the different investment returns and their respective benchmarks:-



8.5 At the 31 December investments that were placed in instruments with a one year duration initially totalled £17m, and shorter term investment totalled £23m.

8.6 The details of these investments are shown at Appendix 2.

9. INVESTMENT INSTRUMENTS

9.1 All investments have been made in money market or bank deposits or in Money Market Funds.

9.2 All deposits earn a yield that is made up entirely of interest earnings. There is no capital appreciation. No Gilts or Certificates of Deposits are traded.

10. INVESTMENT STRATEGY AMENDMENTS

10.1 There have been no amendments required to the overall investment strategy.

10.2 However, with the ongoing problems in the banking world the Council is currently operating a much more limited working investment strategy than the one approved in February 2012.

10.3 The current working practice is that investments are limited to the counterparties shown in the following table. Investments are restricted both in the sum invested in each institution and the term of the deposit. This list is regularly reviewed at monthly investment meetings.

Counter-party	Credit Rating	Element of UK Government Control	Maximum Investment	Maximum Term	Comments
Lloyds	A	Yes	£10m	1 year	
Barclays	A	No	£10m	3 Months	
HSBC	AA	No	£10m	3 Months	
RBS Group (NatWest/ RBS)	A	Yes	£10m	1 year	Group limited to £10m.
Nationwide	A+	No	£10m	3 Months	
DMO	AAA	Yes	£10m	1 year	UK Government
Other Local Authorities	AAA	Yes	£10m per Authority	1 year	Not rated but deemed AAA.
MMF	AAA	No	£10m per MMF	n/a	Instant Access

11. BORROWING STRATEGY AMENDMENTS

11.1 There have been no amendments required to the borrowing strategy.

12. COMPLIANCE WITH THE CIPFA CODE OF PRACTICE

12.1 All treasury functions and debt management procedures, which were undertaken during the period, complied with the existing CIPFA Code of Practice on Treasury Management, as set out in the Council's Treasury Policy Statement, and the Treasury Management Strategy for 2012/13.

13. ENVIRONMENTAL IMPLICATIONS

13.1 There are no environmental implications arising from this report.

14. CRIME AND DISORDER IMPLICATIONS

14.1 There are no crime and disorder implications arising from this report.

15. CONCLUSIONS

15.1 The current forecast for temporary interest earnings is in line with the revised budget of £589,000.

15.2 Interest rates for investments have stabilised over the last few months after reducing significantly in the first part of the year.

15.3 No long term borrowing has been undertaken during the period.

15.4 The current working investment practice is more limited that the approved Treasury Strategy for the year.

15.5 Bank base rates are likely to remain at 0.50% until quarter one 2015.

15.6 The current UK economic situation is unlikely to improve dramatically in the near future.

16. RECOMMENDATIONS

16.1 That the performance of the treasury management function for the period from 1 April 2012 to 31 December 2012 be noted.

Further Information
Please contact Jan Hawker, Treasury Management Accountant Ext. 4444
e-mail: jan.hawker@nfdc.gov.uk

Background Papers
Published Papers

jsh/tmperDecember2012

APPENDIX 1

GLOSSARY OF TERMS

BASE RATE

This is the minimum lending rate of a bank or financial institution in the UK. In this report the Base Rate refers to the Bank of England Base Rate.

BENCHMARK

A measure against which the investment policy or performance of a fund can be compared.

CERTIFICATES OF DEPOSIT

This is evidence of a deposit with a specified bank of building society that is repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before its maturity.

COUNTERPARTY

The other party to an agreement or contract (e.g.: the lender or borrower).

DEBT MANAGEMENT OFFICE (DMO)

The DMO offers a Debt Management Account Deposit Facility which provides councils with a flexible and secure facility to supplement their existing range of investment options. The DMO is a Government Office and therefore has the highest possible credit rating. The DMO pay a very low rate of interest to councils depositing funds with this facility.

GILT

A Gilt is a registered British government security that gives the investor an absolute commitment from the government to honour the debt that those securities represent.

MONEY MARKET FUND (MMF)

A pool of cash which is managed by an independent fund management company. Frequently these are well known banks or investment houses. Investors purchase units of the fund which are held on their behalf in a custody account. These funds have the highest possible credit rating.

TEMPORARY BORROWING AND INVESTMENT

Loans which are capable of being repaid within one year. The term of the loans will be negotiated from overnight to 364 days.

TERM DEPOSIT

A deposit held in a financial institution for a fixed term at a fixed rate.

APPENDIX 2

TEMPORARY INVESTMENTS OUTSTANDING AT 31 DECEMBER 2012

Institution	Amount of Investment £	Interest Rate %	Start Date	Maturity Date
Nationwide Building Society	2,000,000	0.44	03.12.12	04.03.13
Barclays Bank PLC	3,000,000	0.46	28.12.12	28.03.12
Barclays Bank PLC	1,000,000	0.46	28.12.12	28.03.12
National Westminster Bank PLC	2,000,000	2.25	05.04.12	04.04.13
Lloyds TSB Bank PLC	7,000,000	3.15	11.04.12	11.04.13
National Westminster Bank PLC	3,000,000	2.25	23.05.12	23.05.13
Lloyds TSB Bank PLC	3,000,000	3.00	23.07.12	04.07.13
National Westminster Bank PLC	2,000,000	2.25	17.08.12	16.08.13
IGNIS Money Market Fund	10,000,000	0.48	Instant	Access
Prime Rate Money Market Fund	6,800,000	0.41	Instant	Access
	39,800,000			