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TREASURY MANAGEMENT PERFORMANCE REPORT – 1 APRIL 2013 TO 31 AUGUST 2013

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 2013 to 31 August 2013 for the Council's treasury management activities.

1.3 A glossary is attached as appendix 1.

2. STRATEGY FOR 2013/14

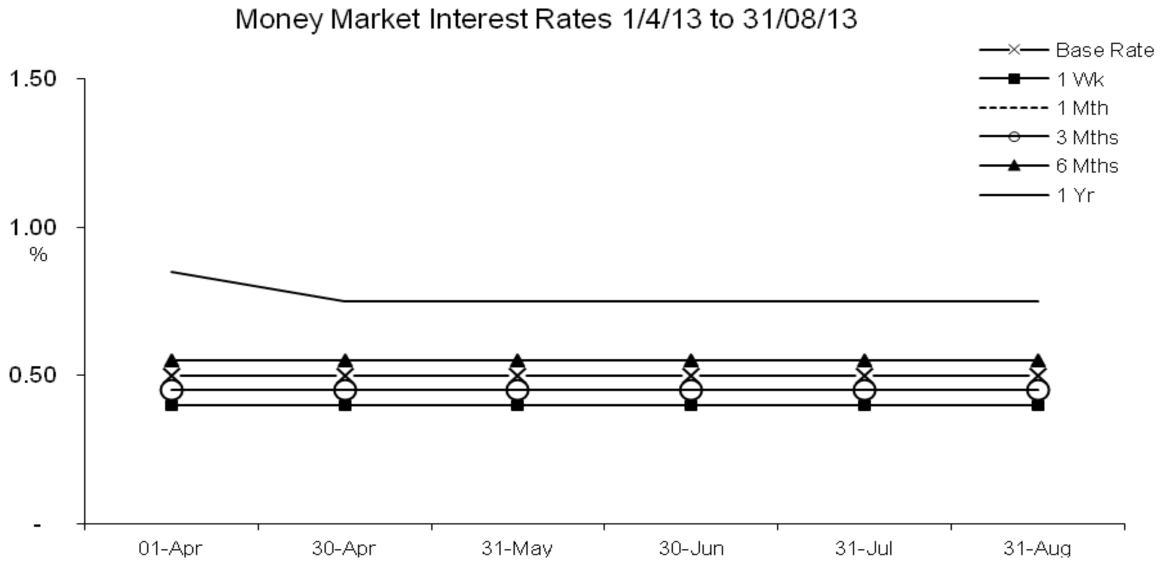
2.1 The Council approved the Treasury Management Strategy for 2013/14 in February 2013. This strategy is monitored by Council Staff on a daily basis.

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

3. SUMMARY OF INTEREST RATES - to 31 August 2013

3.1 Investment Rates

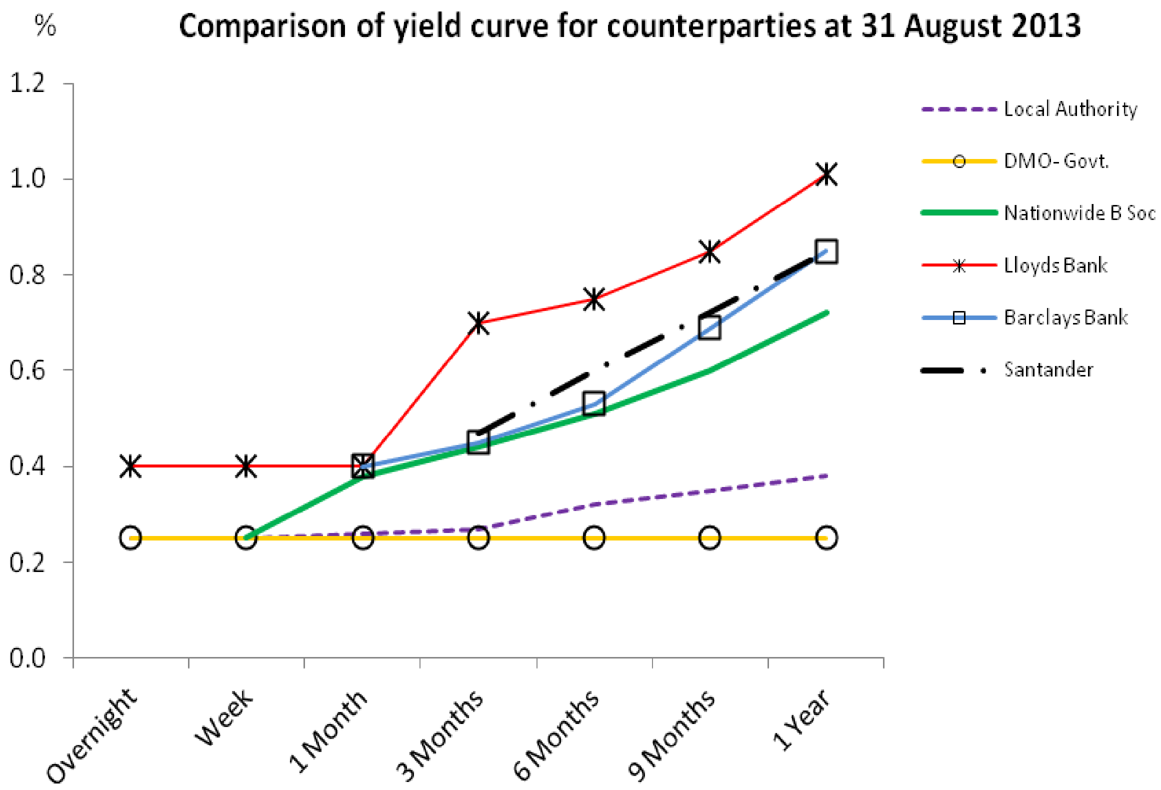
3.1.1 Since April 2013, money market investment rates for one week to one year have varied between 0.40% and 0.85%.



