AGENDA ITEM 5

HAMBLETON DISTRICT COUNCIL

Report To: Cabinet
27 November 2012

Subject: **TREASURY MANAGEMENT PERFORMANCE – INTERIM REPORT**

All Wards

Portfolio Holder for Resources: Councillor R Kirk

1.0 PURPOSE AND BACKGROUND:

1.1 The purpose of this report is to advise Members of the performance of the internal fund management team for the first half of the financial year. Members will recall that all fund management is now carried out in-house. Annex A contains details of performance, Annex B provides a schedule of investments either existing or undertaken since 1 April 2012 and their performance against the interest rate benchmark.

1.2 As part of the Council's Treasury Management Strategy I am required to report to Members on treasury management issues at least three times per year. This report fulfils one part of that requirement.

2.0 DECISIONS SOUGHT:

2.1 Members are asked to consider the in-house investment performance for the first six months of 2012/13.

3.0 LINK TO CORPORATE PRIORITIES:

3.1 The investment of Council funds is an important aspect of good financial management which is required to sustain all Corporate Priorities.

4.0 RISK ASSESSMENT:

4.1 There are no significant risks associated with approving (or not approving) the recommendations in this report.

5.0 FINANCIAL IMPLICATIONS:

5.1 Average fund management performance over the last 6 months has seen a return of 1.57% for core investments and 0.63% for cash flow investments. This performance is above the benchmark of 0.43% and for core cash is above the target of 0.93% (benchmark plus ½%).

5.2 The investment returns (or rates) have been higher than the benchmark and target and have therefore produced a small surplus compared to the estimates. In cash terms the investment interest received (£213,994) is (£19,994) higher than what has been budgeted (£194,000) for the first six month period. In the current financial climate this is satisfactory performance.

6.0 **RECOMMENDATION:**

6.1 It is recommended that Cabinet note the investment performance of the in-house team to date.

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Background papers: None

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Annex A

FUND MANAGEMENT PERFORMANCE APRIL - SEPTEMBER 2012

1.0 BACKGROUND:

1.1 CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2009. It recommends that members should be updated on treasury management activities at least twice a year, but preferably quarterly. This report therefore ensures this council is implementing best practice in accordance with the Code

2.0 ECONOMIC UPDATE:

2.1 Economic performance to date

2.1.1 Economic sentiment, in respect of the prospects for the UK economy to recover swiftly from recession, suffered a major blow in August when the Bank of England substantially lowered its expectations for the speed of recovery and rate of growth over the coming months and materially amended its forecasts for 2012 and 2013. It was noted that the UK economy is heavily influenced by worldwide economic developments, particularly in the Eurozone, and that on-going negative sentiment in that area would inevitably permeate into the UK's economic performance.

2.1.2 With regard to the Eurozone, investor confidence remains weak because successive "rescue packages" have first raised, and then disappointed, market expectations. However, the uncertainty created by the continuing Eurozone debt crisis is having a major effect in undermining business and consumer confidence not only in Europe and the UK, but also in America and the Far East/China.

2.1.3 In the UK, consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on real incomes from high inflation and low pay rises, all taking a toll. Whilst inflation has fallen considerably (CPI @ 2.6% in July), UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession. This means that the UK's recovery from the initial 2008 recession has been the worst and slowest of any G7 country apart from Italy (G7 = US, Japan, Germany, France, Canada, Italy and UK). It is also the slowest recovery from a recession of any of the five UK recessions since 1930 and total GDP is still 4.5% below its peak in 2008.

2.1.4 This weak recovery has caused social security payments to remain elevated and tax receipts to be depressed. Consequently, the Chancellor's plan to eliminate the annual public sector borrowing deficit has been pushed back further into the future. The Monetary Policy Committee has kept Bank Rate at 0.5% throughout the period while quantitative easing was increased by £50bn to £375bn in July. In addition, in June, the Bank of England and the Government announced schemes to free up banking funds for business and consumers.

