Appendix 1

Treasury Management Activities in 2012/13

A1. Introduction

A1.1 This Appendix covers:

- Capital Expenditure and Financing 2012/13;
- Capital Financing Requirement;
- Treasury Position at year End;
- The Strategy for 2012/13;
- The Economy and Interest rates 2012/13;
- Borrowing Rates in 2012/13;
- Borrowing Outturn for 2012/13;
- Investment Rates in 2012/13;
- Investment Outturn for 2012/13;
- Revenue Budget Performance;
- Reporting Arrangements and Management Evaluation

A2 Capital Expenditure and Financing 2012/13

A2.1 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 (though the timing of borrowing may be delayed through the application of cash balances held by the Council).

A2.2 The actual capital expenditure forms one of the required prudential indicators and is shown in the table below. Other Prudential and Treasury Indicators are presented at Annex 1 to this report.

	2011/12 Actual £m	2012/13 Revised £m	2012/13 Actual £m
Total capital expenditure	22	24	19

A3 Capital Financing Requirement

A3.1 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 net 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 and prior years' net or unfinanced capital expenditure which has not yet been financed by revenue or other resources.

A3.2 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 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.

A3.3 **Reducing the CFR** – the Council's 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 the reserving of funds for repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. 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 13th February 2012.

A3.4 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).

A3.5 Following the transfer of Local Government reorganisation debt from Devon County Council in 2010/11 the Council now budgets £500,000 per annum to reflect a provision for the repayment of this debt on maturity (similar to MRP) and all payments to 31st March 2013 have been made.

A3.6 The Council's CFR for the year represents a key prudential indicator analysed at Annex 1 and summarised below. This includes PFI schemes on the balance sheet, which increase the Council's long term liabilities. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

CFR (£m)	31 March 2012 Actual	31 March 2013 Revised Indicator	31 March 2013 Actual
CFR at Year End	137	138	136

A3.6 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit presented at Annex 1 to this report.

A4 Treasury Position at Year End

A4.1 The Council's funding and investment positions at the beginning and end of year was as follows:

	31 March 2012 Principal		Rate/ Return	Average Life yrs	31 March 2013 Principal		Rate/ Return	Average Life yrs
Fixed rate funding:								
-PWLB	£143.5m				£138.1m			
-Market	£10.0m	£153.5m	4.31%	27.0	£10.0m	£148.1m	4.33%	26.9
Variable rate funding:								
-PWLB	£0.00m				£0.0m			
-Market	£0.00	£0.00m	0%		£0.0m	£0.0m	0%	
Total Borrowing		*£153.5m*	*4.31%*	*27.0*		*£148.1m*	*4.33%*	*27.0*
Other Long Term Liabilities		£9.7M	5.26%	15.0		£9.3M	5.26%	14.0
Total Borrowing/Other LTL		***£163.2M***	***4.37%***	***25.9***		***£157.4M***	***4.39%***	***24.9***
CFR		***£137.0m***				***£136.0m***		
Borrowing in excess of CFR*		***£26.2m***				***£21.4m***		
Investments**								
- in house		£67.6m	1.41%			£52.1m	2.03%	
- with managers***		£35.5m	1.51%			£29.8m	1.40%	
Total investments		***£103.1m***	***1.43%***			***£81.9m***	***1.81%***	

* The Capital Investment Plan approved in February 2013 requires £27m to support approved schemes over the next four years.

** Rates for investments reflect the average rate achieved over the full year.

*** The principal for external management of funds reflects the original amount applied to the contract in 2007 and subsequent additions and withdrawals

A4.2 The total borrowing figure at year end of £148.1m includes borrowing supported by central government. The Local Government Finance Settlement for 2012/13 (available on the Communities and Local Government website) recognises a figure of £89m on which central funding is based for interest payments and MRP.

A4.3 The outturn against approved treasury limits is analysed at Annex 1 to this report.

A5. The Strategy for 2012/13

A5.1 The central strategy aimed to reduce the difference between gross and net borrowing levels in order to reduce the credit risk and cost incurred by holding high levels of investment.