3.1.2 The chart above reflects the average published money market rates that have been available over the financial year to date.

3.1.3 Money market investment rates have remained constant for most of the period in view of no forecast improvement in the overall economy generally. Central Government money supplies to the financial institutions have also deadened the need for organisations to attract funds and this has depressed interest rates. Towards the end of August some improvement has been anticipated but the new Governor of the Bank of England has suggested that it will still be some considerable time before interest rates rise.

3.1.4 There is a variation between one type of counterparty and another. This variation has reduced over the last six months mainly in response to inexpensive Central Government funding. Examples of the current money market yield curves for different organisations are shown below.



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 2013	0.50%
31 August 2013	0.50%

4. ECONOMIC UPDATE

4.1 UK economy

The Bank of England Inflation Report for August 2013 upgraded growth forecasts for 2013 from 1.2% to 1.4% and for 2014 from 1.7% to 2.5%. The new Governor of the Bank of England, Mark Carney, described this as still being too little to ensure a return to strong growth after what has been the weakest recovery on record after a recession.

There remains the potential for further Quantitative Easing (QE) and for the Funding for Lending Scheme (FLS), which is aimed at encouraging banks to expand lending to small and medium size enterprises. A second phase of Help to Buy aimed to support purchasing of second hand properties is due to start in January 2014. However, concerns are increasing that QE, FLS and Help to Buy are in danger of causing house price inflation.

Inflation is forecast to fall back to 2% within two years and to remain at this level during year three.

Interest rate forecasts have been revised following the issue of the Inflation Report and forward guidance. The Governor and the MPC have indicated that markets should not expect the first increase in Bank Base Rate (BBR) to be as early as quarter 4 of 2014 and is unlikely to be before quarter 4 of 2016.

4.2 Global economy

GDP data suggested that the euro-zone's 18-month recession may have ended. This may restrain the European Central Bank from policy easing in the immediate future. The UK is very dependent on Eurozone recovery for a strong recovery itself.

The Eurozone crisis has abated recently but the current situation for Greece and Cyprus is yet to be resolved.

In China there are concerns at how unbalanced the Chinese economy is. These are around the level of credit in the economy and the robustness of the banking system in respect of dubious lending practices to state owned organisations and into the property market.

The new Japanese Government has launched a stimulus programme which appeared to have a positive initial impact in trying to get the Japanese economy out of twenty years of stagnation and deflation. However, the positive initial impact now appears to be reducing.

In the US indications are that Quantitative Easing (QE) in America is likely to start tapering off later this year. This has caused a sharp rise in US treasury and UK gilt yields

4.3 Outlook for the UK

Although the recent economic data are encouraging, the UK economy is still a long way from a strong and robust revival. Growth has been flat for more than two years, per capita income is still below its pre-crisis peak, unemployment remains at 7.8%, with youth unemployment at 21%, and credit supply to the economy remains constrained. Improvements in many parts of the economy are still needed before there is a sustainable recovery.

