

# APPENDIX A

## **Annual Treasury Management Review 2012/13**

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# Annual Treasury Management Review 2012/13

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## Purpose

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2012/13. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2012/13 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 01/02/2012)
- a mid-year (minimum) treasury update report (Council 12/12/2012)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, Members have received quarterly treasury management update reports as part of the Members Newsletter.

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Budget & Strategic Planning Working Group before they were reported to the full Council. Member training on treasury management issues has also been undertaken in order to support members' scrutiny role.

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## Executive Summary

During 2012/13, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	2011/12 Actual £000	2012/13 Original £000	2012/13 Actual £000
Capital expenditure	4.586	4.448	4.527
Capital Financing Requirement:	0.189	7.913	0.176
• Non-HRA	31.904	32.078	31.890
• HRA	32.093	39.991	32.066
• Total			
Net borrowing	16.961	36.321	18.261
External debt	31.861	36.549	31.861
Investments			
• Longer than 1 year	All investments - £14.9m are less than one year	N/A	All investments - £13.6m are less than one year
• Under 1 year			
• Total			

Other prudential and treasury indicators are to be found in the main body of this report. The Head of Central Services also confirms that no borrowing was undertaken for a capital purpose and therefore the statutory borrowing limit (the authorised limit) was not breached.

The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns.

## Recommendations

The Council is recommended to:

1. Approve the actual 2012/13 prudential and treasury indicators in this report
2. Note the annual treasury management report for 2012/13

## Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

### 1. The Council's Capital Expenditure and Financing 2012/13

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

General Fund	2011/12 Actual £m	2012/13 Estimate £m	2012/13 Actual £m
<b>Capital expenditure</b>	<b>3.225</b>	<b>5.830</b>	<b>3.472</b>
Financed in year	3.225	5.830	3.472
<b>Unfinanced capital expenditure</b>	<b>0</b>	<b>0</b>	<b>0</b>

HRA	2011/12 Actual £m	2012/13 Estimate £m	2012/13 Actual £m
<b>Capital expenditure</b>	<b>1.36</b>	<b>1.803</b>	<b>1.055</b>
Financed in year	1.36	1.803	1.055
<b>Unfinanced capital expenditure</b>	<b>0</b>	<b>0</b>	<b>0</b>

## 2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2012/13 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

**Reducing the CFR** – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need (there is no statutory requirement to reduce the HRA CFR). This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2012/13 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2012/13 on 01/02/2012.

The Council's CFR for the year is shown below, and represents a key prudential indicator..

CFR : General Fund	31 March 2012 Actual £m	31 March 2013 Revised Budget £m	31 March 2013 Actual £m
Opening balance	5.297	0.189	0.189
Add unfinanced capital expenditure (as above)	0	0	0
Less MRP/VRP*	-0.228	-0.013	-0.013
Use of capital receipts to repay General Fund CFR	-4.88	0	0

CFR : General Fund	31 March 2012 Actual £m	31 March 2013 Revised Budget £m	31 March 2013 Actual £m
Closing balance	0.189	0.176	<b>0.176</b>

CFR : HRA	31 March 2012 Actual £m	31 March 2013 Budget £m	31 March 2013 Actual £m
Opening balance	4.296	31.904	31.904
Add unfinanced capital expenditure (as above)	0	0	0
Less VRP*	-0.014	-0.014	-0.014
Add adjustment for HRA reform	27.622	0	<b>0</b>
Closing balance	31.904	31.890	<b>31.890</b>

\* Includes voluntary application of capital receipts

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

**Net borrowing and the CFR** - in order to ensure that borrowing levels are prudent over the medium term, the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2012/13 plus the expected changes to the CFR over 2013/14 and 2014/15 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2012/13. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

It should be noted that this indicator is changing to compare gross borrowing to the CFR with effect from 2013/14; this is expected to provide a more appropriate indicator.

	31 March 2012 Actual £m	31 March 2013 Budget £m	31 March 2013 Actual £m
Net borrowing position	16.961	20.837	18.261
CFR	32.093	32.066	32.066

**The authorised limit** - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2012/13 the Council has maintained gross borrowing within its authorised limit.

