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Report of the Director of Finance to the meeting of Governance and Audit Committee to be held on 1 November 2013.

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Subject:

Annual Treasury Management Report 2012/13

Summary statement:

This report shows the Council's Treasury Management activities for the year ending 31 March 2013.

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Director

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Portfolio:

Corporate

Overview & Scrutiny Area:

[Insert where appropriate]

1. Introduction and Background

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 30/03/2012)
- a mid-year (minimum) treasury update report (Council 21/09/2012)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

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 also 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 Governance and Audit Committee before they were reported to the full Council.

2.0 The Economy and Interest Rates

The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk (the risk of a counterparty defaulting on a loan) . The original expectation for 2012/13 was that Bank Rate (Bank of England interest rate)would start gently rising from quarter 4 2014. However, economic growth in the UK was disappointing during the year due to the UK austerity programme, weak consumer confidence and spending, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the European Union (EU). 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. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £50bn in July to a total of £375bn. Bank Rate therefore ended the year unchanged at 0.5% while CPI(Consumer Price) inflation fell from 3% at the start of the year to end at 2.8% in March, with a fall back to

below 2% pushed back to quarter 1 2016. The European Union (EU) sovereign debt crisis was an ongoing saga during the year with first Greece and then Cyprus experiencing crises which were met with bailouts after difficult and fraught negotiations.
Government debt 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 government debt(gilts). This, together with a further £50bn of Quantitative Easing (QE) in July and widely expected further QE still to come, combined to keep Public Works Loan Board(PWLB) rates depressed for much of the year at historically very low levels.
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 European Central Bank (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.

2.1 Overall Treasury Position as at 31 March 2013

At the beginning and the end of 2012/13 the Council‘s treasury position was as follows:

	31 March 2012 Principal	31 March 2013 Principal
Total debt	**£418.1m**	**£418.5m**
CFR	**£704.2m**	**£689.3m**
Over / (under) borrowing	**£(286.1m)**	**£(270.8m)**
Total investments	**£175.8m**	**£200.9m**
Net debt	**£242.3m**	**£217.6m**

2.2 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 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.

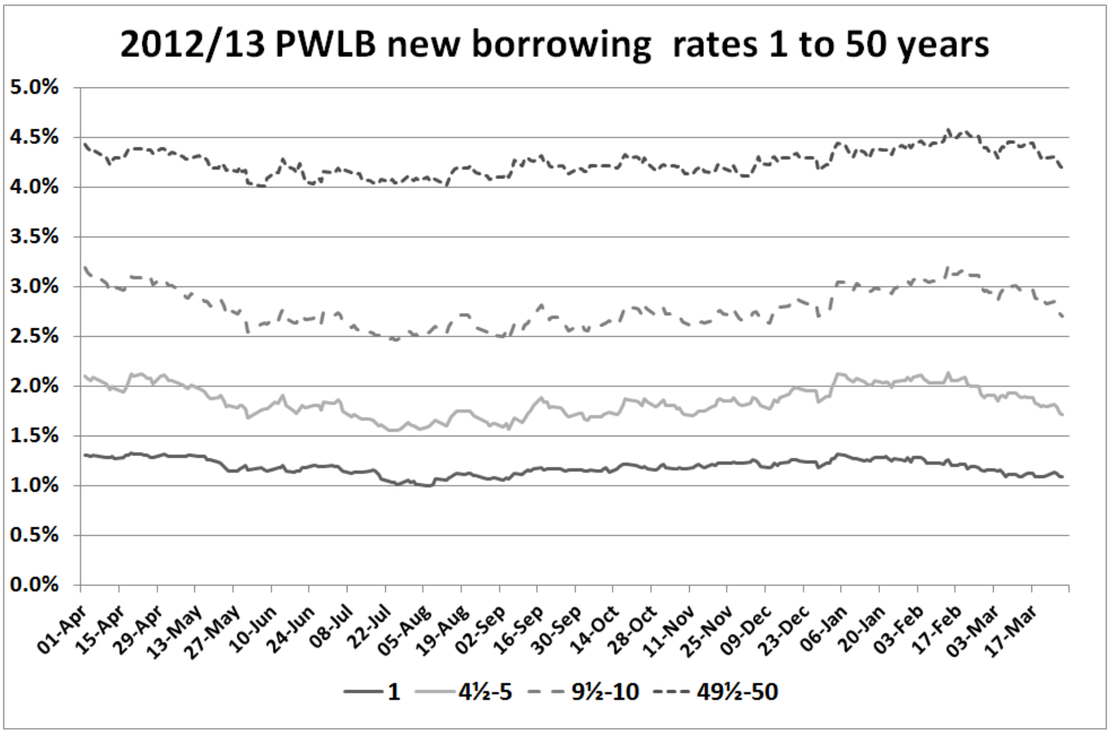
2.3 The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2012 Actual	31 March 2013 Budget	31 March 2013 Actual
CFR General Fund (£m)	704.2m	765.3m	689.3m

2.4 Borrowing Rates in 2012/13

PWLB borrowing rates - the graph below shows how PWLB rates remained close to historically very low levels during the year.

