Treasury Management Interim Report **Appendix C**
Eleven months to 29 February 2012

This report ensures the council is embracing best practice in accordance with CIPFA's recommendations, by keeping members informed of Treasury Management activity.

1. The Economy

1.1. Recent economic events and statistics show the following:

- The second estimate of economic growth in the final quarter of 2011 confirmed that the UK economy contracted by 0.20%. Year on year growth was revised down from 0.80% to 0.70%.
- Inflation is currently 3.60% and is expected to fall further to gradually drop back towards the 2% target. However, further oil price rises may impact on this.
- There was a further deterioration in domestic employment data with the number of unemployed increasing by 28,000 in the three months to January. However this represented the lowest increase in almost a year and government sees this as an encouraging sign of stabilisation.
- Over the short-term gilts will retain their "safe-haven" status. This should keep the interest rates available on loans from the Public Works Loan Board at relatively low levels.
- No change in the Bank Base Rate on the horizon which is expected to remain at 0.50% throughout 2012/13.

2. The Council's Investments

2.1 As at 29th February 2012 the council held the following investments:

Investment	Term	Maturity Date	Interest Rate	Amount invested	
				£m	£m
Instant access Money Market Funds:					
Prime Rate	N/A	N/A	0.88%	3.50	
Ignis	N/A	N/A	0.85%	3.50	
Deutsche	N/A	N/A	0.76%	2.97	
Insight	N/A	N/A	0.70%	4.25	
Blackrock	N/A	N/A	0.57%	0.12	14.34
Rolling monthly programme of £1 million one year term deposits (now discontinued):					
Newcastle City Council	364 days	15/03/12	1.55%	1.00	
Bank of Scotland	364 days	05/04/12	2.05%	1.00	
Bank of Scotland	364 days	02/05/12	2.05%	1.00	
Barclays	364 days	14/06/12	1.52%	1.00	
Lloyds TSB	364 days	25/07/12	2.05%	1.00	5.00
Rolling monthly programme of £1 million six month term deposits (now also discontinued):					
Barclays	189 days	23/03/12	1.20%	1.00	1.00
Other fixed term deposits:					
Barclays	328 days	20/03/12	1.47%	1.00	
Lloyds TSB	449 days	27/07/12	2.65%	0.50	
Lancashire C C	274 days	01/08/12	0.90%	3.00	4.50
Total					**24.84**

No term deposits placed between 01/11/11 and 29/02/12	

2.2 As advised in the previous report, due to stress in the financial markets, coupled with uncertainty over the extent to which the government could and would support the banks should there be another financial crisis, the credit rating agencies have reduced the credit ratings of nearly all the major UK banks. Most banks are now rated at a level below the minimum acceptable long-term credit rating stipulated in the council's 2011/12 Treasury Management Strategy Statement (TMSS).

2.3 In accordance with our advisors' (Arlingclose) advice, the 2012/13 TMSS includes a minimum acceptable long term credit rating (using Fitch's ratings) of A- rather than A+ which will mean that, based on current credit ratings, most of the suspended institutions will be reinstated with effect from 1st April 2012 (the exception being Clydesdale bank which will still not meet the minimum criteria).

2.4 Until 1st April 2012 there are only two UK banks on the council's lending list, being:

Bank	Maximum maturity for new investments
HSBC	6 months
Santander	35 days

2.5 On a more positive note, very recently the council's treasury advisors (Arlingclose) have extended their recommended maximum maturity limits for new term deposits. Looking at the two banks above, they have recommended extending the limits from overnight to 35 days for Santander and from 3 months to 6 months for HSBC. The reason is increased stability or improvement in most of the credit risk indicators which they monitor (such as the price of credit default swaps and share prices).

2.6 Another recent and significant development has been the £1.1 trillion of 3-year funding made available by the European Central Bank which has allowed European financial institutions access to low cost funding at 1%. Long-Term Refinancing Operations saw £489 billion borrowed by 520 banks in December 2011 and £530 billion borrowed by 800 institutions in the February 2012. It is recognised however that some banks will not immediately pass on the benefit of the cheaper funds and it may be several months before the Eurozone feels the benefit of the cheap loans in the wider economy.

2.7 The crisis in Greece has temporarily abated following the programme of debt restructuring and the approval of the new £174 billion bailout package. However worries persist that these measures will not be enough if Greece does not deliver on pledges to reduce the government workforce, sell government assets and overhaul its tax system. Meanwhile, European governments are turning their attention to protecting other vulnerable economies, including Portugal, Spain and Italy.

2.8 There is no change in the forecast of the Bank Base Rate provided by Arlingclose. As noted in the January report, Arlingclose have advised that it could be 2016 before the first increase in the rate. Their forecast (issued 1st March 2012) is as follows:

Bank Rate	**Mar-12**	**Jun-12**	**Sep-12**	**Dec-12**	**Mar-13**	**Jun-13**	**Sep-13**	**Dec-13**	**Mar-14**	**Mar-14**
Upside risk					+0.25	+0.50	+0.50	+0.50	+0.50	+0.50
Central case	**050**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk										

2.9 The council has earned interest on its investments as follows:

Month	**Average Invested £m**	**Average rate of interest earned**	**Amount of interest earned**
April 2011	40.6	1.08%	£36,046
May 2011	47.4	1.15%	£46,099
June 2011	47.0	1.17%	£45,261
July 2011	48.2	1.17%	£47,788
August 2011	48.0	1.23%	£49,707
September 2011	42.6	1.28%	£44,914
October 2011	38.0	1.30%	£42,061
November 2011	40.0	1.27%	£40,728
December 2011	36.7	1.24%	£39,028
January 2012	36.2	1.17%	£36,075
February 2012	32.4	1.11%	£29,859
Total to date			**£457,566**
Forecast:			
March 2012	25.0	1.00%	21,000
Estimated total for year			**478,566**
Budget			**249,070**
Surplus			**229,496**

2.10 The interest received has exceeded budget due to both higher investment balances and higher average interest rates, due principally to the placement of term deposits for up to twelve months (and then six months) during the first part of the year.