The Bank of England governor has said that the Bank will not consider raising interest rates until the unemployment rate has fallen to 7% or below. This would require the creation of about 750,000 jobs and could take three years. The 7% unemployment figure was not a target, but a point at which the Bank of England would re-examine interest rates.

4.4 Interest rate forecast

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

	NOW	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
BANK RATE	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	0.50	0.75	1.00
3 month LIBID	0.39	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.50	0.60	0.80	1.00
6 month LIBID	0.47	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.60	0.70	0.90	1.10	1.30
12 month LIBID	0.74	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.90	1.00	1.20	1.40	1.60	1.80	2.00
5 yr PWLB	2.20	2.20	2.20	2.20	2.20	2.20	2.30	2.40	2.50	2.60	2.80	2.90	3.00	3.20	3.30	3.40
10 yr PWLB	3.40	3.30	3.30	3.30	3.30	3.30	3.40	3.50	3.60	3.80	3.90	4.10	4.20	4.30	4.40	4.50
25 yr PWLB	4.30	4.20	4.20	4.30	4.30	4.40	4.50	4.60	4.70	4.80	4.90	5.00	5.00	5.10	5.10	5.20
50 yr PWLB	4.30	4.30	4.30	4.40	4.40	4.50	4.60	4.70	4.80	4.90	5.00	5.10	5.10	5.20	5.20	5.30

5. LONG TERM BORROWING

5.1 The balance of long-term debt outstanding was £142.7m at 31 August 2013. This debt was raised in March 2012 and the first instalment of £4.1m is due to be repaid in March 2018.

5.2 The debt is running at an average annual percentage rate of 3.13%. Interest payments of £2.2m are due on 28 September 2013 and 28 March 2014.

6. TEMPORARY BORROWING AND INVESTMENT (SEE GLOSSARY)

6.1 Borrowing

6.1.1 Temporary borrowing may be raised for cash flow purposes. However, no temporary borrowing has been raised during the year to date.

6.2 Temporary Investment

6.2.1 The original estimate, for 2013/14, for interest receivable on temporary investments, was £310,000 based on an anticipated average earnings forecast of 0.87% for the year. As a comparison the earnings for 2012/13 were £578,000 with an actual return of 1.53%.

6.2.2 The total interest earned on temporary investments for the period to 31 August 2013 was equivalent to an annual rate of return of 0.78%. This is likely to decrease as the year progresses.

6.2.3 The revised forecast for 2013/14 is £297,000 based on a revised average earnings forecast of 0.67% for the full financial year and an improved cash flow.

6.2.4 The variation between the original budget and the current forecast is not significant at this time and was not included in the Financial Monitoring reported to Cabinet on 4 September 2013. The position will continue to be monitored.

6.2.5 A list of temporary investments at 31 August 2013 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 categories of investments.