A5.2 The economic outlook for 2012/13 however, expected little opportunity to repay borrowing. The expectation for interest rates anticipated continuing low levels with only a gradual rise in the latter part of the year.

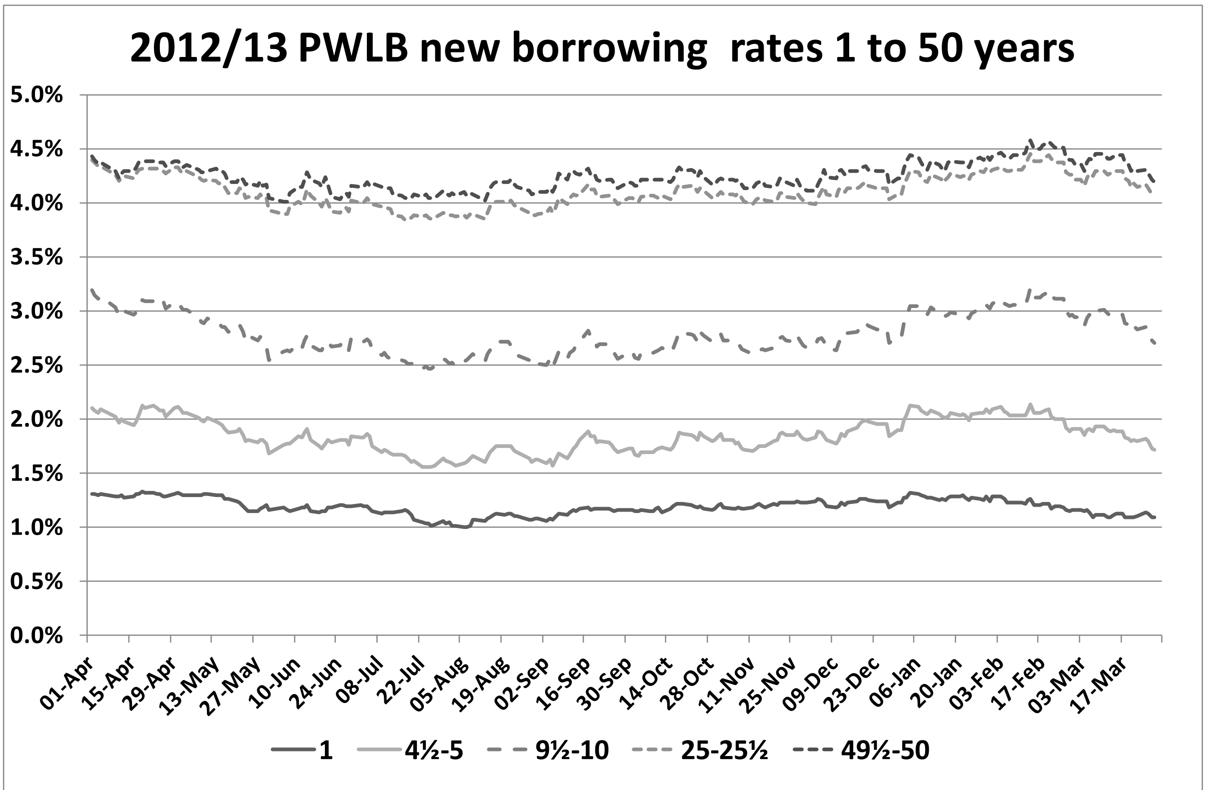
A5.3 Investment strategy was strongly influenced by market and credit risk considerations with deposits planned generally for shorter durations with a limited number of secure counterparties, particularly UK part-nationalised banks, with relatively low returns.

A6 The Economy and Interest Rates 2012/13

A6.1 A commentary of the economic factors prevalent in 2012/13 is given at Annex 2.

A7. Borrowing Rates in 2012/13

A7.1 The following graph below shows, for a selection of PWLB maturity periods, the path of rate movements during 2012/13 remaining close to historically low levels throughout the year.



A7.2 A separate tier of rates applies to early repayment of loans which is around 1% lower than new borrowing levels. Repayment rates need to be as high as possible (matching or exceeding the individual loan rate) to make debt rescheduling economic. Given the overriding aim to reduce borrowing the rate environment during the year restricted opportunities for loan repayment.

