APPENDIX A

Annual Treasury Management Review 2012/13

Pendle Borough Council

August 2013

Contents

Annual Treasury Management Review 2012/13

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 included the following reports:

- an annual treasury strategy in advance of the year (Council 22/03/2012)
- a mid-year (minimum) treasury update report (Executive 18/10/2012)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, the Accounts and Audit Committee has received quarterly treasury management update reports during the year.

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.

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	10,582	9,513	7,327
Capital Financing Requirement:	10,038	20,103	12,747
Net borrowing	(4,241)	3,310	(1,141)
External debt at 31st March	6,859	8,859	8,859
Investments at 31st March • All under 1 year	11,100	5,549	10,000

The value of capital expenditure shown for 2012/13 (original) of £9.513m was estimated before the level of capital programme slippage from 2011/12 was confirmed. The actual slippage was £5.794m as reported in the capital programme outturn report presented to the Executive in June 2013.

The actual Capital Financing Requirement in 2012/13 was lower than the estimate owing primarily to significant slippage on the capital programme and as a result of decisions taken by the Head of Central and Regeneration Services in deciding how to finance the capital programme within the scope of his delegated authority.

The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. Other prudential and treasury indicators are to be found in the main body of this report. The Head of Central and Regeneration Services confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit), was not breached.

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.

£'000 General Fund	2011/12 Actual	2012/13 Estimate	2012/13 Actual
Capital expenditure	**10,582**	**9,513**	**7,327**
Financed in year	8,782	4,695	4,267
Unfinanced capital expenditure (borrowing need)	**1,800**	**4,818**	**3,060**

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 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 borrowing need. 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 22/03/2012.

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

CFR (£'000): General Fund	31 March 2012 Actual	31 March 2013 Budget	31 March 2013 Actual
Opening balance	8,632	15,688	10,038
Add unfinanced capital expenditure (as above)	1,800	4,818	3,060
Less MRP	(394)	(403)	(351)
Closing balance	10,038	20,103	12,747

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.

£'000	31 March 2012 Actual	31 March 2013 Budget	31 March 2013 Actual
Net borrowing position	(4,241)	3,310	(1,141)
CFR	10,038	20,103	12,747

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.

£m	2012/13
Authorised limit (Debt only)	£14m
Maximum gross borrowing position	£9.36m
Operational boundary (Debt only)	£11m
Average gross borrowing position	£7.05m
Financing costs as a proportion of net revenue stream	2.63%

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 finance leases) position was as follows:

TABLE 1	31 March 2012 Principal	Rate/ Return	Average Life yrs	31 March 2013 Principal	Rate/ Return	Average Life yrs
Fixed rate funding:						
PWLB	£6.86m	3.63%	12.0yrs	£8.86m	3.39%	10.4yrs
Total debt	£6.86m	3.63%	12.0yrs	£8.86m	3.39%	10.4yrs
CFR	***£10.04m***			***£12.75m***		
Over / (under) borrowing	***(£3.18m)***			***(£3.89m)***		
Investments (all less than 1 yr):	£11.1m	0.7% - 3.1%	<1yr	£10.0m	0.7% - 2.7%	<1yr
Total investments	£11.1m	1.12%	<1yr	£10.0m	1.52%	<1yr

The maturity structure of the debt portfolio was as follows:

	31 March 2012 actual	2012/13 original limits	31 March 2013 actual
Under 12 months	£1.0m	£2.7m (30%)	£1.0m
12 months and within 24 months	£0.0m	£3.5m (40%)	£0.0m
24 months and within 5 years	£1.0m	£5.3m (60%)	£2.0m
5 years and within 10 years	£2.0m	£6.6m (75%)	£3.0m
10 years and above	£2.86m	£8.9m (100%)	£2.86m

With regard to investments, all deposits were made with approved counterparties at durations of less than one year, ranging from overnight money to 364 days. The exposure to fixed and variable rates was as follows:

	31 March 2012 Actual	2012/13 Original Limits	31 March 2013 Actual
Fixed rate (principal or interest)	100%	Up to 100%	100%
Variable rate (principal or interest)	Nil	Up to 25%	Nil

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.