**The operational boundary** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

**Actual financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

All Funds	2012/13 £m
Authorised limit	44.0
Operational boundary	32.040

Non-HRA	2012/13 £m
Financing costs as a proportion of net revenue stream	-1.75%

HRA	2012/13 £m
Maximum gross borrowing position	31.861
Average gross borrowing position	31.861
Financing costs as a proportion of net revenue stream	16.29%

### 3. Treasury Position as at 31 March 2013

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2012/13 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

TABLE 1	31 March 2012 Principal £m	Rate/ Return %	Average Life yrs	31 March 2013 Principal £m	Rate/ Return %	Average Life yrs
Fixed rate funding:						
-PWLB	31.86	4.6	39	31.86	3.68	35
-Market	0	0	0	0	0	0
Variable rate funding:						
-PWLB	0	0	0	0	0	0
-Market	0	0	0	0	0	0
<b>Total debt</b>	<b>31.86</b>	<b>4.6</b>	<b>39</b>	<b>31.86</b>	<b>3.68</b>	<b>35</b>

<b>CFR</b>	<b>32.1</b>				
<b>Over / (under) borrowing</b>	<b>-0.24</b>				
Investments:					
- in house	14.9	0.49		13.6	0.58
- with managers	0	0		£0	0
<b>Total investments</b>	<b>£14.9</b>	<b>0.49</b>		<b>13.6</b>	<b>0.58</b>

The maturity structure of the debt portfolio was as follows:

	31 March 2012 Actual £m	31 March 2013 Actual £m
Under 12 months	0	0
12 months and within 24 months	0	0.448
24 months and within 5 years	0.448	0
5 years and within 10 years	0	0
10 years and above	31.413	31.413

The maturity structure of the investment portfolio was as follows:

	2011/12 Actual £000	2012/13 Original £000	2012/13 Actual £000
Investments			
Longer than 1 year	All investments are less than one year--£14.9m	N/A	All investments are less than one year--£13.6m
Under 1 year			
Total			



The exposure to fixed and variable rates was as follows:

	31 March 2012 Actual £m	2012/13 Original Limits £m	31 March 2013 Actual £m
Fixed rate (principal or interest)	23	41	24
Variable rate (principal or interest)	-6	8	-6

*Both rows are expressed as net principal sums outstanding of borrowing and investments*

## 4. The Strategy for 2012/13

The expectation for interest rates within the strategy for 2012/13 anticipated low but rising Bank Rate (starting in quarter 4 of 2014), with similar gradual rises in medium and longer term fixed borrowing rates over 2012/13. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant that PWLB rates fell during the first quarter of the year to historically low levels. This was caused by a flight to quality into UK gilts from EU sovereign debt, and from shares, as investors became concerned about the potential for a Lehman's type crisis of financial markets, if the Greek debt crisis were to develop into a precipitous default and exit from the Euro. During the second and third quarters, rates rose gradually and agreement of a second bail out for Greece in December saw the flight to quality into gilts reverse somewhat, as confidence rose that the Eurozone crisis was finally subsiding. However, gilt yields then fell back again during February and March as Eurozone concerns returned, with the focus now shifting to Cyprus, and flight to quality flows into gilts resumed. This was a volatile year for PWLB rates, driven by events in the Eurozone which oscillated between crises and remedies.

**Change in strategy during the year** – the strategy adopted in the original Treasury Management Strategy Report for 2012/13 and approved by the Council was not subject to revision during the year.

**The wording contained in the following section has been provided by the Council's Treasury Management Advisors.**

## 5. The Economy and Interest Rates

**Sovereign debt crisis.** The EU sovereign debt crisis was an ongoing saga during the year. However, the ECB statement in July that it would do “whatever it takes” to support struggling Eurozone countries provided a major boost in confidence that the Eurozone was (at last) beginning to get on top of its problems. This was followed by the establishment of the Outright Monetary Transactions Scheme in September. During the summer, a €100bn package of support was given to Spanish banks. The crisis over Greece blew up again as it became apparent that the first bailout package was insufficient. An eventual very protracted agreement of a second bailout for Greece in December was then followed by a second major crisis, this time over Cyprus, towards the end of the year. In addition, the Italian general election in February resulted in the new Five Star anti-austerity party gaining a 25% blocking vote; this has the potential to make Italy almost ungovernable if the grand coalition formed in April proves unable to agree on individual policies. This could then cause a second general election – but one which could yield an equally ‘unsatisfactory’ result! This result emphasises the dangers of a Eurozone approach heavily focused on imposing austerity, rather than promoting economic growth, reducing unemployment, and addressing the need to win voter support in democracies subject to periodic general elections. This weakness leaves continuing concerns that this approach has merely postponed the ultimate debt crisis, rather than provide a conclusive solution. These problems will, in turn, also affect the financial strength of many already weakened EU banks during the expected economic downturn in the EU. There are also major questions as to whether the Greek Government will be able to deliver on its promises of cuts in expenditure and increasing tax collection rates, given the hostility of much of the population.

