East Northamptonshire Council

Finance Sub Committee - 26 October 2009

Treasury Management - Half Year Report

Summary

This report provides details of our treasury activities for the first half of the year in accordance with the draft revised code for Treasury Management.

Attachment(s)

None

1. Introduction

1.1. The collapse of the banking sector and the subsequent loss of deposits with the Icelandic banks resulted in a review of treasury management activities within the public sector. One of the recommendations of the resulting draft revised code was to increase the frequency of reporting to Members of treasury activity. Although the revised code is still to be finalised we are adopting the principles contained within it.

1.2. This report is designed to provide members with:

- a summary of the economic conditions affecting our investment strategy
- details of all fixed term deposits made during the first half of the year
- a summary of our current investment portfolio.

2. Market Conditions

2.1. When the Treasury Management Strategy was drafted in February, as a result of the credit crunch and the recession, the outlook for the economy was gloomy. Unfortunately the reality was worse than predicted with base rates falling 0.50% further than anticipated and the Bank of England pumping money into the economy (termed Quantitative Easing) to try and stave off a recession that was deeper and more prolonged than originally thought.

2.2. At their meeting on 5 August, the Monetary Policy Committee of the Bank of England agreed to extended the amount of quantitative easing by a further £50billion to £175billion. (To put this into perspective this equates to roughly £3,000 per person in the UK). This action was a result of growing concern of the effect of previous policy decisions to halt the deepening of the recession and to try and stimulate the economy. At the time of writing it is not clear how effective this policy will be as to date the banks (who are the recipients of this cash injection) are not passing this on in the form of loans to business and individuals.

2.3. When we drafted our original strategy in February the forecast for bank rates was as follows.

	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
Official Bank Rate									
Upside risk							+0.25	+0.25	+0.25
Central case	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.50**	**2.00**	**2.50**	**2.50**
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.50	-0.50	-0.50	-0.50

Since then the Bank of England has cut base rates to 0.50%. Based on the most recent inflation report considered by the Bank of England we are now expecting base rates to remain lower for longer. Although market rates indicate a pick up in the base rate to 2.2% by the end of 2010 and 3.8%, the anticipated level of inflation (after taking this and the £175bn of QE into consideration) is below the target level of 2%. It is predicted that based on these assumptions inflation will fall below the lower threshold of 1% during 2010. This would indicate that market expectations for rates are higher that economic reality. A further indication that the market expectations are too high can be gleaned from the expected level of inflation based on a constant base rate of 0.5%. The Bank of England's report indicated that inflation would remain just below the 2% target level over the time scale, thus potentially discounting the need for base rate rises to curb inflation. It should though be noted that we are in unchartered territory and there are significant risks in either direction.

2.4. The UK's finances are also struggling. Tax receipts from individuals and businesses have plummeted forcing the Government to borrow in the month of July for the first time in 13 years. Borrowing for the first four months of this financial year has exceeded £50billion pushing the total public debt up to £800billion (that's just over £13,000 per person). This debt represents 56.8% of the Country's turnover, the highest level since records began.

2.5. As a result of the above we have reassessed our expectations for interest rates and the impact this will have on the earnings on our portfolio. The tables below set out our revised predictions for the base rate and the average returns likely on our portfolio.

	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Official Bank Rate;										
Upside risk							+0.25	+0.25	+0.50	+0.50
Central Projection	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00	1.50	2.25
Downside risk								-0.50	-0.50	-0.50

As Members can see base rates are not expected to pick up as quickly as previously thought with rates being at 1.5% by March 2011 rather than the previous estimate of 2.5%. It should though be noted that once rates start to pick up there is the expectation that they will rise fairly rapidly. Based on these predictions are revised estimate for investment returns is as follows.

Year	**Average Return Original Estimate**	**Average Return Revised Estimate**
2009/10	4%*	3.3%
2010/11	2.5%	1.75%
2011/12	4%	3.0%
2012/13	5%	4.0%

* The figures for 2009/10 take into consideration existing investments which will run into this financial year. We are estimating that any new investments will return between 1 and 1.5% (previously 2 and 2.5%). It should also be noted that as the total of our portfolio is reduced due to the utilisation of revenue and capital reserves our ability to invest strategically to take advantage of higher rates is also reduced; with a much higher proportion of our portfolio utilised to manage day to day cash flows.