2.11 Due to the restricted number of eligible counterparties (banks we can deal with), term deposits maturing before the end of March have resulted in surplus funds being placed in the council's Money Market Funds or in the Santander instant access account or on term deposit with other Local Authorities. The lack of counterparties in recent months is reflected above in the falling average rate of interest earned. This reduction in rate would have been greater had it not been for falling balances in February and March following the cessation of council tax receipts.

2.12 The actual surplus will depend upon various factors including the amount and timing of any additional borrowing taken out before the year end and the net interest payable to trusts and other third parties. However, as previously reported, investment income should exceed the budget by around £230,000.

3. The Council's Borrowing

3.1 So far this year the council has borrowed the following amounts from the PWLB:

Date	Amount	Interest rate	Term	Type of loan
14/07/11	7,500,000	3.59%	15 years	EIP
03/11/11	3,000,000	3.35%	20 years	EIP
*EIP = Equal Instalments of Principal (with the loan being repaid in equal instalments over the term of the loan)				

3.2 The financial concerns in the Eurozone means UK government sterling gilts have remained relatively attractive to investors keeping interest rates on loans offered by the Public Works Loan Board relatively low.

3.3 The approval of the new Greek bailout package and the provision of cheap loans by the European Central Bank have reassured financial markets to a degree and have led to a recent fall in the demand for gilts. As a result the interest rates provided by gilts, and hence the rates charged on loans from the Public Works Loan Board, have increased. In the last two days the 20 year EIP rate has increased from 3.17% to 3.44%. The council's treasury adviser, Arlingclose, believes that the increase is not the start of a longer-term upward trend but that the underlying issues in the Eurozone remain and that PWLB rates will fall back again.

3.4 Because of the large difference between borrowing rates and the rates earned on investments the council generally postpones borrowing for as long as possible to avoid the large cost of carry. In addition, in the current financial climate there are relatively few good quality counterparties where funds may be placed. However, recent events show how quickly PWLB rates can increase and so, when rates are at low levels, there is also an argument for taking out loans sooner rather than later in the belief that the cost of carry will be outweighed by interest savings over the period of the loan.

3.5 Economic events and PWLB rates will continue to be monitored and advice will be sought from the council's treasury advisers regarding the best time to take out new loans. This will informed the Chief Finance Officer's decision making.

3.6 As previously reported, the long-term borrowing budget was set in January 2011 at a time when PWLB rates were steadily increasing and there was concern over the interest rates that would need to be paid on future borrowing. Arlingclose's forecast was for the 20 year PWLB rate to reach 6% in the third quarter of 2011. In order to set a prudent budget, and give the council flexibility with regard to maturity periods, the budget was set using an interest rate of 5.75%. With actual borrowing rates being much lower than the forecast the borrowing budget will result in a surplus for the year which is analysed below.

	Budget	Forecast	Surplus
	£m	£m	£m
Minimum Revenue Provision	9.87	9.61	0.26
Interest on existing loans (January 2011 position)	5.43	5.43	-
Borrowing of £5m taken out before the end of 2010/11 (Budget 4.00%; Actual 3.71%)	0.20	0.18	0.02
Borrowing requirement for 2011/12 of £7m £7.0m borrowed 14/07/11 at 3.59%	0.40	0.18	0.22
Borrowing of £10m to externalise net internal borrowing used in 2008/09 and 2009/10: £0.5m borrowed 14/07/11 at 3.59% £3.0m borrowed 03/11/11 at 3.35% £3.5m to borrow at say 4.00% or less £3.0m balance not now required due to slippage in capital programme from when the budget was set	 0.03 0.17 0.21 0.17	 0.01 0.04 0.01 -	 0.02 0.13 0.20 0.17
Provision for refinancing of LOBO loans at a higher rate (Now unlikely that lenders will increase rates)	0.12	-	0.12
Original budget	**16.60**	**15.46**	**1.14**
Agreed budget virement to property disposal costs	**(0.05)**	**-**	**(0.05)**
Budget adjustment relating to a reduction in capital financing contributions from directorates	**(0.12)**	**-**	**(0.12)**
Adjustment for capitalised interest		**(0.10)**	**0.10**
Forecast budget surplus as at 31 March 2012	**16.43**	**15.36**	**1.07**

3.7 The council is able to capitalise interest costs relating to interest paid on borrowing used to fund large capital schemes that take substantial periods of time to get to the point at which the assets may be utilised. Such interest, incurred at the construction or installation phase, may be capitalised and added to the cost of the associated asset. In accordance with accounting policy the council intends capitalising interest costs totalling around £100,000 and this figure has increased the forecast surplus at the end of the year.

3.8 The anticipated surplus for the year on capital financing costs is estimated to be in the region of £1.07 million, as detailed above.