**The UK coalition Government** maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Moody’s followed up this warning by actually downgrading the rating to AA+ in February 2013 and Fitch then placed their rating on negative watch, after the Budget statement in March. Key to retaining the AAA rating from Fitch and S&P will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within a reasonable timeframe.

**UK growth.** 2012/13 started the first quarter with negative growth of -0.4%. This was followed by an Olympics boosted +0.9% in the next quarter, then by a return to negative growth of -0.3% in the third quarter and finally a positive figure of +0.3% in the last quarter. This weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing (QE) by £50bn in July to a total of £375bn on concerns of a downturn in growth and a forecast for inflation to fall below the 2% target. QE was targeted at further gilt purchases. In the March 2013 Budget, the Office of Budget Responsibility yet again slashed its previously over optimistic growth forecasts, for both calendar years 2013 and 2014, to 0.6% and 1.8% respectively.

**UK CPI inflation** has remained stubbornly high and above the 2% target, starting the year at 3.0% and still being at 2.8% in March; however, it is forecast to fall to 2% in three years time. The MPC has continued its stance of looking through temporary spikes in inflation by placing more importance on the need to promote economic growth.

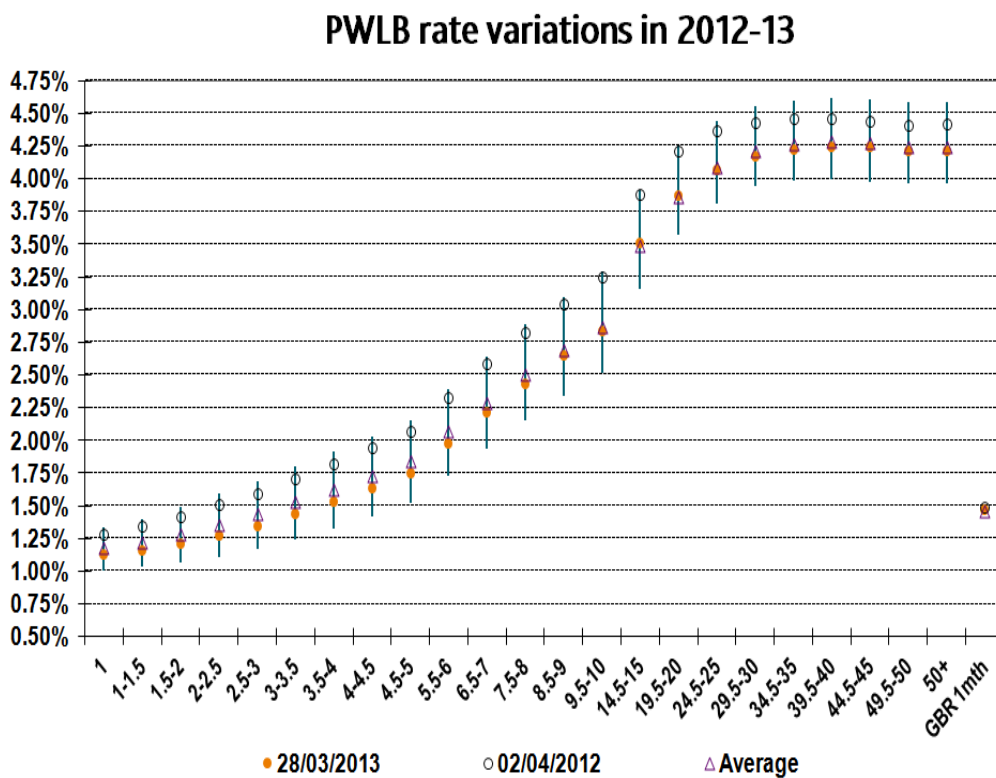
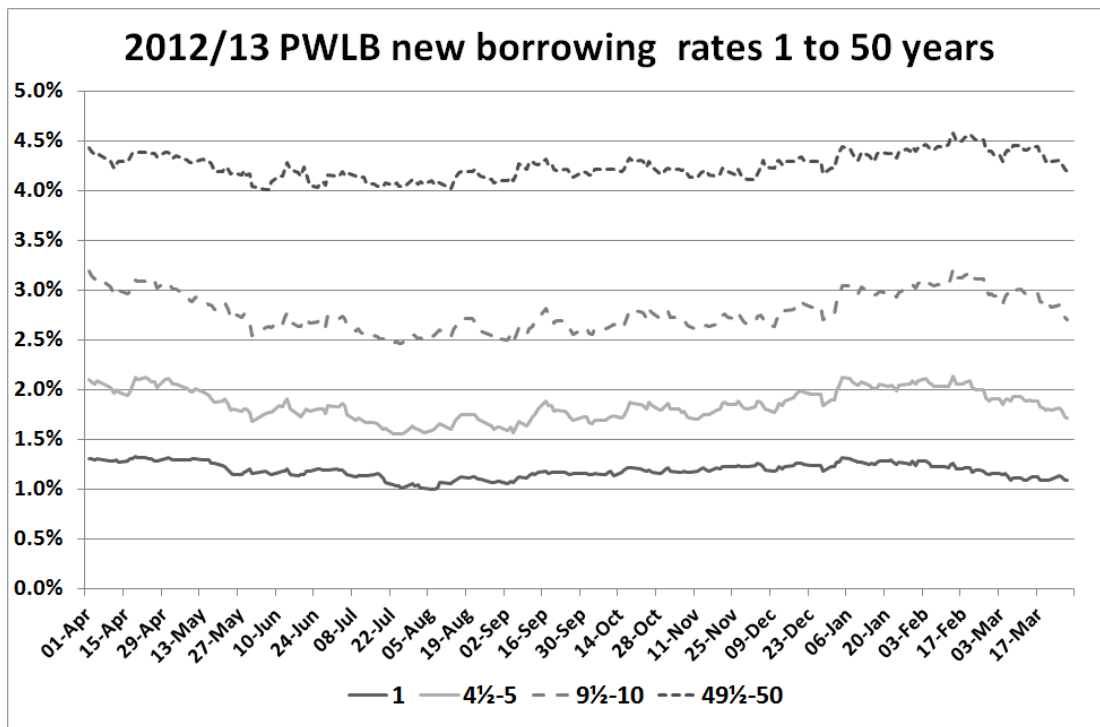
**Gilt yields** oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PwLB rates depressed for much of the year at historically low levels.

