

NEW FOREST NATIONAL PARK AUTHORITY

AUTHORITY MEETING – 11 DECEMBER 2008

TREASURY MANAGEMENT PERFORMANCE REPORT – 1 APRIL 2008 TO 31 OCTOBER 2008

Report by: Jan Hawker, Treasury Manager

Summary:

This report sets out Treasury Management activity results for the first half year. In themselves these are unaffected by the holding of £0.5m with Heritable Bank, which is in receivership, as this is not yet due to be repaid. However, the opportunity is taken to update the Authority on the position in this respect, and on the approach being applied to Treasury Management in the light of the current economic position.

Recommendation:

To note the performance of the treasury management function for the period from 1 April 2008 to 31 October 2008.

Papers:

NFNPA 276/08:	Treasury Management Performance Report – 1 April 2008 to 31 October 2008
NFNPA 276/08 Annex 1:	Temporary investments outstanding as at 31 October 2008

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1 Introduction

1.1 This report covers the period 1 April 2008 to 31 October 2008 for the Authority's treasury management activities.

2 Strategy for 2008/09

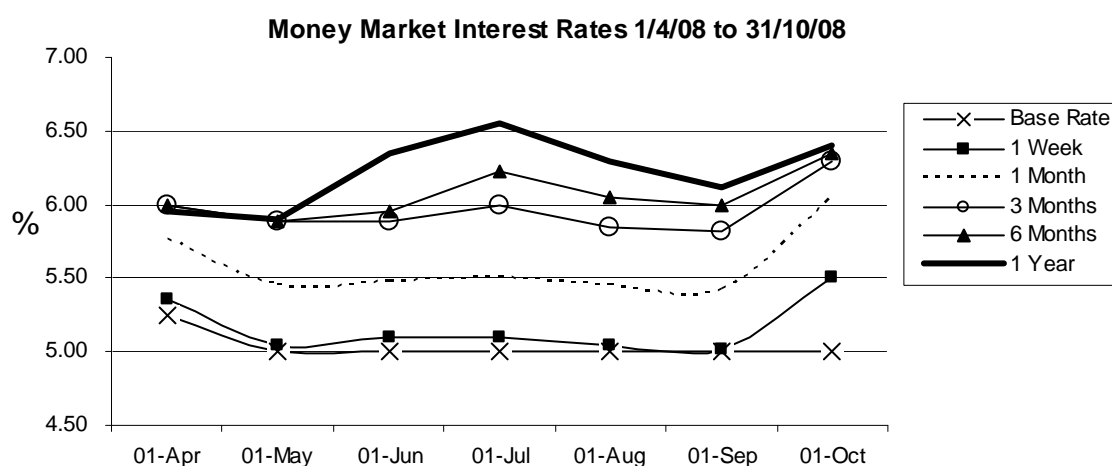
2.1 The Committee approved the Treasury Management Strategy for 2008/09 at its meeting on 4 March 2008.

2.2 Within the strategy, the overriding principle is the security of the Authority's investments, also requiring sufficient liquidity to be maintained in those investments and specific approval of categories of acceptable investments and investment counterparties. These are monitored on a daily basis.

3 Summary of interest rates

Investment Rates

3.1 Since April 2008, money market investment rates for one week to one year have varied between 4.95% and 7.00%.



3.2 The chart above shows that, in April, the money market investment rates were decreasing steadily as expected as the shortage of cash in the system was thought to be slowly easing. Then six-month rates and one-year rates took a sharp upturn in June and July as cash shortages saw banks struggling to continue trading and banks willingness to lend to each other becoming more restrictive. The one-year rate peaked at 7% in mid June.

- 3.3 Following the Bank of England's intervention, interest rates in all periods eased back. However, there was still a cash shortage which kept interest rates artificially high in the shorter investment periods. During this period the Authority took the opportunity of investing some surplus cash for up to 6 months at interest rates in excess of 6%.

