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Date	15/11/13

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REPORT TO: Members' Library Service

MEETING DATE:

BY: Depute Chief Executive (Resources & People Services)

SUBJECT: Annual Treasury Management Review 2012/13

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1 PURPOSE

1.1 To update elected members on Treasury Management activity during 2012/13

2 RECOMMENDATIONS

2.1 Members are asked to note the contents of this report.

3 BACKGROUND

3.1 The Council is required by regulations issues under the Local Government Scotland Act 2003 to produce an annual treasury management review.

3.2 The attached review updates members on treasury management activity during 2012/13.

4 POLICY IMPLICATIONS

4.1 There are no direct policy implications associated with this report however the Council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

5 EQUALITIES IMPACT ASSESSMENT

5.1 This report is not applicable to the well being of equalities groups and an Equalities Impact Assessment is not required.

6 RESOURCE IMPLICATIONS

6.1 Financial – There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.

6.2 Personnel - None

6.3 Other - None

7 BACKGROUND PAPERS

7.1 Capital Investment & Treasury Management Strategy 2012/13 to 2014/15 – Members' Library 02/05/2012

AUTHOR'S NAME	Kirsten Maguire
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DATE	13/11/13

Annual Treasury Management Review 2012/13 – East Lothian Council

Annual Treasury Management Review 2012/13

1. Introduction

This Council is required by regulations issued under the Local Government in Scotland 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 council's Treasury Management activities were supported by the following reports:

- The annual treasury strategy which was submitted to the Members Library on 2/5/12
- 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.

Member training on treasury management issues was undertaken during the year on 30/10/2012 in order to support members' scrutiny role.

2. 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 original expectation for 2012/13 was that Bank 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 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 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.

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 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 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.

3. Overall Treasury Position as at 31 March 2013

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	31 March 2013 Principal
Total debt	***£334m***	***£361m***
CFR	***£389m***	***£412m***
Over / (under) borrowing	***(£55m)***	***(£51m)***
Total investments	***£0***	***£0***
Net debt	**£334m**	**£361m**

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 counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, ELC's strategy was to postpone borrowing as long as possible to avoid the cost of holding investments and to minimise any security risks. When borrowing was required for cash flow purposes, advantage was taken of cheap short term borrowing from other public bodies.

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.

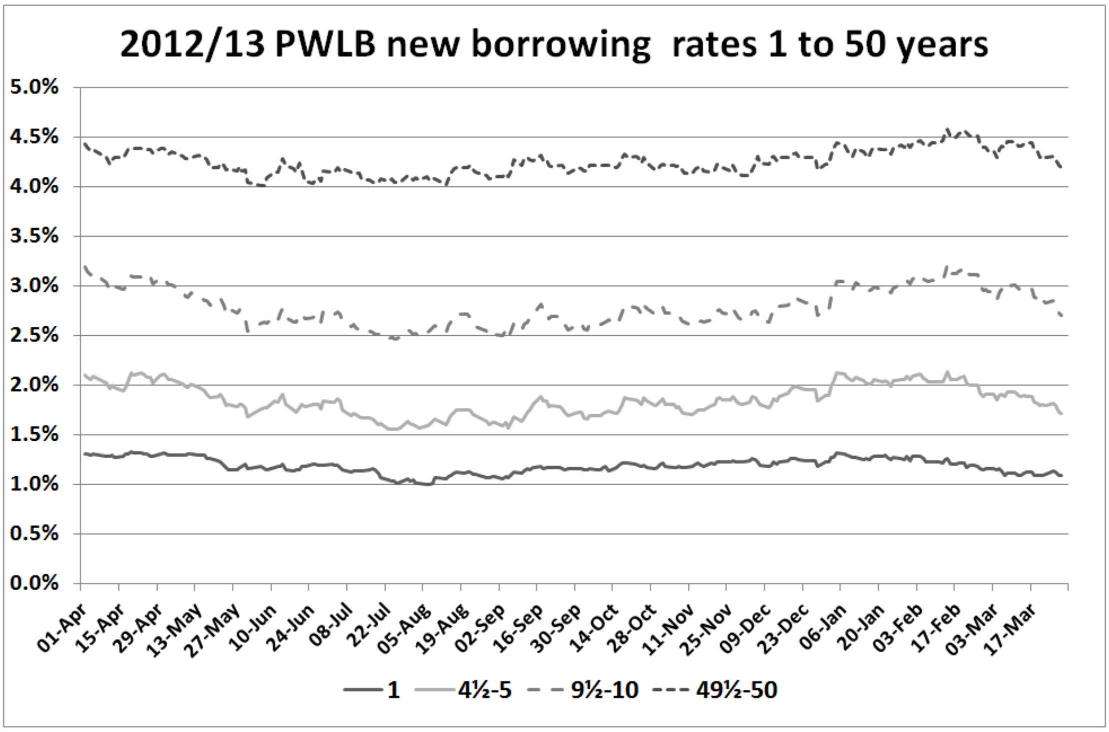
5. The Borrowing Requirement and Debt

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

	31 March 2012 Actual £'000	31 March 2013 Budget £'000	31 March 2013 Actual £'000
CFR General Fund (£m)	282,112	291,826	288,430
CFR HRA (£m)	106,827	129,126	123,597
Total CFR	388,939	420,952	412,027

6. 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.