**Bank Rate** was unchanged at 0.5% throughout the year, while expectations of when the first increase would occur were pushed back to quarter 1 2015 at the earliest.

**Deposit rates.** The Funding for Lending Scheme, announced in July, resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling sharply in the second half of the year. However, perceptions of counterparty risk have improved after the ECB statement in July that it would do “whatever it takes” to support struggling Eurozone countries. This has resulted in some return of confidence to move away from only very short term investing.

## 6. Borrowing Rates in 2012/13

**PWLB borrowing rates** - the graphs and table for PWLB maturity rates below, and in appendix 3, show, for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.



## 7. Borrowing Outturn for 2012/13

**Treasury Borrowing** – there was no requirement for any short term borrowing during the year.

### Borrowing

Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.

### Rescheduling

No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

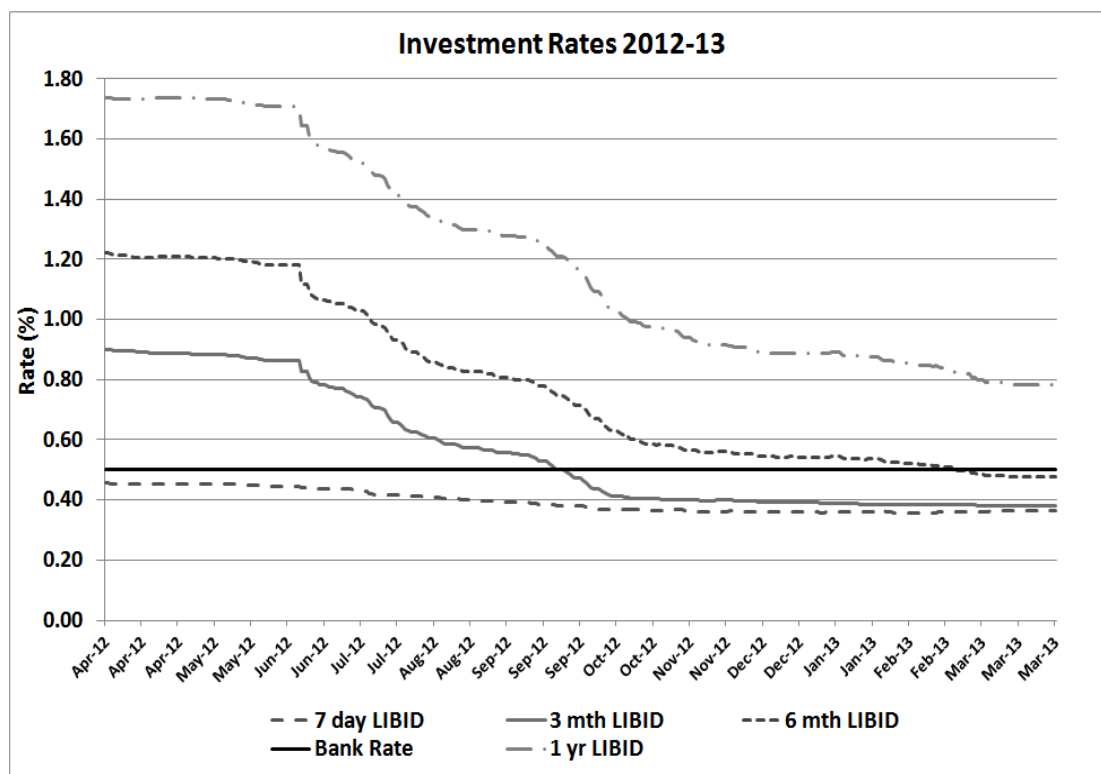
### Repayments

No repayments were made during the year.

**Summary of debt transactions** – A change in the debt portfolio following the repayments of General Fund debt resulted in a fall in the average interest rate by 0.92%.

## 8. Investment Rates in 2012/13

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for four years. Market expectations of the start of monetary tightening were pushed back during the year to early 2015 at the earliest. The Funding for Lending Scheme resulted in a sharp fall in deposit rates in the second half of the year.



<b>Money market investment rates 2012/13</b>						
	<b>overnight</b>	<b>7 day</b>	<b>1 month</b>	<b>3 month</b>	<b>6 month</b>	<b>1 year</b>
<b>1/4/12</b>	<b>0.432</b>	<b>0.457</b>	<b>0.571</b>	<b>0.902</b>	<b>1.221</b>	<b>1.738</b>
<b>31/3/13</b>	<b>0.361</b>	<b>0.365</b>	<b>0.371</b>	<b>0.382</b>	<b>0.478</b>	<b>0.784</b>
<b>High</b>	<b>0.432</b>	<b>0.457</b>	<b>0.571</b>	<b>0.902</b>	<b>1.221</b>	<b>1.739</b>
<b>Low</b>	<b>0.348</b>	<b>0.355</b>	<b>0.366</b>	<b>0.382</b>	<b>0.476</b>	<b>0.783</b>