4 Market background

- 4.1 The Bank of England reduced interest rates to 5.0% in April and then again to 4.5% in October. These reductions continued a falling trend which started from a high point of 5.75% in July 2007.
- 4.2 The uncertainties in the economic and financial outlook were reflected in the split of votes on the Monetary Policy Committee with a three-way split in July and August with one member calling for a cut, another for a rise, while the majority voted for no change. The minutes of the June meeting of the Committee indicated that there was discussion about whether interest rates should be raised because of the danger of wage demands and the associated inflation that this would generate.
- 4.3 In September economists suggested that because of the level of inflation and the fear about wage bargainers' expectations it was expected that there was little prospect of any immediate cut in interest rates, although they did believe there would be cuts next year.
- 4.4 In October the continuing credit crisis was the catalyst for some banks to have difficulty in funding their debt despite the intervention of Central Banks. Several US and Icelandic banks failed, stock markets across the world recorded record loses and economists stated that the UK was officially in recession. The Monetary Policy Committee cut the bank base rate to 4.5%.
- 4.5 These events cumulated with the UK promising to inject substantial cash into UK banks and underwriting UK retail savers with the Icelandic banks. The G7 countries agreed to bank rescue plans similar to that of the UK.
- 4.6 September's consumer price index reached 5.2%. This continued a trend that had developed over the summer and was in excess of the Monetary Policy Committee's target inflation figure.
- 4.7 Available funds in the money markets were already restricted but these further events lessened supply still further and placed significant upward pressure on money market yields for periods from one month up to one year.
- 4.8 With falling consumer confidence and worsening trade figures, signally the probability of recession, the Monetary Policy Committee cut the bank base rate to 3% in November.
- 4.9 The movements in the bank base rate during the year to date were as follows:

Date	Bank Base Rate
At 1 April 2008	5.25%
11 April 2008	5.00%
9 October 2008	4.50%
7 November 2008	3.00%

- 4.10 At the time of writing this report, economists were forecasting a reduction in the bank base rate in the early spring with further reductions in the summer. The money markets show no such forecast but are an unreliable indicator of future rates currently as they are showing an unrealistic margin over the base rate because the supply of cash is still limited by the “credit crunch”.

5 Temporary investments

- 5.1 Temporary Investments are deposits which are capable of being repaid within one year. The term of the loans will be negotiated from overnight to 364 days.
- 5.2 The interest earned on temporary investments for the period to 31 October 2008 was equivalent to an annual rate of return of 5.83%.
- 5.3 The original estimate for interest earnings for 2008/09 was £120,000 based on an average forecast interest rate of 5.25%.
- 5.4 The current estimate for interest receivable on temporary investments, for 2008/09, is £160,000 based on an anticipated return of 5.85% for the year.
- 5.5 The increased interest rate accounts for £14,000 of the estimated additional earnings, the remaining £26,000 is due to a higher than anticipated balance of investments during the year.
- 5.6 A list of temporary investments at 31 October 2008 is shown at **Annex 1**.
- 5.7 All temporary investments have been invested according to the parameters set within the Authority’s Treasury Policy Statement.

6 Icelandic Banks

- 6.1 In October the Sovereign Government of Iceland withdrew support from one of the country’s banks and allowed the others to fail. This action has caused many local authorities, companies, charities and individual savers concern over whether their money will be repaid.
- 6.2 In the case of individual savers the UK Government has guaranteed the money deposited with the banks. This guarantee has not however been extended to the other categories of depositor.
- 6.3 The Government’s first priority has been to do everything it can to help local authorities, along with other creditors, get their money back. The Chancellor of the Exchequer acted quickly to freeze the UK assets of Landsbanki and, on 17 October, the Bank of England provided a short term secured loan of up to £100 million to the London branch of Landsbanki, which will help to ensure an orderly wind down for Landsbanki and maximise returns to UK creditors.
- 6.4 Following conversations between the Chancellor and Icelandic Prime Minister, officials from the Treasury and Bank of England travelled to Iceland on 22 October to have further discussions with the Icelandic authorities. The aim of these discussions was to agree a mechanism whereby the Icelandic government can honour its obligations to UK depositors and ensure the fair treatment of UK creditors. In relation to the banks in administration in the UK - Kaupthing Singer & Friedlander and Heritable – the Government is working to ensure that deposits are recovered as quickly as possible. The Local Government Association has opened discussions with the administrators, Ernst and Young. The Association reported on 14 October that, in broad terms, the administrators considered that the book value of the assets of

each business appeared to be of the same order of magnitude as the liabilities, but that the recoveries for the local authorities would be dependent on the final level of actual realisations.