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. As a result of events in the final quarter of 2012/13 the decision was taken to borrow £2m from the Public Works Loan Board. This action was taken with reference to advice from Sector and was consistent with the level of borrowing set out in the 2012/13 Treasury Management Strategy approved by Council in March 2012.

5. The Economy and Interest Rates

The original expectation for 2012/13 was that Bank Rate would not rise in 2012/13 or 2013/14 and for it to start gently rising from quarter 4 2014. This forecast rise has now been pushed back to a start in quarter 1 2015 at the earliest. Economic growth (GDP) in the UK was virtually flat during 2012/13, due to the UK austerity programme, subdued domestic consumer expenditure, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the European Union (EU). This 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 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 EU sovereign debt crisis was an ongoing saga during the year, with an eventual very protracted agreement of a second bailout for Greece in December followed by a second major crisis, this time over Cyprus, towards the end of the year.

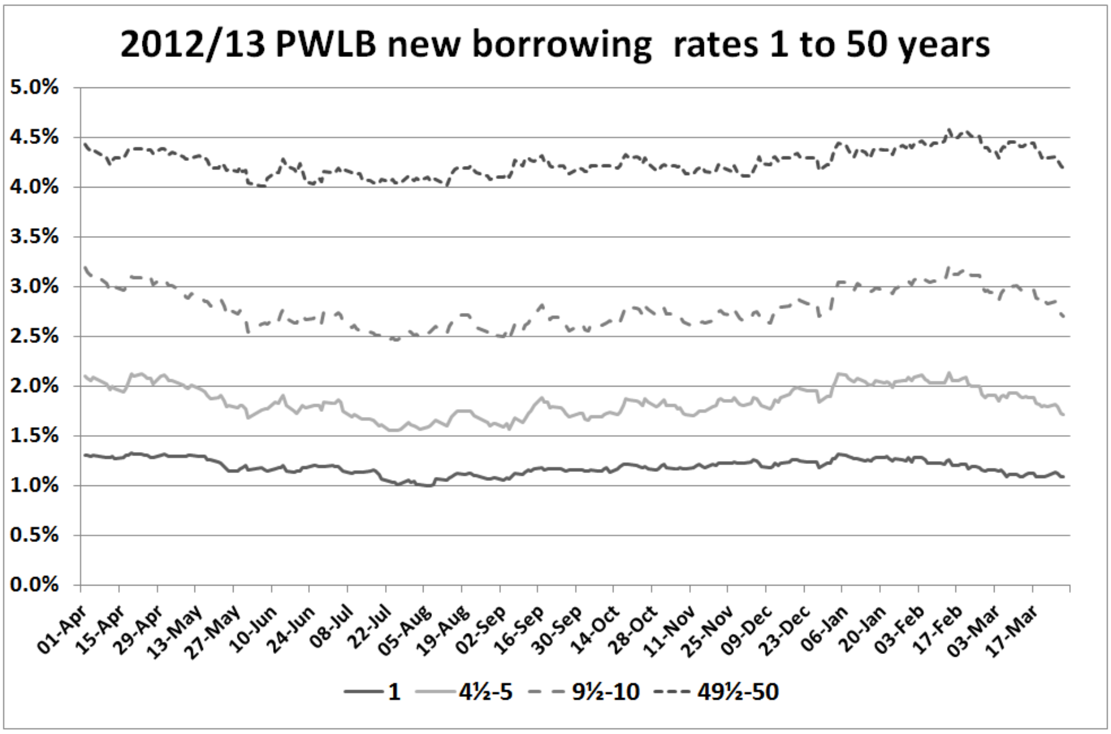
Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB rates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

The Funding for Lending Scheme, announced in July, has resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling drastically 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.