A8 Borrowing Outturn for 2012/13

A8.1 In line with the overall strategy of reducing borrowing levels, an approach was made by the Mayor and local MPs to central government requesting the Council be allowed to repay a significant level of PWLB loans without repayment penalty. This request was declined by the Treasury.

A8.2 Officers continued to monitor market conditions rates for opportunities to reduce borrowing and £5.4 million of PWLB loans were prematurely repaid during the year with breakage costs of £374,816. The resultant interest savings will fund these costs over a two year payback period.

A8.3 ***Borrowing Performance*** – Total borrowing was reduced from £153.4 million to £148.1 million during the year generating ongoing annual savings of £204k The average rate of interest paid on loans in 2012/13 was 4.31%.

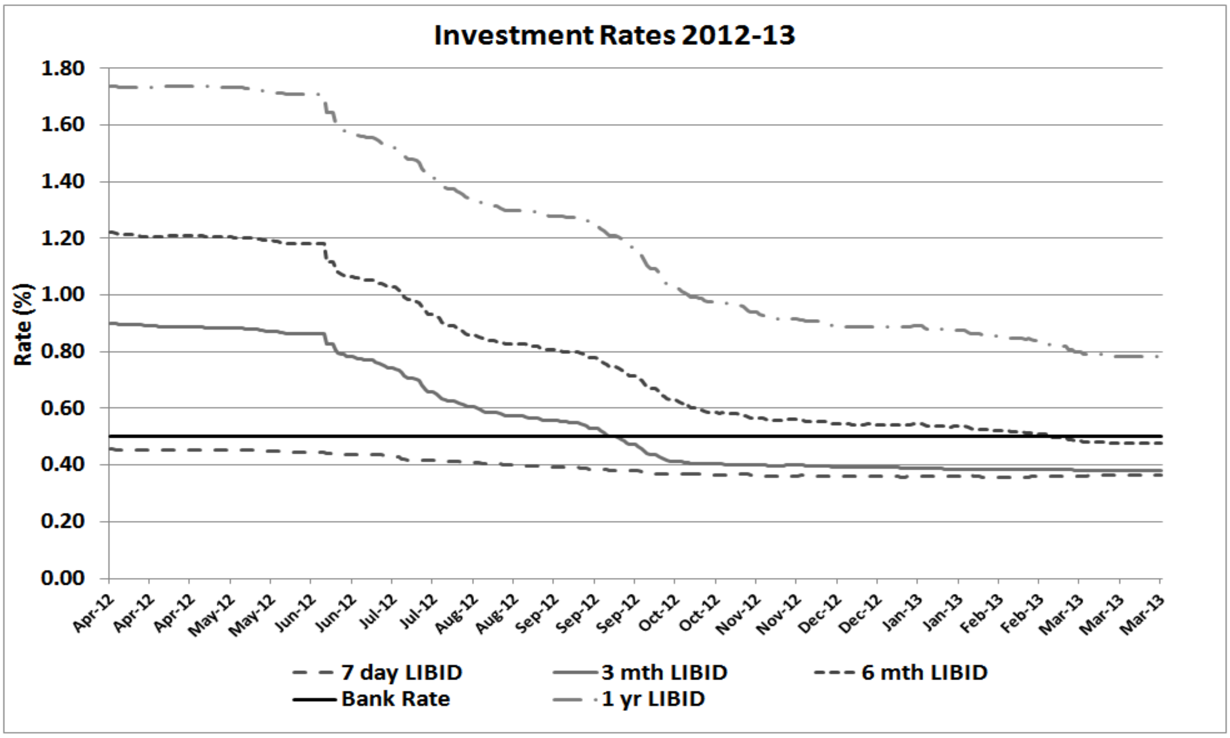
A9 Investment Rates in 2012/13

A9.1 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.

A9.2 In July 2012 the Bank of England launched Funding for Lending, a scheme which allows banks and building societies to borrow from the Bank of England at cheaper than market rates for up to four years, creating an incentive for banks to increase lending to businesses and households.

A9.3 The cheaper funding provided by the scheme meant Banks were less reliant on normal funding sources, including local authorities, with a resulting fall in market rate levels.