2.1.5 On a positive note, despite all the bad news on the economic front, the UK's sovereign debt remains one of the first ports of call for surplus cash to be invested in and gilt yields, prior to the ECB bond buying announcement in early September, were close to zero for periods out to five years and not that much higher out to ten years.

2.2 Outlook for the next six months of 2012/13

2.2.1 The risks in economic forecasts continue unabated from the previous treasury strategy. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while America is hamstrung by political deadlock which prevents a positive approach to countering weak growth. Whether the presidential election in November will remedy this deadlock is debatable but urgent action will be required early in 2013 to address the US debt position. However, on 13 September the Fed. announced an aggressive stimulus programme for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, and this time with no time limit. They also announced that it was unlikely that there would be any increase in interest rates until at least mid 2015.

2.2.2 Eurozone growth will remain weak as austerity programmes in various countries curtail economic recovery. A crunch situation is rapidly developing in Greece as it has failed yet again to achieve deficit reduction targets and so may require yet another (third) bail out. There is the distinct possibility that some of the northern European countries could push for the ejection of Greece from the Eurozone unless its financial prospects improve, which does not seem likely at this juncture. A financial crisis was also rapidly escalating over the situation in Spain. However, in early September the ECB announced that it would purchase unlimited amounts of shorter term bonds of Eurozone countries which have formally agreed the terms for a bailout. Importantly, this support would be subject to conditions (which have yet to be set) and include supervision from the International Monetary Fund. This resulted in a surge in confidence that the Eurozone has at last put in place the framework for adequate defences to protect the Euro. However, it remains to be seen whether the politicians in charge of Spain and Italy will accept such loss of sovereignty in the light of the verdicts that voters have delivered to the politicians in other peripheral countries which have accepted such supervision and austerity programmes. The Eurozone crisis is therefore far from being resolved as yet. The immediate aftermath of this announcement was a rise in bond yields in safe haven countries, including the UK. Nevertheless, this could prove to be as short lived as previous “solutions” to the Eurozone crisis.

2.2.3 The Bank of England Quarterly Inflation Report in August pushed back the timing of the return to trend growth and also lowered its inflation expectations. Nevertheless, concern remains that the Bank’s forecasts of a weaker and delayed robust recovery may still prove to be over optimistic given the world headwinds the UK economy faces. Weak export markets will remain a drag on the economy and consumer expenditure will continue to be depressed due to a focus on paying down debt, negative economic sentiment and job fears. The Coalition Government, meanwhile, is likely to be hampered in promoting growth by the requirement of maintaining austerity measures to tackle the budget deficit.

2.2.4 The overall balance of risks is, therefore, weighted to the downside:

- We expect low growth in the UK to continue, with Bank Rate unlikely to rise in the next 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB borrowing rates is for them to eventually rise, primarily due to the need for a high volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries. However, the current safe haven status of the UK may continue for some time, tempering any increases in yield.
- This interest rate forecast is based on an assumption that growth starts to recover in the next three years to a near trend rate (2.5%). However, if the Eurozone debt crisis worsens as a result of one or more countries having to leave the Euro, or low growth in the UK continues longer, then Bank Rate is likely to be depressed for even longer than in this forecast.

3.0 SECTOR'S INTEREST RATE FORECAST:

	17.9.12 actual	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
3m LIBID	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.70	0.90	1.10	1.40
6m LIBID	0.85	0.85	0.85	0.85	0.85	0.85	1.00	1.10	1.30	1.50	1.80
12m LIBID	1.30	1.30	1.30	1.30	1.40	1.50	1.70	1.90	2.10	2.30	2.60
5yr PWLB	1.89	1.50	1.50	1.50	1.60	1.70	1.80	1.90	2.00	2.10	2.30
10yr PWLB	2.91	2.50	2.50	2.50	2.60	2.70	2.80	2.90	3.00	3.20	3.30
25yr PWLB	4.15	3.70	3.70	3.70	3.80	3.80	3.90	4.00	4.10	4.20	4.30
50yr PWLB	4.32	3.90	3.90	3.90	4.00	4.00	4.10	4.20	4.30	4.40	4.50

The above Sector forecasts for PWLB rates incorporate the introduction of the **PWLB certainty rate** in November 2012 which will reduce PWLB borrowing rates by 0.20% for most local authorities. The actual PWLB rates on 17.9.12 ought therefore to be reduced by 20bps to provide a true comparison to the forecasts.

