Treasury Management Update

Quarter Ended 31 December 2013

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The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report therefore ensures this council is implementing best practice in accordance with the Code.

1. Economic background:

- After strong UK growth of 0.7% in quarter 2 and 0.8% in quarter 3, it appears that UK GDP is likely to have grown at an even faster pace in quarter 4 of 2013. Forward surveys are also very encouraging in terms of strong growth and there are positive indications that recovery is broadening away from reliance on consumer spending and the housing market into construction, manufacturing, business investment and exporting. This strong growth has resulted in unemployment falling much faster towards the threshold of 7%, set by the MPC before it said it would consider any increases in Bank Rate, than it expected last August when that threshold was initially set. Accordingly, markets are expecting a first increase in early 2015 though recent comments from MPC members have emphasised they would want to see strong growth well established, and an increase in real incomes, before they would consider raising Bank Rate.
- Also encouraging has been a sharp fall in inflation (CPI) to 2.1% in November and forward indications are that inflation will continue to be subdued. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and fostered optimism for achieving a balance in the cyclically adjusted budget within five years, a year earlier than previously forecast.
- The big news in financial markets was that the Federal Reserve, in December, felt sufficiently confident that the premise for strong growth had been established in America that it could start to taper its asset purchases by reducing them by $10bn per month from January 2014. These encouraging growth scenarios in the USA and UK led to a sharp jump up, in December, in short dated gilts; this, accordingly, impacted 5 and 10 year PWLB rates.

2. Interest rate forecast

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%
5yr PWLB rate	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%
10yr PWLB rate	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%
25yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%
50yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%

Capita Asset Services undertook a review of its interest rate forecasts in late November, after the Bank of England's latest quarterly Inflation Report. This latest forecast now includes a first increase in Bank Rate in quarter 2 of 2016 (previously quarter 3) and reflects greater caution as to the speed with which the MPC will start increasing Bank Rate than the current expectations of financial markets.

SUMMARY OUTLOOK

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market, Forward surveys are currently very positive in indicating that growth prospects are also strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. Labour productivity must improve significantly before increases in pay rates are warranted. With regard to the US, the main world economy, it faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although labour force participation rates remain lower than ideal.

As for the Eurozone, concerns have subsided considerably in 2013. However, sovereign debt difficulties have not gone away and major concerns could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

3. NHDC Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2013/14, which includes the Annual Investment Strategy, was approved by the Council on 13th Feb 2013. It sets out the Council's investment priorities as being security of capital, liquidity and yield.

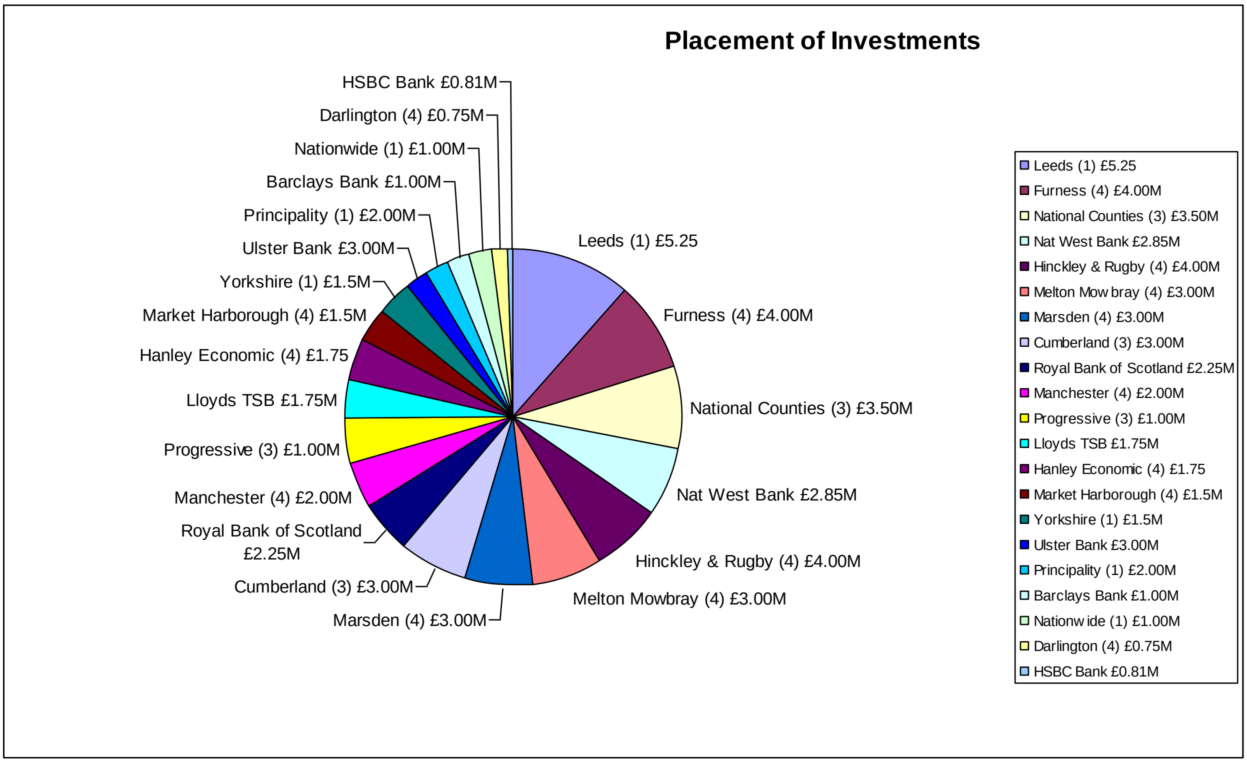
The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in higher rates in periods up to 24 months.