A9.4 The following graph below illustrates the path of investment rate movements during 2012/13. The effect of the Funding for Lending scheme is clearly illustrated.



A10 Investment Outturn for 2012/13

A10.1 **Investment Policy** – the Council's investment policy is governed by DCLG guidance which emphasises the priorities of security and liquidity of funds and requires Local Authorities to set out their approach for selecting suitable counterparties. The policy was approved by Council within the Annual Investment Strategy on 13th February 2012 and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data.

A10.2 In line with the Strategy investments were made within a tight counterparty selection framework with significant sums kept in liquidity accounts. As forecasts for the timing of interest rate rises were pushed back a number of one to two year deals were taken with UK part-nationalised banks to provide protection to investments returns.

A10.3 Due to the Euro zone sovereign debt crisis and its potential impact on banks the Chief Finance Officer has removed Eurozone Banks from the approved list. A further restriction reducing the maximum duration for new deposits to three months for all counterparties regardless of their individual credit quality (excluding UK part-nationalised Banks) was lifted in February 2013.

A10.4 The longer investments with UK part-nationalised Banks reflects officer's view that these institutions continue to offer the safest domicile for Council cash with the implicit UK government guarantee overriding individual credit ratings.

A10.5 A list of those institutions with which the in-house team invested funds during the year is provided at Annex 3. No institutions with which investments were made showed any difficulty in repaying investments and interest in full during the year.

A10.6 ***Externally Managed Investments*** – Scottish Widows Investment Partnership (SWIP) was appointed to a proportion of the Council's cash on 21st June 2007. The CFO has set a maximum of 35% of total investments to be managed externally and the fund was reduced to £28.9M at year end to comply with this limit. The average size of the holding in 2012/13 was £34.5M

A10.7 During the year SWIP has made use of good quality credit assets to enhance returns. The supply of these assets began to dry up approaching the end of the year. SWIP also invested in a number of other instruments over a diverse range of counterparties.

A10.8 ***Performance Analysis*** - Detailed below is the result of the investment strategy undertaken by the Council. Despite the continuing difficult operating environment the Council's investment returns remain well in excess of the benchmark.

	Average Investment Principal	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark/ Target Return
Internally Managed	£66,133,588	2.031%	na	0.394%
Externally Managed	£34,464,000	1.400%	1.250%	0.436%

The benchmark for internally managed funds is the average 7-day LIBID rate (uncompounded).
The benchmark for externally managed funds is the 7-day LIBID rates, averaged for the week and compounded weekly.

A10.9 In interest terms, the in-house treasury function contributed an additional £1,082,000 to the General Fund over and above what would have been attained from the benchmark return. SWIP's net return achieved an additional £280,000 over their target return level of 10% above benchmark.

A10.10 Alternative forms of investment e.g. loans to Housing Associations, sovereign instruments, supplier discounts for upfront payments were considered by officers as ways to enhance returns.

A11 Revenue Budget Performance

A11.1 The effect of the decisions outlined in this report on the approved revenue budget is outlined in the table below.

	Revised Budget 2012/13	Actual 2012/13	Variation
	£M	**£M**	**£M**
Investment Income	(1.0)	(1.8)	(0.8)
Interest Paid on Borrowing	6.6	6.6	0.0
Premium on early repayment of Borrowing	0.1	0.3	0.2
Net Position (Interest)	**5.7**	**5.1**	**(0.6)**
Minimum Revenue Provision	4.4	4.7	0.3
PFI Grant re: MRP	(0.4)	(0.4)	0.0
Net Position (Other)	**4.0**	**4.3**	**0.3**
Net Position Overall	**9.7**	**9.4**	**(0.3)**

A11.2 The Revenue Grant settlement 2012/13 formula includes notional funding of £8.4m for interest payments and MRP related to supported borrowing within the above figures.

