Appendix 2

Annual Treasury Outturn Report 2012/13

1 Purpose

1.1 The County Council adopts the key recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice, which includes an annual report on the treasury management strategy after the end of each financial year.

2 Summary

2.1 Treasury management in the context of this report is defined as:

"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2.2 This annual report sets out the performance of the treasury management function during 2012/13, to include the effects of the decisions taken and the transactions executed in the past year.

2.3 Overall responsibility for treasury management remains with the County Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the County Council's treasury management objectives.

2.4 All treasury activity has complied with the County Council's Treasury Management Strategy Statement and Investment Strategy for 2012/13, and all relevant statute, guidance and accounting standards. In addition the County Council's treasury advisers, Arlingclose, provide support in undertaking treasury management activities.

2.5 The prudential and treasury management indicators which are all covered in Section 6 of this report are:

- actual capital financing requirement
- actual external debt
- authorised limit and operational boundary for external debt
- upper limits for fixed interest rate exposure and variable interest rate exposure
- maturity structure of fixed rate borrowing
- total principal sums invested for periods longer than 364 days
- ratio of financing costs to net revenue stream.

3 Economic background

3.1 The following Section outlines the key economic themes against which investment and borrowing decisions have been made in the past financial year. Despite elements of stability returning to the economy there have been periods of uncertainty, as outlined below, and there remain significant risks that have to be managed.

3.2 The global outlook stabilised mainly due to central banks maintaining low interest rates and expansionary monetary policy for an extended period. Equity market assets recovered sharply with the FTSE 100 registering a 9.1% increase over the year. This was despite economic growth in G-7 nations being either muted or disappointing.

3.3 In the UK the economy shrank in the first, second and fourth quarters of calendar 2012. It was the impressive 0.9% growth in the third quarter, aided by the summer Olympic Games, which allowed growth to register 0.2% over the calendar year 2012.

3.4 The expected boost to net trade from the fall in the value of sterling did not materialise, but raised the price of imports, especially low margin goods such as food and energy. Annual CPI dipped below 3%, falling to 2.4% in June before ticking up to 2.8% in February 2013. Higher food and energy prices and higher transport costs were some of the principal contributors to inflation remaining above the Bank of England's 2% CPI target.

3.5 The lack of growth and the fall in inflation were persuasive enough for the Bank of England to maintain the Bank Rate at 0.5% and also sanction additional £50 billion asset purchases, Quantitative Easing (QE) in July, taking total QE to £375 billion. In the March 2013 Budget the Bank's policy was revised to include the 2% CPI inflation remit alongside the flexibility to commit to intermediate targets.

3.6 The resilience of the labour market, with the International Labour Organisation (ILO) unemployment rate falling to 7.8%, was the main surprise given the challenging economic backdrop. Many of the gains in employment were through an increase in self-employment and part time working.

3.7 In March 2013 the Office for Budgetary Responsibility (OBR) halved its forecast growth in 2013 to 0.6% which then resulted in the lowering of the forecast for tax revenues and an increase in the budget deficit. The government is now expected to borrow an additional £146bn and sees gross debt rising above 100% of GDP by 2015-16. With the national debt metrics out of kilter with a triple-A rating, it was not surprising that the UK's sovereign rating was downgraded by Moody's in February 2013 and more recently by Fitch.

3.8 The Euro region suffered a further period of stress when Italian and Spanish government borrowing costs rose sharply and Spain was also forced to officially seek a bailout for its domestic banks. Markets were becalmed after the European Central Bank's (ECB) declaration that it would do whatever it takes to stabilise the Eurozone and the ECB's announcement in September 2012 of its Outright Monetary Transactions (OMT) facility, buying time for the necessary fiscal adjustments required. Neither the Italian elections which resulted in political gridlock nor the poorly-managed bailout of Cyprus which necessitated 'bailing-in' non-guaranteed depositors proved sufficient for a market downturn. Growth was hindered by the rebalancing processes under way in Euroland economies, most of which contracted in the fourth quarter of 2012.

3.9 The government's Funding for Lending initiative commenced in August 2012 which gave banks access to cheaper funding on the basis that it would then result in them passing this advantage to the wider economy. There was an improvement in the flow of credit to mortgagees, but was still below expectation for Small to Medium Enterprises (SMEs). One direct consequence of the Funding for Lending Scheme was the sharp drop in rates at which banks borrowed from local government. 3-month, 6-month and 12-month Libid rates which were 1%, 1.33% and 1.84% at the beginning of the financial year fell to 0.44%, 0.51% and 0.75% respectively.

4 The borrowing requirement and debt management

	Balance on 31/03/2012 £m	Net new borrowing £m	Balance on 31/03/2013 £m
Capital Financing Requirement	720.0	-14.9	705.1

4.1 The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31/3/2013 was estimated at £705.1m. The Council's borrowing requirement during the year in the capital programme was £16.3m. External borrowing in the form of long-term loans has decreased through a small repayment of external debt, whilst liabilities resulting for Private Finance Initiatives (PFI), shown in the table below under long-term liabilities, has increased.