Investments as at 31 Dec 2013

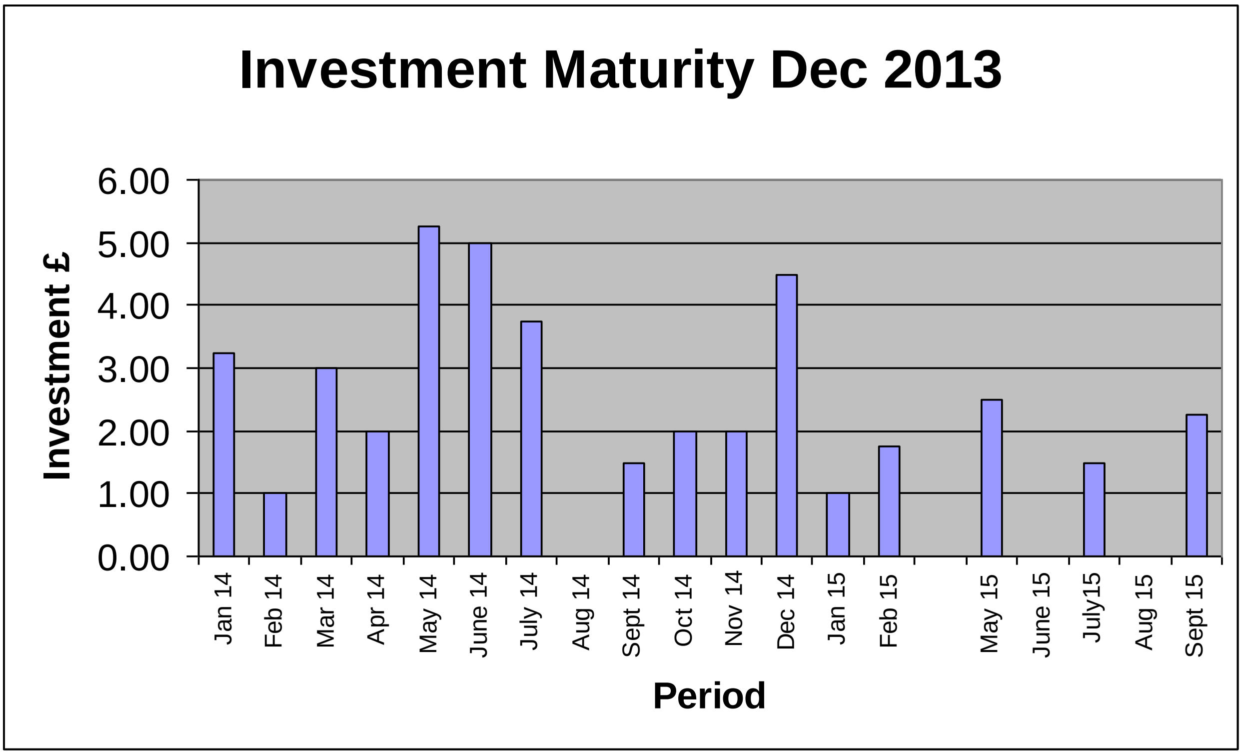
	Amount £	**Average Interest Rate %**
Managed by NHDC		
Banks	3,260,000	0.49
NHDC Total	**3,260,000**	**0.49**
Managed by Sterling		
Building Societies	19,250,000	1.17
Sterling Total	**19,250,000**	**1.17**
Managed by Tradition		
Banks	6,000,000	1.70
Building Societies	17,000,000	1.10
Tradition Total	**23,000,000**	**1.27**
TOTAL	**45,510,000**	**1.22**

The pie chart below shows the spread of investment balances as at 31 Dec 2013. The figures shown are in millions whilst the figure in brackets denotes the value of the building societies total assets:

(1) Building Societies with Assets over £4.5bn
(2) Building Societies with Assets between £2.5bn - £4.5bn
(3) Building Societies with Assets between £1.0bn - £2.5bn
(4) Building Societies with Assets between £0.3bn - £1.0bn



The chart below shows the Council's investment maturity profile. (This does not include the £3.065M held in the Nat West Liquidity account or £0.195M held in the HSBC call account which can be called back on any day).