A11.3 The changing position was regularly reported to OSB and Council throughout the year as part of the budget monitoring reports to Members

A12 Reporting Arrangements and Management Evaluation

A12.1 The management and evaluation arrangements identified in the annual strategy and followed for 2012/13 were as follows:

- Weekly monitoring report to Executive Lead for Finance and Chief Finance Officer
- Monthly meeting of the Treasury Manager and Chief Accountant to review previous months performance and plan following months activities
- Regular meetings with the Council's treasury advisors
- Regular meetings with the Council's appointed Fund Managers
- Membership and participation in the CIPFA Benchmarking Club

A12.2 Draft results for the 2012/13 CIPFA Benchmarking Club, show that the treasury management team achieved interest rate performance in the top 30% of participating Authorities for borrowing and the top 10% for investments.

Annex1

Prudential and Treasury Indicators 2012/13

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. 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.

CFR (£m)	31 March 2012 Actual	31 March 2013 Revised Q3 Indicator	31 March 2013 Actual
Opening balance	137.6	137.1	137.1
Capital expenditure in year funded from borrowing	3.4	6.4	3.6
Minimum Revenue Position	(3.9)	(4.6)	(4.6)
Repayment of Deferred Liabilities	0	0	0
CFR at Year End	**137.1**	**138.9**	**136.1**
Net borrowing position	**60.1**	**73.1**	**75.5**

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. Borrowing levels were maintained well below the operational boundary throughout the year.

	2012/13
Authorised limit	£192m
Maximum gross borrowing position	£154m
Operational boundary	£173m
Average gross borrowing position	£152m

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 liabilities net of investment income) against the net revenue stream.

	2012/13
Total Financing Costs	**£9.4m**
Net Revenue Stream	£123.7m
Ratio – Including direct financing from Revenue	8.84%
Ratio - Excluding direct financing from Revenue	**7.62%**

Treasury Indicators:

Maturity Structure of the fixed rate borrowing portfolio - This indicator assists Authorities avoid large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time.

	31 March 2013 Actual	31 March 2013 Proportion	2012/13 Original Limits Upper-Lower
Under 12 months	£0	0%	7% - 0%
12 months and within 24 months	£0	0%	7% - 0%
24 months and within 5 years	£0	0%	7% - 0%
5 years and within 10 years	£19M	13%	19% - 6%
10 years and within 25 years	£38M	26%	32% - 12%
25 years to 40 years	£55M	37%	45% - 12%
Over 40 years	£36M	24%	35% - 10%

Principal sums invested for over 364 days - The purpose of this indicator is to contain the Council's exposure to the possibility of losses that might arise as a result of it having to seek early repayment or redemption of principal sums invested. The 2012/13 Actual applies to a £5m 2-year in-house deal and funds administered by the external Fund Manager.

	2011/12 Actual	2012/13 Limit	2012/13 Actual
Investments of 1 year and over	£12m	£68m	£19m

Exposure to Fixed and Variable Rates - The Prudential Code requires the Council to set upper limits on its exposure to the effects of changes on interest rates.

The fixed rate limit set allows for the Council's entire borrowing to be locked out at affordable levels. The variable limit reflects the use of Liquidity Accounts for investing cash. (The negative Actual net values reflects the extensive use of these variable rate instruments due to attractive rates and counterparty concerns), netted against a zero level of variable debt.)

	31 March 2012 Actual	2012/13 Upper Limits	31 March 2013 Actual
Net principal re fixed rate borrowing / investments	£101m	£150m	£144m
Net principal re variable rate borrowing / investments	-£51m	£41m	-£38m
Limits on fixed interest rates: • *Debt only* • *Investments only*	*153* *52*	*163* *85*	*148* *44*
Limits on variable interest rates • *Debt only* • *Investments only*	*0* *51*	*41* *70*	*0* *38*

Annex 2

The Economy and Interest Rates 2012/13

By Sector Treasury Services 29th April 2013

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.

Annex 3

Counterparties with which funds were deposited (April 2012 – March 2013)

Banks and Building Societies

Bank of Scotland
Lloyds TSB
Nationwide Building Society
Royal Bank of Scotland/National Westminster
Santander UK
Svenska Handelsbanken

Local Authorities

City of Newcastle upon Tyne

Other Approved Institutions

Public Sector Deposit Fund
Royal Bank of Scotland Money Market Fund
Scottish Widows Investment Partnership