	Balance on 31/03/2012 £m	Net new borrowing £m	Balance on 31/03/2013 £m
Long Term Borrowing	384.4	-8.4	376.0
Temporary borrowing	39.8	1.3	41.1
Total Borrowing	424.2	-7.1	417.1
Other Long Term Liabilities	103.2	30.6	133.8
Total External Debt	527.4	23.5	550.9

4.2 The indicator for total external debt is obtained directly from the Authority's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

4.3 A cautious approach has been applied in terms of take-up of new borrowing to minimise debt interest payments without compromising the long-term stability of the portfolio. No new external borrowing took place in 2012/13. Internal resources in lieu of external borrowing have been used in order to lower overall treasury risk by reducing both external debt and temporary investments.

5 Investment activity

5.1 The County Council has invested according to a low risk, high quality lending list as outlined in the Investment Strategy for 2012/13.

	Balance on 31/03/2012 £m	Balance on 31/03/2013 £m	Average Rate on 31/03/2013	Average Life on 31/03/2013
Instant access monies	62.5	62.4	0.75%	0 yrs
Short term investments	192.5	275.0	1.09%	0.26 yrs
Long term investments	65.0	110.0	1.27%	3.97 yrs
Total investments	320.0	447.4	1.09%	1.14 yrs

5.2 Security of capital remained the County Council's main investment objective. This was maintained by following the County Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2012/13. Investments during the year included:

- deposits in AAA-rated Money Market Funds
- deposits with UK local authorities
- call accounts and deposits with banks and building societies systemically important to the UK's banking system.

5.3 Counterparty credit quality was assessed and monitored with reference to:

- credit ratings
- credit default swaps
- any potential support mechanisms
- share prices.

5.4 The minimum long-term counterparty credit rating determined for the 2012/13 treasury strategy was A-/A3 across rating agencies Fitch, S&P and Moody's. Based on the factors above and advice from the Treasury Management advisors, Arlingclose, the Director of Corporate Resources has varied investment duration limits for new investments according to the assessment of credit risk and will suspend investing with individual counterparties at any time if this is felt to be necessary to protect the County Council's capital.

5.5 The County Council maintained a sufficient level of liquidity through the use of Money Market Funds and the use of call accounts. The County Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK base rate was maintained at 0.5% through the year and short term money market rates remained at very low levels which had a significant impact on cash investment income. The County Council's average cash investment balance was £464.58m during 2012/13, and interest earned was £5.04m giving a yield of 1.08%.

5.6 Since the end of the 2012/13 financial year the County Council's cash balances have risen due to the Government increasing the extent to which grant is paid at the beginning of the financial year instead of in monthly instalments. It is recommended that to more effectively manage cash balances the counterparty limit for approved banks and building societies in the Council's Treasury Management Strategy is increased from £75m to £90m. The Director of Corporate Resources will continue to ensure that within this limit there is prudent diversification between counterparties to minimise risk.

6 Compliance with Prudential Indicators

6.1 The County Council can confirm that it has complied with its Prudential Indicators for 2012/13, which were set in February 2012 as part of the

County Council's Treasury Management Strategy Statement. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

6.2 The County Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 18 February 2010. In compliance with the requirements of the Code this section of the report provides Members with a summary of actual performance against each of the Prudential Indicators.

Capital Financing Requirement

6.3 The underlying need to borrow for capital purposes, as measured by the Capital Financing Requirement (CFR) is a core driver of treasury management activity. The estimates and actual position as at 31 March 2013 are:

	31/03/2013 Estimate £m	31/03/2013 Actual £m
Total Capital Financing Requirement	717	705
Less:		
Existing profile of long term borrowing	-388	-376
Other long term liabilities	-139	-134
Gross borrowing requirement	190	195
Less usable reserves	-307	-419
Net borrowing requirement / -internal borrowing	-117	-224

Authorised Limit and Operational Boundary for external debt

6.4 CIPFA's Code of Practice requires authorities to set an Authorised Limit for external debt, defined as the sum of external borrowing and other long-term liabilities. This is a statutory limit which should not be breached. The County Council's Authorised Limit was set at £820m for 2012/13.

6.5 This limit is based on the estimated Capital Financing Requirement (CFR) in order to enable it to be financed entirely from external borrowing should the County Council's internal reserves become depleted. The limit also includes an allowance for temporary borrowing to cover normal revenue cash flow requirements and unexpected outflows or delays in receiving cash.