4.0 <u>ANNUAL INVESTMENT STRATEGY</u>:

4.1 The Treasury Management Strategy Statement (TMSS) for 2012/13, which includes the Annual Investment Strategy, was approved by Cabinet on 20 March 2012 and by the full Council on 10 April 2012. It sets out the Council's investment priorities as being:

- The **security** of capital, and
- The **liquidity** of its investments

4.2 The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate and the heightened credit concerns it is considered appropriate to keep investments short term with a maximum of 3 months.

4.3 This limit is a change to the original Strategy and will apply to all entities on the suggested Sector Credit List with the following exceptions:

1. UK Government and related entities such as Local Authorities. Their suggested duration limit will remain at 1 year.
2. UK semi-nationalised institutions (Lloyds / RBS). Sector continues to view the current significant UK ownership of these entities as providing significant comfort to investors.
3. Money Market Funds.

4.4 A full list of investments held as at 1 April 2012 and made up to 30 September 2012 is contained at Annex B. It is confirmed that the approved limits within the Annual Investment Strategy were not breached during the half year to 30 September 2012.

4.5 Investment rates available in the market have continued at historically low levels. The average level of funds available for investment purposes during the last half year was **£25.473m.** The level of funds available was mainly dependent on the timing of precept payments, receipt of grants, the timing of major payments (for example Housing Benefits) and progress on the Capital Programme. At 30 September 2012 the authority held **£28.300m** core cash balances for investment purposes (i.e. funds available for more than one year).

5.0 PERFORMANCE APRIL – SEPTEMBER:

5.1 Fund management at the Council is performed entirely by an in-house team and conducted in accordance with the Council's Treasury Management Strategy which includes the Annual Investment Strategy. The in-house performance measure is to exceed the 7 day benchmark by 0.5%.

5.2 The first 6 months of the financial year has seen strong performance in the two quarters in relation to core and cash flow investments.

1st Quarter (April to June)

5.3 For core cash investments performance in the first quarter was strong **with returns of 1.55% against the 7 day LIBID benchmark of 0.43%**. This performance, which was achieved purely by investing in fixed term deposits, not only exceeded the benchmark but also exceeded the target of 0.93% (benchmark plus 0.5%).

5.4 For cash flow investments performance in the first quarter was still good **with returns of 0.63% against the 7 day LIBID benchmark of 0.43%**. Although this performance did not exceed the target interest rate, in times when interest rates are as low as they currently are, this was a target that was not expected to be achieved.

2nd Quarter (July to September)

5.5 For core cash investments performance in the second quarter was again strong **with returns of 1.59% against the 7 day LIBID benchmark of 0.40%**. This performance also exceeded the target of 0.90% (benchmark plus 0.5%) and was higher than the first quarter.

5.6 For cash flow investments performance in the second quarter was steady **with returns of 0.63% against the 7 day LIBID benchmark of 0.40%**. Again, this performance did not exceed the target interest rate for the reason stated above.

5.7 Quarterly performance is summarised in the table below.

	Annualised Returns 2012/13		
	April – June	July-Sept	Year to Date
	%	%	%
Core Cash	1.55	1.59	1.57
Cash Flow	0.63	0.63	0.63
Benchmark	0.43	0.40	0.415
Target	0.93	0.90	0.915

5.8 From the table it can be seen that for the full half year the in-house team has exceeded both the benchmark and its performance target for core cash investments, whilst cash flow performance only exceeded the benchmark.