<b>Average</b>	<b>0.382</b>	<b>0.394</b>	<b>0.428</b>	<b>0.564</b>	<b>0.782</b>	<b>1.207</b>
<b>Spread</b>	<b>0.084</b>	<b>0.102</b>	<b>0.205</b>	<b>0.520</b>	<b>0.744</b>	<b>0.956</b>
<b>Date</b>	<b>1/4/12</b>	<b>1/4/12</b>	<b>1/4/12</b>	<b>1/4/12</b>	<b>1/4/12</b>	<b>24/4/12</b>
<b>Date</b>	<b>31/12/12</b>	<b>31/1/13</b>	<b>29/1/13</b>	<b>1/3/13</b>	<b>13/3/13</b>	<b>19/3/13</b>

## 9. Investment Outturn for 2012/13

**Investment Policy** – the Council’s investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 1 February 2012. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.)

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

**Resources** – the Council’s cash balances comprise revenue and capital resources and cash flow monies. The Council’s core cash resources comprised as follows:

<b>Balance Sheet Resources</b>	<b>31 March 2012 £m</b>	<b>31 March 2013 £m</b>
Balances	1.417	1.909
Earmarked reserves	2.240	3.670
Provisions	0	0
Usable capital receipts	10.133	7.594
<b>Total</b>	<b>13.790</b>	<b>13.173</b>

**Investments held by the Council** - the Council maintained an average balance of £17.36m of internally managed funds. The internally managed funds earned an average rate of return of 0.58%. The comparable performance indicator is the average 7-day money market rate which was 0.29%. This compares with a budget assumption of £11.65m investment balances earning an average rate of 0.5%.

## 10. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investment activities. The Council's performance indicators were set out in the Annual Treasury Management Strategy.

This service has set the following performance indicators:

- *Investments* – to achieve a return on external investments in excess of the seven day money market rate. In 2012-13 the rate of return was 0.58% (+£50,833) compared to the money market rate of 0.29%. This compares to a gain of £11,212 (0.49%) in the previous year.

The use of benchmarks for investments are inappropriate for local authorities with small cash balances as they may only be able to place funds for short periods and possibly at lower rates.

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