7. Borrowing Outturn for 2012/13

PWLB Borrowing – the following new PWLB fixed interest rate loans were taken during the year:

Date of borrowing	Principal	Maturity	Interest rate
21 Sept 2012	£3.5m	12 years	3.09%
24 Sept 2012	£3.5m	12 years	3.04%
18 Dec 2012	£5m	9 years	2.59%
18 Dec 2012	£10m	14 years	3.25%
1 March 2013	£5m	18 years	3.75%
1 March 2013	£5m	19 years	3.81%
Total	£32m		

PWLB Repayment – the following PWLB fixed interest rate loans matured and were repaid:

Date of borrowing	Principal	Maturity	Interest rate
9 Oct 2008	£5m	4 years	3.97%
8 Dec 2008	£2m	4 years	2.82%
Total	£7m		

Temporary borrowing – the following temporary loans were taken from other local authorities during 2012/13:

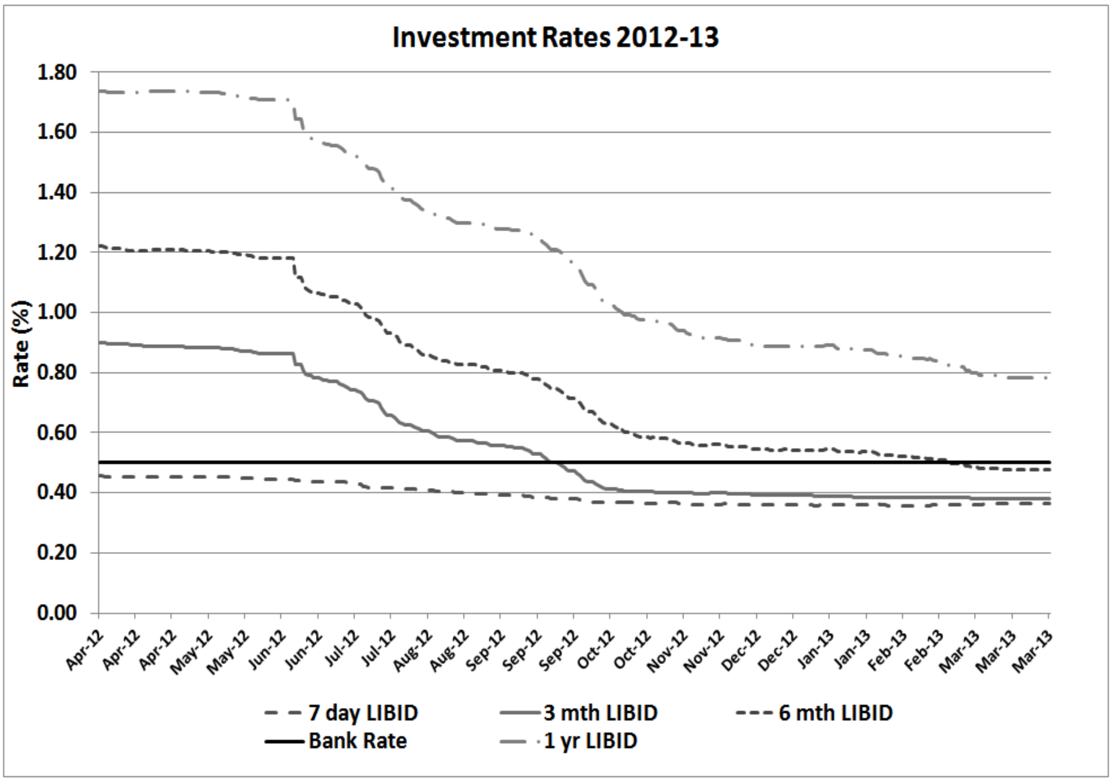
Date of borrowing	Lender	Principal	Interest rate	Date repaid
27 April 2012	Winchester	£1m	0.45%	27 July 2012
27 April 2012	Surrey CC	£5m	0.5%	28 May 2012
27 April 2012	Islington	£4m	0.5%	27 July 2012
30 May 2012	Rhondda	£4m	0.3%	29 June 2012
28 June 2012	Ealing	£1m	0.27%	28 Sept 2012
28 June 2012	West Mercia	£4m	0.26%	28 Sept 2012
29 June 2012	City of Edinburgh	£1m	0.5%	2 July 2012
29 June 2012	Caerphilly	£3m	0.3%	2 July 2012
29 June 2012	Cambridge City Council	£1m	0.31%	13 Sept 2012
29 June 2012	Cambridge City Council	£1m	0.31%	19 Sept 2012
26 July 2012	Surrey CC	£5m	0.32%	28 Jan 2013
31 July 2012	Worcestershire	£3m	0.27%	31 Oct 2012
19 Sept 2012	Leicester CC	£2m	0.26%	1 Oct 2012
24 Sept 2012	Kensington & Chelsea	£5m	0.26%	24 Dec 2012
24 Sept 2012	Cambridge City Council	£2m	0.31%	24 Dec 2012
27 Sept 2012	Wandsworth	£7m	0.3%	4 Jan 2013
28 Sept 2012	Caerphilly CC	£1m	0.27%	28 Nov 2012
30 Oct 2012	Ealing	£2m	0.4%	30 July 2013
1 Nov 2012	Oxfordshire CC	£5m	0.5%	24 Oct 2013
30 Nov 2012	Cambridge City Council	£1.5m	0.32%	14 Dec 2012
14 Dec 2012	Surrey Heath BC	£1.5m	0.4%	14 June 2013
22 Jan 2013	Swansea	£3m	0.32%	22 April 2013
28 Jan 2013	Northumberland CC	£2m	0.32%	29 April 2013
	Total	£65m		