6.6 During 2012/13, the gross borrowing reached a maximum of £559.2m which is within the Authorised Limit of £820m.

6.7 The County Council also needs to set an Operational Boundary for external debt. This should reflect the most likely scenario and be consistent with the County Council's capital plans and Treasury Management Strategy. Temporary breaches of the 2012/13 Operational Boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. The County Council approved an Operational Boundary for 2012/13 of £740m.

6.8 During 2012/13, the gross borrowing reached a maximum of £559.2m which is within the Operational Boundary of £740m.

Upper limits for fixed interest rate exposure and variable interest rate exposure

6.9 These indicators allow the County Council to manage the extent to which it is exposed to changes in interest rates.

6.10 The County Council has to set an upper limit on its fixed interest rate exposure, which is expressed in terms of the maximum long-term fixed-rate principal sums which can be outstanding on any day in each year. The County Council approved an upper limit on fixed interest rate exposure for 2012/13 of £740m.

6.11 During 2012/13, the long-term fixed-rate principal sums outstanding reached a maximum of £438.8m which is within the upper limit on fixed interest rate exposure of £740m.

6.12 The County Council also has to set an upper limit on its variable interest rate exposure. The County Council approved an upper limit on variable interest rate exposure for 2012/13 of £740m, which is based on the Operational Boundary and has been set to give the County Council maximum policy flexibility. The limit enables the potential for a refinancing from, e.g. fixed to variable rate borrowing.

6.13 During 2012/13, the variable interest rate exposure reached a maximum of £126.0m which is within the upper limit on variable interest rate exposure of £740m.

Maturity structure of fixed rate borrowing

6.14 The Code also requires the County Council to set upper and lower percentage limits on the maturity structure of its long-term fixed rate borrowing during 2012/13. The following table shows the limits approved by the County Council. These have been set in order to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio.

	Upper limit (%)	Lower limit (%)	Actual (%)
Under 12 months	50	0	2.8
12 to 24 months	50	0	3.8
24 months to 5 years	50	0	9.9
5 years to 10 years	75	0	11.5
10 years to 20 years	75	0	30.6
20 years to 30 years	75	0	35.6
30 years to 40 years	100	0	4.2
40 years to 50 years	100	0	1.6
50 years and above	100	0	0

6.15 The County Council's long-term fixed rate borrowing during 2012/13 has not breached these set limits.

Total principal sums invested for periods longer than 364 days

6.16 For 2012/13, the County Council originally set an upper limit of £120m on investments for periods longer than one year in February 2012. On setting the Treasury Management Strategy Statement for 2013/14 in February 2013, the opportunity was taken to revise the upper limit for 2012/13 to £150m, to take account of increases to the County Council's cash balances.

6.17 This indicator allows the County Council to manage the risk inherent with longer term investments, and lending for longer than 364 days and up to a maximum of two years (revised to three years in February 2013) is currently restricted to UK local authorities only (including police and fire authorities).

6.18 An exception to this is £15m invested with other Local Authorities for periods up to 19 years. specifically in relation to forecasted cash flow surpluses on the Council's 25 year Street Lighting PFI project, which has secured an investment income stream for the project at an interest rate of nearly 4%.

6.19 The County Council's long-term investments during 2012/13 have not breached either the original or revised limit.

Capital Expenditure

6.20 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on Council tax.

	2012/13 Approved	2012/13 Actual
	£m	£m
Capital Expenditure	181.2	167.5

6.21 Capital expenditure has been financed or funded as follows:

Capital Financing	2012/13 Approved	2012/13 Actual
	£m	£m
Capital receipts	41.4	41.8
Government Grants	70.2	65.9
Capital reserve	-28.9	-32.9
Revenue contributions	50.0	50.0
Capital contributions	11.7	12.4
Contributions from reserves	13.9	13.9
Total Financing	158.3	151.1
Supported borrowing	7.8	3.2
Finance Lease for Street Lighting PFI	35.6	35.6
Unsupported borrowing	-20.7	-22.5
Total Funding	22.7	16.3
Total Financing and Funding	181.0	167.4

6.22 The table shows that the capital expenditure plans of the Authority could not be funded entirely from sources other than external borrowing.

Ratio of financing costs to net revenue stream

6.23 The ratio of financing costs to the net revenue stream shows the estimated annual revenue costs of borrowing (interest payable on debt plus the minimum revenue provision for repaying the principal less interest on balances) as a percentage of the amount in the draft revenue budget to be met from central government grant and by local taxpayers. Actual figures for 2011/12 and 2012/13 together with the estimate for 2012/13 are set out in the table below.

	2011/12 Actual £m	2012/13 Estimate £m	2012/13 Actual £m
Financing costs	59.4	68.0	65.8
Net revenue stream	715.6	711.6	711.6
Ratio	8.30%	9.56%	9.26%

6.24 Lower financing costs in 2012/13 than estimated are a result of a combination of lower borrowing costs and higher investment returns than originally forecast.