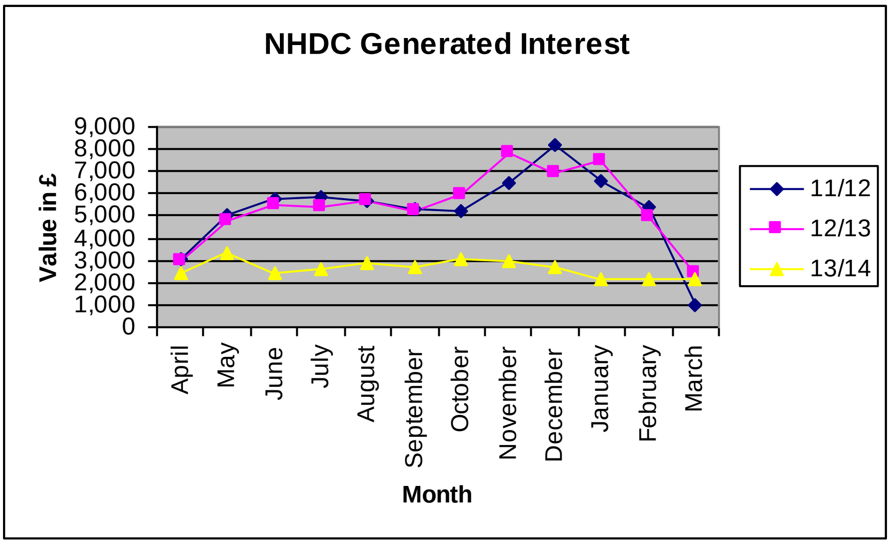


The average level of funds available for investment purposes during the quarter was £7.32M. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. In April, the Council held £46M core cash balances for investment purposes (i.e. funds available for more than one year). This reduced to £42.25M in August when £3.75M was brought back in house in anticipation of the purchase of the DCO. This balance will reduce further in the final quarter of 2013/14 to fund the Capital Programme.

Investment performance for quarter ended 31 Dec 2013

The Council's budgeted investment return for 2013/14 is £0.691M, and performance for the year to date is £2k above budget, giving a new budget of £0.693M.

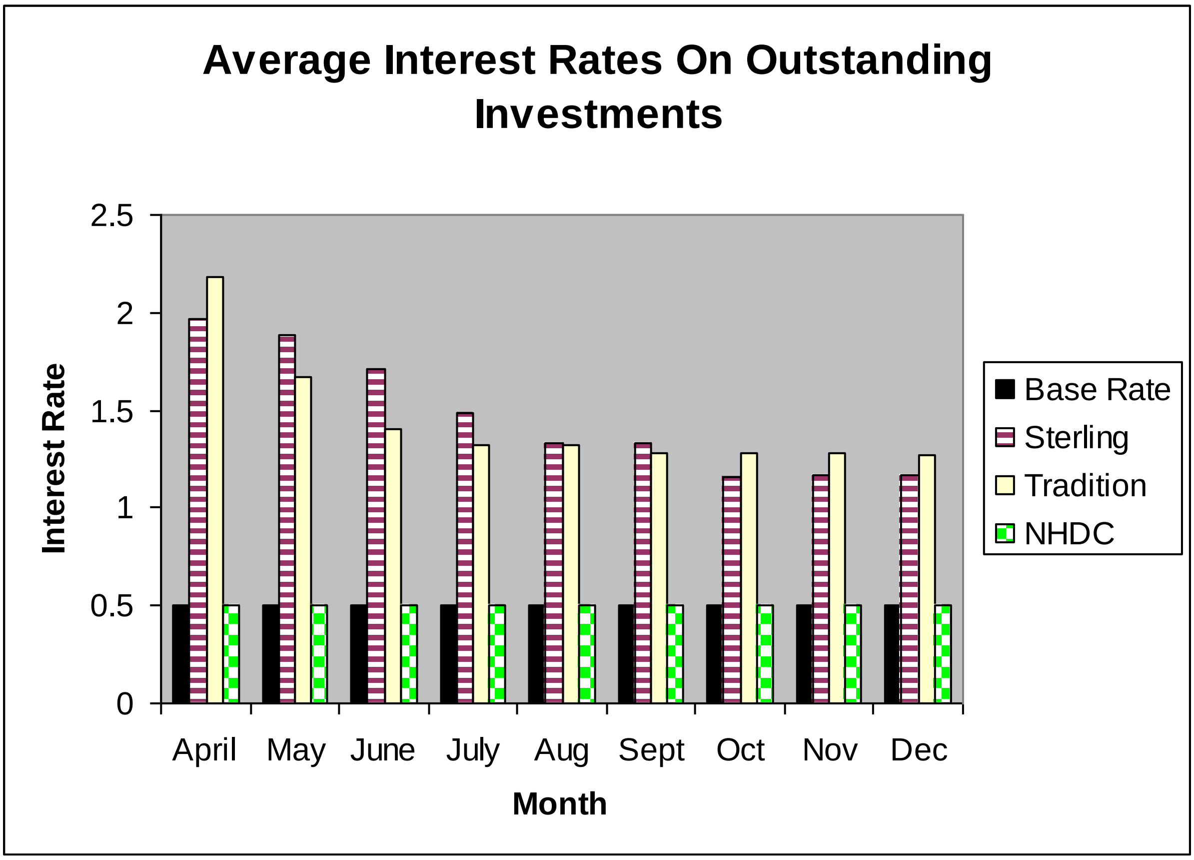
The graph below shows the level of interest expected to be generated from the cash available in-house over the year which is maintained to ensure adequate cashflow.