The following loan taken out in 2011/12 was repaid during 2012/13

Date of borrowing	Lender	Principal	Interest rate	Date repaid
29 March 2012	City of Manchester	£5m	0.45%	30 April 2012

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.



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

9. Investment Outturn for 2012/13

Investment Policy – the Council's investment policy is governed by Scottish Government investment regulations, which have been implemented in the annual investment strategy submitted to the Members Library on 2nd May 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.

Investments held by the Council - the Council did not hold any internally managed investment funds during 2012/13. It did however have the following loans to third parties which fall within the scope of the Council's approved Investment strategy:

Loan	Balance at 31/3/13
East Lothian Housing Association	£5.182m
East Lothian Investments	£0.176m
Musselburgh Old Course Golf Club	£0.47m

Investments held by fund managers – the Council uses Investec external fund managers to invest cash balances held on behalf of the 4 Common Good funds and ELC Charitable Trusts. The performance of the managers against the benchmark return was:

Fund	Value of Investments Held @ 31/3/13	Return	Benchmark*
Common Good funds	£2.685m	14.5%	13.8%
Charitable Trusts	£2.637m	14.6%	14.1 %
Total	£5.322m		

Appendix 1: Prudential and treasury indicators

1. PRUDENTIAL INDICATORS	2011/12	2012/13	2012/13
Extract from budget and rent setting report	**actual**	**Estimate**	**actual**
	£'000	**£'000**	**£'000**
Capital Expenditure			
General Services	£38,265	£37,283	£28,526
HRA	£33,231	£32,111	£23,690
TOTAL	£71,496	£69,394	£52,216
Ratio of financing costs to net revenue stream			
General Services	7.02%	7.79%	7.73%
HRA	23.75%	32.41%	26.58%
Net borrowing requirement General Fund			
brought forward 1 April	£266,785	£257,857	£282,112
carried forward 31 March	£282,112	£273,752	£288,430
in year borrowing requirement	£ 15,327	£ 15,895	£ 6,318
Net borrowing requirement HRA (*where relevant*)			
brought forward 1 April	£81,385	£112,785	£106,827
carried forward 31 March	£106,827	£139,159	£123,597
in year borrowing requirement	£ 25,442	£ 26,374	£ 16,770
Annual change in Cap. Financing Requirement			
Non – HRA	£15,327	£15,895	£ 6,318
HRA (applies only to housing authorities)	£25,442	£26,374	£16,770
TOTAL	£40,769	£42,269	£23,088
Incremental impact of capital investment decisions	**£**	**£**	**£**
Increase in council tax (band D) per annum	£20.22	£35.21	£37.66
Increase in average housing rent per week (housing authorities only)	£2.33	£3.76	£2.27

2. TREASURY MANAGEMENT INDICATORS	2011/12	2012/13	2012/13
	actual	**original**	**Actual**
	£'000	**£'000**	**£'000**
Authorised Limit for external debt -			
borrowing	£449,000	£450,000	£450,000
other long term liabilities	£ 56,000	£ 55,000	£ 55,000
TOTAL	£505,000	£505,000	£505,000
Operational Boundary for external debt -			
borrowing	£419,041	£420,195	£420,195
other long term liabilities	£ 45,851	£ 44,697	£44,697

TOTAL	£464,892	£464,892	£464,892
Actual external debt	£334,000	£376,000	£361,000

Appendix 2: Graphs

Please find below two graphs which clients may wish to use.