Treasury Management Interim Report **Appendix C**
Seven months to 31 October 2011

This report is based on best practice in accordance with CIPFA's recommendations.

1. Economic Summary

1.1. Recent economic events and statistics show the following:

- The Eurozone continuing to struggle to defuse their deteriorating debt and deficit problems.
- Financial conditions worsening in most major economies prompting downward revision to growth forecasts. In the UK the Monetary Policy Committee voting to inject a further £75 billion in the form of quantitative easing to try to stimulate demand.
- The first estimate of economic growth for the third quarter was 0.50% but this was thought to be less to do with strength of economic activity than the effect of the previous quarter (when a late Easter and the royal wedding bank holiday had a negative effect on growth).
- Inflation remains high (5.2% in September and 5.0% in October) although it is expected to fall in 2012 as the effect of the VAT and energy price increases subside.
- Unemployment increasing in the quarter to September 2011 from 7.9% to 8.3%. This is the highest since 1996.
- The Bank Base Rate is now expected to remain at 0.50% for at least the next year or so.

2. The Council's Investments

2.1 As at 31 October 2011 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%	5.00	
Ignis	N/A	N/A	0.86%	2.50	
Deutsche	N/A	N/A	0.73%	1.83	9.33
Rolling monthly programme of £1 million one year term deposits:					
Nationwide	364 days	24/11/11	1.33%	1.00	
Bank of Scotland	335 days	28/12/11	1.82%	1.00	
Bank of Scotland	364 days	26/01/12	1.95%	1.00	
Bank of Scotland	364 days	13/02/12	2.05%	1.00	
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	9.00
Rolling monthly programme of £1 million six month term deposits:					
Lloyds TSB	182 days	17/02/12	1.42%	1.00	
Barclays	189 days	23/03/12	1.20%	1.00	2.00
Other fixed term deposits:					
Santander	122 days	25/11/11	1.21%	2.00	
Nationwide	215 days	05/12/11	1.09%	1.00	

Santander	148 days	21/12/11	1.28%	2.00	
Nationwide	245 days	01/01/12	1.14%	1.00	
Santander	184 days	26/01/12	1.41%	1.00	
Barclays	275 days	27/01/12	1.32%	1.00	
Nationwide	278 days	06/02/12	1.19%	1.00	
Newcastle City Council	339 days	27/02/12	1.48%	2.00	
Barclays	306 days	27/02/12	1.41%	1.00	
Barclays	328 days	20/03/12	1.47%	1.00	
Lloyds TSB	449 days	27/07/12	2.65%	0.50	13.50
Total					**33.83**

The term deposits shaded grey are those placed in the last two months

2.2 As advised in the previous report, the council suspended its monthly rolling programme of investing £1 million for 364 days. On 11th August 2011 the council's treasury advisors, Arlingclose, recommended reducing the maximum maturity limit for new investments from one year to six months. We reviewed and then followed the advice and decided since the previous report the council has applied further limitations on both its eligible counterparties (bodies it deals with) and maximum maturity limits. A summary of recent events is as follows:

Date	Event
7th October	Moody's, one of the three main credit rating agencies completed their review of UK financial institutions. Their review considered the likelihood of UK government support that would be forthcoming should the banks get into financial difficulty. Moody's considered that the government was now less likely to provide support over the medium to long-term. The result was a one-point downgrade to the long-term ratings of both Lloyds TSB and Santander and a two point downgrade to both Royal Bank of Scotland (including Nat West) and Nationwide. The downgrades meant that Royal Bank of Scotland, Nat West and Nationwide all fell below the minimum long term credit rating of A+ specified in the council's 2011-12 Treasury Management Strategy. Because of this Arlingclose recommended withdrawing funds from instant access accounts and suspending these institutions for new investments.
13th October	For the same reason Fitch, another of the main credit rating agencies, downgraded Lloyds TSB, Bank of Scotland, Royal Bank of Scotland and Nat West. It also placed Barclays Bank on Rating Watch Negative. The result of these downgrades meant that Lloyds TSB and Bank of Scotland also fell below the council's minimum credit rating criteria and so were suspended for new investments.
11th November	Due to the continued financial deterioration in the Eurozone, Arlingclose recommended a reduction in the maximum maturity limits for investment counterparties. In terms of the remaining banks on the council's lending list, Arlingclose are now recommending 3 month limits for Barclays and HSBC and a 1 month limit for Santander.