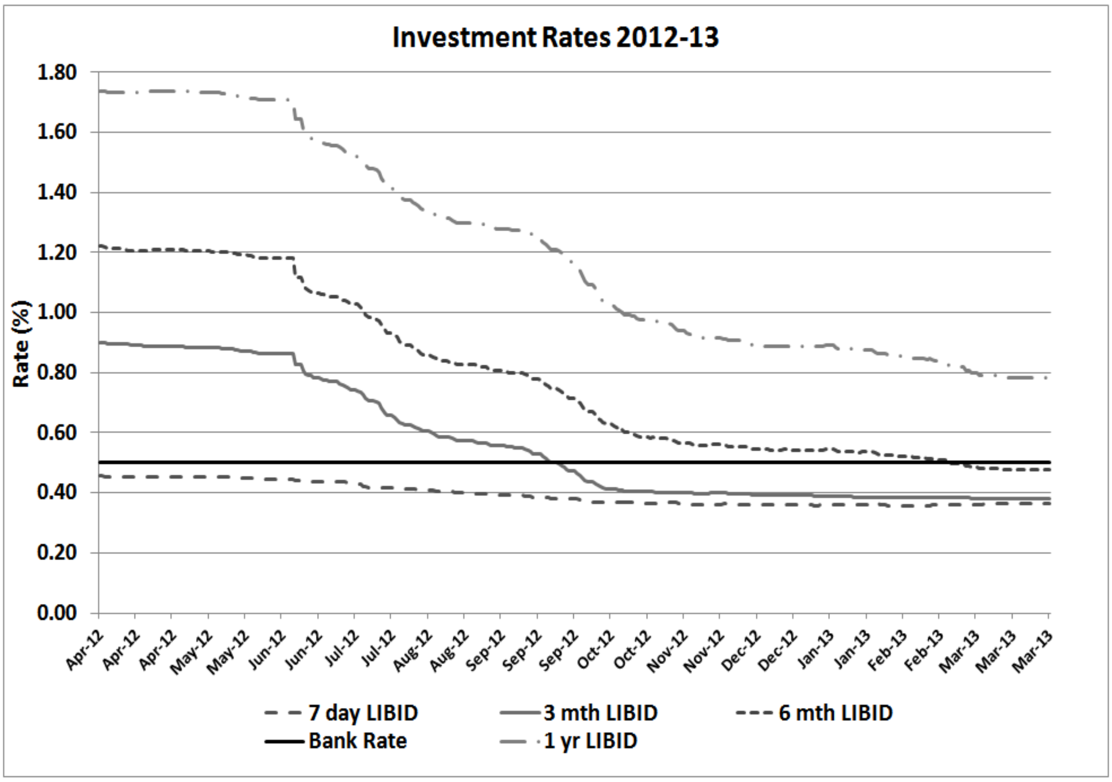


2.5 Borrowing Outturn for 2012/13

Due to investment concerns, both counterparty risk and low investment returns, no borrowing was undertaken during the year.
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

2.6 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.


Investment Rates 2012-13
Rate (%)
1.80
1.60
1.40
1.20
1.00
0.80
0.60
0.40
0.20
0.00
Apr-12
Apr-12
Apr-12
May-12
May-12
Jun-12
Jun-12
Jul-12
Jul-12
Aug-12
Aug-12
Sep-12
Sep-12
Sep-12
Oct-12
Oct-12
Nov-12
Nov-12
Dec-12
Dec-12
Jan-13
Jan-13
Feb-13
Feb-13
Mar-13
Mar-13
Mar-13
7 day LIBID
3 mth LIBID
6 mth LIBID
Bank Rate
1 yr LIBID

2.7 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 12TH October 2010. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies.
The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.
Investments held by the Council - the Council maintained an average balance of £174.1m.The funds earned an average rate of return of 0.92%.The comparable performance indicator is the average 7-day LIBID rate , which was 0.396%. This compares with a budget assumption of £120m investment balances earning an average rate of 0.7%.

2.8 Other Issues

No other issues.

3. Other Considerations

3.1 None

4. Financial and Resources Appraisal

4.1 The financial implications are set out in Section 2

5. Risk Management and Governance Issues

5.1 None

6. Legal Implications

6.1 Any relevant legal considerations are set out in the report

7. Other Implications

7.1 Equal & Diversity – no direct implications

7.2 Sustainability implications – no direct implications

7.3 Green Gas Emission Impacts – no direct implications

7.4 Community Safety Implications – no direct implications

7.5 Human Rights Act – no direct implications

7.6 Trade Union – no direct implications

7.7 Ward Implications - none

8. Not for publications documents

8.1 None

9. Recommendations

9.1 Be noted by Governance and Audit Committee and passed to full council for adoption.

10. Appendices

Appendix 1 Prudential and Treasury Indicators

Appendix 2 Treasury Management Indicators

11. Background Documents

Treasury Management Practices

Treasury Management Schedules

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2011/12	2012/13	2012/13
Extract from budget and rent setting report	actual	original	actual
	£'000	£'000	£'000
Capital Expenditure	224.7	99.9	96.9
Ratio of financing costs to net revenue stream	13%	14.3%	15.3%
CFR	704.2	765.3	689.3

Appendix 2

2. TREASURY MANAGEMENT INDICATORS	**2011/12**	**2012/13**	**2012/13**
	actual	original	actual
	£m	£m	£m
Authorised Limit for external debt -			
borrowing	£418.1	£496.1	£418.5
other long term liabilities	£218.4	£260	£209.2
TOTAL	£636.5	£756.1	£627.2
Operational Boundary for external debt -			
borrowing	£418.1	£476.1	£418.5
other long term liabilities	£218.4	£240	£209.2
TOTAL	£636.5	£716.1	£627.2
Actual external debt	£418.1	£n/a	£418.5
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments OR:-	175 %	175 %	175 %
Upper limit for variable rate exposure Net principal re variable rate borrowing / investments OR:-	20 %	20 %	20 %
Upper limit for total principal sums invested for over 364 days	£40	£40	£40

Maturity structure of fixed rate borrowing during 2012/13	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	20%	0%
5 years and within 10 years	75%	0%
10 years and above	80%	20%