7 Exposure to Heritable Bank

- 7.1 The Authority has an exposure of £500,000 to Heritable Bank, one of the Icelandic Banks that failed in October.
- 7.2 This deposit was made on 14 March 2008 at 5.87% and was for a term of 364 days maturing on 13 March 2009.
- 7.3 At the time of investment the credit rating of the bank was of a good investment grade. On the 1 April 2008 all Icelandic banks were placed on negative rating watch. This means that the credit rating agencies were considering downgrading the credit rating of the organisation. No other investments were made in any Icelandic bank after this date.
- 7.4 This Investment is at risk currently. Although the administrators, Ernst and Young have stated that assets are sufficient to cover the liabilities of Heritable Bank it is not known yet whether the full amount of the investment will be recovered.
- 7.5 The interest due on this loan at the end of the investment period is £29,269.59. This sum has been registered as a creditor and will rank ahead of shareholders when settlement is complete.
- 7.6 The interest earnings estimate at paragraph 5 above assumes that this money will be received in full.

8 Current investment policy

- 8.1 Following the failure of the Icelandic banks, and the Authority's exposure to Heritable Bank, investments have been concentrated in the British building society sector.
- 8.2 Some deposits may also be placed with the Authority's bankers, other local authorities and with institutions that are fully guaranteed by a sovereign government.
- 8.2 The Authority is able to deposit funds currently with:
- British building societies with assets in excess of £250 million
 - other local government borrowers
 - banks and building societies in Ireland which are fully guaranteed by the Irish government
 - Dexia Bank which is fully guaranteed by the Belgian, French and Luxembourg governments
 - National Australia Bank which is fully guaranteed by the Australian government
 - Lloyds TSB bank, the Authority's bankers.
- 8.3 The maximum investment is for £500,000 with any one counterparty at any one time and for a maximum term of three months currently.
- 8.4 No funds will be placed with any institution that is subject to a negative rating watch.
- 8.5 This restricted policy will be monitored daily and reviewed periodically.

9 Investment benchmark

- 9.1 The interest earnings are measured against a benchmark.
- 9.2 The benchmark is equivalent to the average seven day LIBID rate available through the money markets and is measured over the financial year.
- 9.3 The table below shows the performance of the Authority's investments compared with the benchmark. The performances are shown as annualised figures.
- 9.4 Results to 31 October 2008 are summarised as follows:

	%
Benchmark Return (annualised)	5.06
Actual Return (annualised)	<u>5.83</u>
Return above Benchmark	<u>0.77</u>

- 9.5 As at 31 October 2008 interest earnings exceeded the benchmark by an annualised 0.77%; this equates to £14,000 for the period to 31 October 2008.

10 Investment instruments

- 10.1 All of the investments are made in money market deposits.
- 10.2 Money market deposits earn a yield that is made up entirely of interest earnings. There is no capital appreciation. No Gilts or Certificates of Deposits are used.

11 Compliance with the CIPFA code of practice

- 11.1 All treasury functions and debt management procedures, which were undertaken during the period, complied with the existing CIPFA Code of Practice on Treasury Management, as set out in the Authority's Treasury Policy Statement, and the Treasury Management Strategy for 2008/09.

12 Conclusions

- 12.1 Temporary interest earnings of £160,000 are now forecast for 2008/09.
- 12.2 The performance of the treasury function is estimated to exceed the benchmark by £22,000 for the year.
- 12.3 The Authority has an exposure of £500,000 to an Icelandic bank.

13 Recommendations

To note the performance of the treasury management function for the period from 1 April 2008 to 31 October 2008.

**TEMPORARY INVESTMENTS OUTSTANDING
AT 31 OCTOBER 2008**

Institution	Amount of Investment £	Interest Rate %	Start Date	Maturity Date
Derbyshire Building Society	500,000	5.49	09.01.08	07.01.09
Heritable Bank	500,000	5.87	14.03.08	13.03.09
EBS Building Society	500,000	6.00	21.08.08	23.02.09
Darlington Building Society	500,000	5.60	17.09.08	19.11.08
Irish Life & Permanent Bank	500,000	6.12	03.10.08	20.11.08
West Bromwich Building Society	450,000	6.13	03.10.08	19.12.08
Lloyds TSB Bank (call account)	350,000	3.75		
	<u>3,300,000</u>			