2.3 Therefore at the time of writing the only banks that meet the criteria specified in the council's 2011-12 Treasury Management Strategy Statement are as follows:

Bank	Maximum maturity for new investments
HSBC	3 months
Barclays	3 months
Santander	1 month

2.4 It should be noted that the recent suspension of the banks and Nationwide has been made to ensure compliance with the council's 2011-12 Treasury Management Strategy Statement (TMSS). Arlingclose do not recommend breaking term deposits and have confirmed that they are otherwise still comfortable with clients investing in the suspended institutions, albeit with a reduced maximum maturity period of one month. Arlingclose have recommended that for the 2012-13 TMSS the minimum acceptable long term credit rating (using Fitch's ratings) should be reduced from A+ as at present to A- (at present the currently suspended institutions have a long-term credit rating of A).

2.5 Due to the ongoing economic problems it is now considered possible that the Bank Base Rate will remain at 0.50% for the next few years. Arlingclose have provided the following forecast (issued 31 October 2011) and have advised that their central forecast is for the first change in the Bank Base Rate to be in 2015 or later.

Bank Rate	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Upside risk				+0.25	+0.25	+0.25	+0.50	+0.75	+1.00	+1.25
Central case	**0.50**	**050**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk										

2.6 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
Total			**£311,876**

2.7 With no change in the Base Rate on the horizon, the 2011/12 budget was set in January 2011 at the same level as in the previous year (£249,070). Interest earned in the first seven months has exceeded budget due to both higher investment balances and higher average interest rates, due principally to the effect on income of maintaining the rolling programme of one year deposits. The reducing number of counterparties, together with the reduction in maturity limits, will impact on the amount of investment income received in the next five months. However, assuming that in the next five months the council can earn average monthly interest of at least £30,000, investment income should still exceed the budget by at least £200,000.

3. The Council's Borrowing

3.1 The increased demand for sterling gilts has led to a fall in interest rates with a corresponding fall in the rates offered by the Public Works Loan Board (PWLB).

3.2 On 3rd November 2011 the council borrowed a further £3 million from the PWLB. The new loan is for a period of 20 years at an interest rate of 3.35%, with £75,000 being repaid to the PWLB every six months. This is an exceptionally low level of interest.

3.3 As previously reported, the long-term borrowing budget was set in January 2011 at a time when PWLB rates were steadily increasing. 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 should result in a surplus for the year which is analysed below.

	Budget	**Forecast**	**Surplus**
	£m	**£m**	**£m**
Minimum Revenue Provision	9.87	9.69	0.18
Interest on existing loans (January 2011 position)	5.43	5.43	-
Borrowing of £5m to be 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 (£7m when budget set, most recent forecast £9m due to 2010/11 slippage) £7.5m borrowed 14/07/11 at 3.59% £1.5m borrowed 03/11/11 at 3.35%	0.40 -	0.19 0.02	0.21 (0.02)
Borrowing of £10m to externalise net internal borrowing used in 2008/09 to 2010/11 inclusive: £1.5m borrowed 03/11/11 at 3.35% £5.5m to borrow at say 3.50% or less (£3.0m balance not required due to 2010/11 slippage in capital programme to 2011/12)	0.09 0.32 0.17	0.02 0.07 -	0.07 0.25 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**	**15.60**	**1.00**
Agreed budget virement to property disposal costs	**(0.05)**	**-**	**(0.05)**
Budget at the end of October 2011	**16.55**	**-**	**0.95**
Outstanding budget adjustment relating to a reduction in capital financing contributions from directorates	**(0.12)**	**-**	**(0.12)**
Forecast position as at 31 March 2012	**16.43**	**15.60**	**0.83**

3.4 PWLB rates will continue to be monitored and, whilst rates are still low, the Chief Financial Officer, on behalf of the Council, may take the opportunity to externalise the balance of £5.5 million internally borrowed in previous years. Depending upon if and when further loans are taken out, the year-end budget surplus relating to borrowing should be in the region of £830,000.