5.9 In cash terms the returns in 2012/13 compared to the benchmark are shown:-

	Returns in Excess of 7 Day Benchmark		
	Actual Return £	Benchmark Return £	Excess Over Benchmark £
In-house Team	213,994	62,121	151,873

6.0 FINANCIAL IMPLICATIONS:

6.1 Performance in terms of the budget for the first half of the year is shown in the table below:

	Total £
Budget for half year	194,000
Investment Returns	213,994
Surplus/(Deficit) returns	19,994

6.2 Compared to the income provided in the revenue budgets for 2012/13, a small surplus of £19,994 has been made in the first half of the year. The effect will be to marginally increase the expected amount transferred to the Council Taxpayers Reserve.

7.0 COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS:

7.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy Statement TMSS.

7.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices.

Annex B

INTERNAL TEAM INVESTMENTS

Comparison to Benchmark

1. Investments Existing at 1 April 2012

Loan No.	Institution	Date of Loan	Loan Period (Days)	Loan Amount £	Interest Rate %	Benchmark Rate %	Excess %
3453	Bank of Scotland	05/07/11	366	2,300,000	2.05	0.45	1.60
3461A	Bank of Scotland	15/07/11	367	3,000,000	2.10	0.45	1.65
3471	Lloyds	19/08/11	367	5,100,000	2.20	0.50	1.70
3516	Cater Allen	19/03/12	79	3,100,000	1.26	0.46	0.80
3504	Santander	12/01/12	91	1,000,000	1.40	0.50	0.90
3432	Newcastle City Council	03/05/11	365	3,000,000	1.70	0.45	1.25
3510	Ulster Bank	15/02/12	90	1,500,000	1.15	0.48	0.67

2. New Investments Made Between 1 April 2012 and 30 September 2012

Loan No.	Institution	Date of Loan	Loan Period (Days)	Loan Amount £	Interest Rate %	Benchmark Rate %	Excess %
3523	Nationwide	12/04/12	91	1,000,000	0.98	0.45	0.53
3524	Ulster Bank	12/04/12	91	2,000,000	1.15	0.45	0.70
3527	Nationwide	20/04/12	91	1,900,000	0.98	0.45	0.53
3531	National Westminster	02/05/12	138	1,000,000	1.25	0.45	0.80
3533	Ulster Bank	02/05/12	92	1,280,000	1.12	0.45	0.67
3534	Nationwide	02/05/12	92	1,720,000	0.95	0.45	0.50
3538	Ulster Bank	15/05/12	92	1,500,000	1.07	0.45	0.62
3540	National Westminster	15/05/12	125	1,500,000	1.25	0.45	0.80
3546	National Westminster	07/06/12	102	1,500,000	1.25	0.45	0.80
3547	Greater London Authority	07/06/12	92	3,000,000	0.32	0.45	-0.13
3555	Bank of Scotland	05/07/12	364	2,300,000	3.00	0.43	2.57
3558	Nationwide	12/07/12	92	1,000,000	0.60	0.42	0.18
3559	Ulster Bank	12/07/12	92	2,000,000	1.00	0.42	0.58
3561	Bank of Scotland	16/07/12	353	3,000,000	3.00	0.42	2.58
3562	Nationwide	20/07/12	94	1,900,000	0.60	0.42	0.18
3566	Ulster Bank	02/08/12	92	1,280,000	0.82	0.41	0.41
3567	Nationwide	02/08/12	92	1,720,000	0.58	0.41	0.17
3570	Ulster Bank	15/08/12	92	2,000,000	0.90	0.40	0.50
3571	Lloyds Bank	20/08/12	365	5,100,000	2.85	0.40	2.45
3576	Barclays Bank	17/09/12	91	2,000,000	0.59	0.38	0.21
3578	Nationwide	17/09/12	91	1,000,000	0.54	0.38	0.16
3579	National Westminster	17/09/12	63	5,000,000	1.25	0.38	0.87