7.4 This is explained more fully in paragraph 8 below.

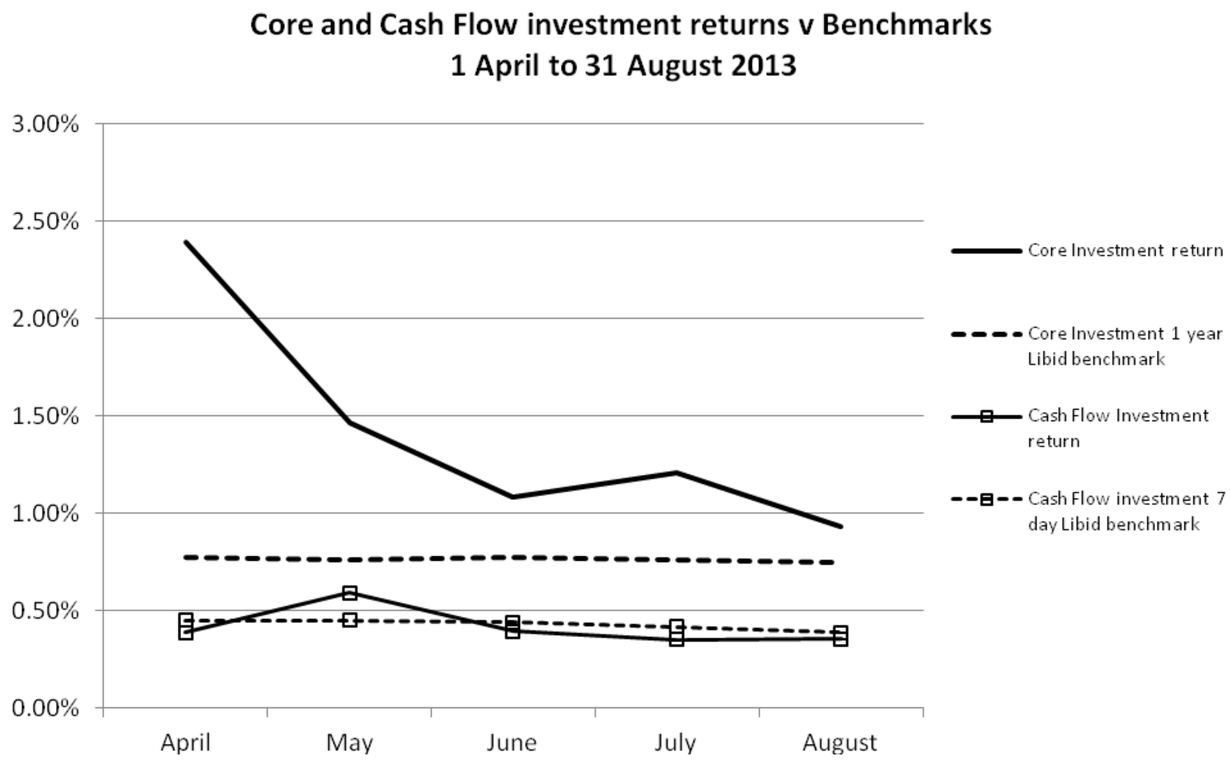
8. INVESTMENT CATEGORIES

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 August investments that were placed in instruments with a one year duration initially, “core” investments, totalled £10m, and shorter term investments totalled £32m.

8.6 In order to take advantage of the positive yield curve, where deposits earns a higher interest rate the longer the term, the current operational strategy for core funds is to invest £2m per month with each investment having a one year term. A total of £24m will be in place at the culmination of this strategy. This will ensure that core funds are earning as much as possible within the treasury strategy. As a £2m deposit will mature each month, flexibility and liquidity will also be maximised.

8.7 The details of all investments are shown at appendix 2.

9. INVESTMENT INSTRUMENTS

9.1 All investments have been made in money market or bank deposits, Government deposits or 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 to 31 August 2013.

10.2 However, with the ongoing problems in the banking world, the Council is currently operating a much more limited operational investment strategy than the one approved in February 2013.

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	N/A	Yes	£6m	1 year	
Barclays	ST-F1	No	£6m	1 year	
RBS Group (NatWest/ RBS)	N/A	Yes	£6m	1 year	Group limited to £10m.
Nationwide	ST-F1	No	£6m	1 year	
DMO	AAA	Yes	N/A	1 year	UK Government
Other Local Authorities	AAA	Yes	£6m 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 2013/14.

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 estimated to be lower than the original 2013/14 budget by £13,000.

15.2 The longer term earnings to date have outperformed the 1 year benchmark and the shorter term earnings are about equal to the 7 day benchmark.

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 low for at least the next three years.

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

16. RECOMMENDATIONS

It is recommended that:-

16.1 Members note the performance of the treasury management function for the period from 1 April 2013 to 31 August 2013.

Further Information
Please contact Jan Hawker, Treasury Management Accountant Ext. 4444
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Background Papers
Published Papers

jsh/tmperSeptember2013

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 AUGUST 2013

Institution	Amount of Investment £	Interest Rate %	Start Date	Maturity Date
National Westminster Bank PLC	2,000,000	0.80	24.05.13	95 day notice
Nationwide Building Society	2,000,000	0.42	05.08.13	07.10.13
Barclays Bank PLC	2,000,000	0.48	03.07.13	04.11.13
Barclays Bank PLC	2,000,000	0.65	28.03.13	29.11.13
Lloyds TSB Bank PLC	2,000,000	0.75	04.07.13	06.01.14
Nationwide Building Society	2,000,000	0.63	04.04.13	06.01.14
Lloyds TSB Bank PLC	2,000,000	1.10	11.04.13	11.04.14
Barclays Bank PLC	2,000,000	0.86	02.05.13	02.05.14
National Westminster Bank PLC	2,000,000	0.70	22.05.13	22.05.14
Nationwide Building Society	2,000,000	0.69	01.07.13	30.06.14
Lloyds TSB Bank PLC	2,000,000	1.01	05.08.13	05.08.14
National Westminster Bank PLC	2,000,000	0.50	Instant	Access
IGNIS Money Market Fund	10,000,000	0.43	Instant	Access
Prime Rate Money Market Fund	8,350,000	0.38	Instant	Access
	42,350,000			