The table below shows the average rates achieved on investments made during the third quarter.

	Ave Interest Rate on Deals made in the 3rd Quarter %
NHDC	0.47
Sterling	1.47
Tradition	1.00

Base rate remained constant at 0.5% through the first nine months. The graph below shows the average rate of interest on outstanding Investments.



As can be seen from the graph, the average rate of interest on outstanding investments for NHDC is consistently lower than that of the Cash Managers. This is because the investments made by NHDC during the year are to meet cash flow requirements and are therefore made for short periods. At present, rates in the shorter periods are lower than the longer periods. The Cash Managers have more long term investments and the turnover of investments is small in comparison to NHDC.

4. New borrowing:

No long tern borrowing was undertaken during the quarter however, £4.61M was borrowed temporarily to aid cashflow.

Lender	Amount £	Date	Maturity	Interest Rate	Total Interest
City of Edinburgh Council	1,000,000	28/11/13	13/01/14	0.5%	630.14
Rhondda Cynon Taff CBC	2,610,000	24/12/13	02/01/14	0.3	193.07
Rhondda Cynon Taff CBC	1,000,000	24/12/13	02/01/14	0.35	86.30
	4,610,000				**909.51**

The table below show the current borrowing rates available from the Public Works Loans Board.

PWLB certainty rates, quarter ended 31st Dec 2013

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.08%	2.23%	3.35%	4.16%	4.18%
Date	17/12/2013	31/10/2013	31/10/2013	30/10/2013	30/10/2013
High	1.23%	2.78%	3.90%	4.47%	4.43%
Date	27/12/2013	30/12/2013	30/12/2013	27/12/2013	27/12/2013
Average	1.13%	2.43%	3.59%	4.32%	4.31%

Loans Outstanding as at 31 Dec 2013

	Amount £	Average Interest Rate %	Cumulative Rate %
Public Works Loans Board	709,461	8.16	8.85
Lender Option Borrower Option Loans	1,000,000	10.13	10.10
Temporary Loans 364 Days and under	4,610,000	0.354	0.422
	6,319,461	2.78	8.53

The Operational Boundary for external debt is £6.0M. This limit was exceeded for 9 days in December by £0.319M due to a shortage in cashflow. The Authorised limit of £8.0M was not exceeded. The total loan repayments during the year will be £7,215,400. This is made up of the temporary loan of £6.61M (£2.0M was repaid in April) and PWLB loans reaching maturity.

5. Debt Rescheduling

No debt rescheduling was undertaken during the quarter.

6. Compliance with Treasury and Prudential Limits

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 TMSS.

During the financial year to date the Council exceeded the Operational Boundary for 9 days. Apart from this breach, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown below.

Prudential Indicator	**2013/14 Budget £'000**	**As at 31 Dec 2013 £'000**
Capital expenditure	8,918	5,535
In year borrowing requirement	0	4.610
Authorised limit for external debt	8,000	6,319
Operational boundary for external debt	6,000	6.319
Gross borrowing	2,265	6.319
Investments	(44,235)Ave	(45,510)
Net borrowing	(41,970)	(39,191)*
Capital Financing Requirement (CFR)	(32,983)	(32,983)
Limit of fixed interest rates based on investment	70%-100%	97%
Limit of variable interest rates based on investments	0%-30%	3%
Principal sums invested > 364 days	20,000 Max	8,000
Maturity structure of borrowing limits		
Under 12 months	605	555
12 months to 2 years	87	87
2 years to 5 years	1,116	1,116
5 years to 10 years	88	88
10 years and above	367	367

* The Net borrowing (outstanding borrowing less cash investments) is a credit of £39M as at the end of Dec. 2013 because the Council has more cash investments than borrowing. As a result the Capital Financing Requirement is negative.