3. Treasury Activity

3.1. As a result of the uncertainty over rates and the ongoing issue of weakness in the baking sector we have primarily adopted a strategy of keeping money liquid in either AAA rated money market funds and instant access accounts operated by those banks with access to the Bank of England's credit guarantee scheme. As the returns from the money market funds have dropped off and with the bleak outlook for interest rates we have looked to fix deposits for period of up to a year. These deposits have been within our treasury management policy and also within the advice given by Arlingclose (our treasury advisors). Advice was sought from Arlingclose whether to proceed with the forward rate deal with Clydesdale Bank and on the basis that they have access to the Bank of England's credit guarantee scheme it was agreed to honour this deal.

3.2. The list of fixed term investments that have commenced during the financial year are;

Lender	Amount £m	Rate %	Start Date	End Date
*Clydesdale bank	£2.00	6.65	13-May-09	13-May-10
Nationwide Building Society	£2.00	1.75	14-Apr-09	14-Oct-09
Clydesdale bank	£1.00	1.50	08-May-09	09-Nov-09
Nationwide Building Society	£1.00	1.58	08-May-09	09-Nov-09
Lloyds TSB	£1.50	1.30	13-Aug-09	15-Feb-10
Lloyds TSB	£1.50	1.85	13-Aug-09	13-Aug-10
Lloyds TSB	£1.00	1.40	23-Sep-09	23-Mar-10

* This was a forward rate deal struck on 13 May 2008. For comparison purposes the equivalent market rate for this deal if dealt on the day would have been 1.85%.

4. Treasury Position

4.1. The table below summarises as at 30 September our current portfolio and the latest returns on these investments.

Lender	Amount £m	Rate %	Start Date	End Date
Fixed Rate Deposits				
Bank of Ireland	£2.00	6.43	23-May-07	24-May-10
Nationwide Building Society	£2.00	1.75	14-Apr-09	14-Oct-09
Clydesdale Bank	£1.00	1.50	08-May-09	09-Nov-09
Nationwide Building Society	£1.00	1.58	08-May-09	09-Nov-09
Clydesdale Bank	£2.00	6.65	13-May-09	13-May-10
Lloyds TSB	£1.00	1.40	23-Sep-09	23-Mar-10
Lloyds TSB	£1.50	1.30	13-Aug-09	15-Feb-10
Lloyds TSB	£1.50	1.85	13-Aug-09	13-Aug-10
Ulster Bank	£2.00	6.28	18-Oct-07	19-Oct-09
Instant Access Accounts Variable Rate				
Henderson Liquid Assets Fund	£0.37	0.66		05-Oct-09
Prime Rate Sterling Liquidity Fund	£1.37	1.13		05-Oct-09
Abbey National	£0.18	0.60		05-Oct-09
Total	**15.92**			

5. Treasury Performance

5.1. The average return on our portfolio for the first six months of the year has been 3.30%. This is 2.91% above the average 7 day LIBID (London Interbank Deposit Bid) rate of 0.39%. At this stage we do not have any comparative data with other local authorities.

5.2. The amount of interest earned on our portfolio to date is £277,600 against an annual budget of £494,000. Although it would appear that we are ahead of budget, anticipated returns for the remainder of the year will mostly offset this. At the time of writing we are expecting to be slightly ahead of budget by the end of the year.

Implications:

Corporate Outcomes or Other Policy/Priority/Strategy

Good Quality of Life	[ ]	Good Reputation	[ ]
Good Value for Money	[x]	High Quality Service Delivery	[x]
Effective Partnership Working	[ ]	Strong Community Leadership	[ ]
Effective Management	[x]	Knowledge of our Customers and Communities	[ ]
Employees and Members with the Right Knowledge, Skills and Behaviours			[x]
Other:			[ ]
Decision(s) would be outside the budget or policy framework and require full Council approval			[ ]

Financial	There are no financial implications at this stage	[x]
	There will be financial implications – see paragraph	[ ]
	There is provision within existing budget	[ ]
	Decisions may give rise to additional expenditure at a later date	[ ]
	Decisions may have potential for income generation	[ ]
Risk Management	An assessment has been carried out and there are no material risks	[ ]
	Material risks exist and these are recorded at Risk Register Reference – 106 & 107 inherent risk score - Primary residual risk score - Contingency	[x]
Staff	There are no additional staffing implications	[x]
	Additional staff will be required – see paragraph	[ ]
Equalities and Human Rights	There will be no impact on equality (race, age, gender, disability, religion/belief, sexual orientation) or human rights implications	[x]
	There will be an impact on equality (see categories above) or human rights implications – see paragraph	[ ]
Legal	Power: Local Government Acts 1989 and 2003	
	Other considerations: CIPFA Code of Practice for Treasury Management The Prudential Code for Capital Finance in Local Authorities	

Background Papers: Treasury records and advice receivedSM

Person Originating Report: Robert Austin, Head of Resources

Date: 13 September 2009

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