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 in March.

6. Borrowing Rates in 2012/13

PWLB borrowing rates - the graph below of PWLB maturity rates shows, 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.

Borrowing - loans were drawn to fund the net unfinanced capital expenditure and naturally maturing debt.

The loans drawn were:

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Lender	Principal	Type	Interest Rate	Maturity
PWLB	£1.0m	Fixed interest rate	2.66%	9 years
PWLB	£1.0m	Fixed interest rate	2.46%	8 years

Total borrowing of £2m was consistent with the strategy approved by Council in March 2012.

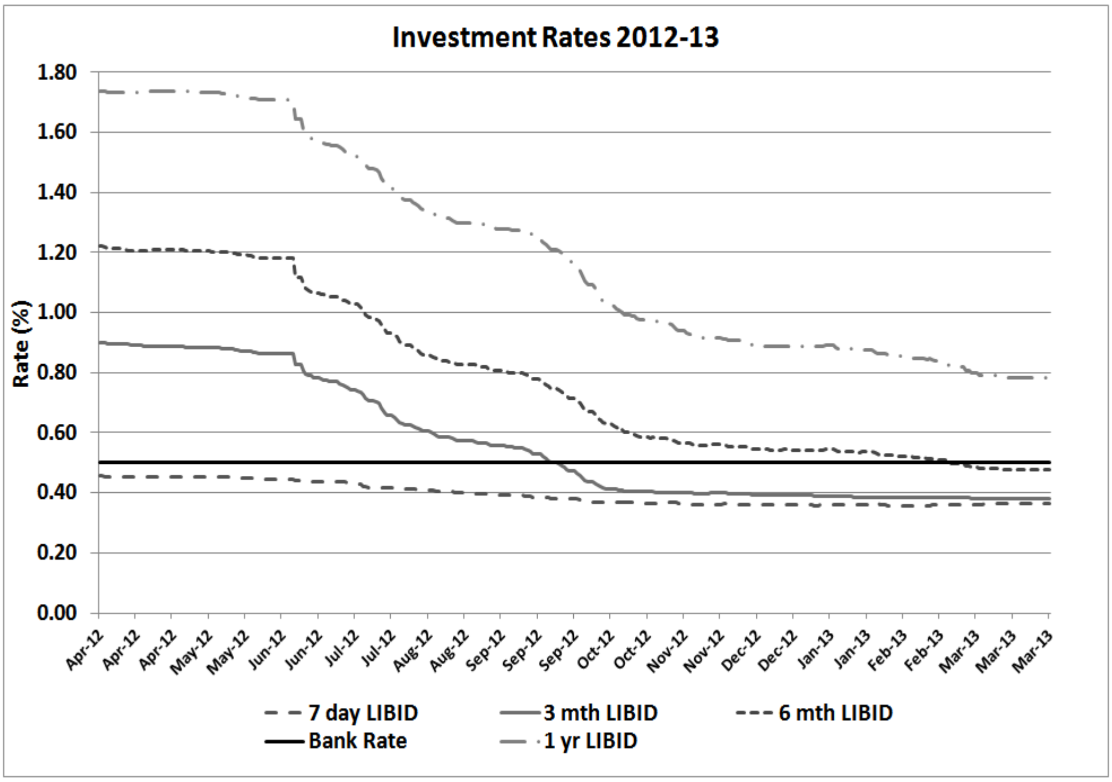
Rescheduling

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 of PWLB debt took place during the year. A loan of £1m was due to be repaid on 31st March 2013 but owing to the Easter Holiday period the actual repayment could not be made until the 2nd April 2013.

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.



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 in March 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:

Balance Sheet Resources (£m)	31 March 2012	31 March 2013
Balances	**1.250**	**1.250**
Earmarked reserves	**12.082**	**12.149**
Provisions / Other	**0.412**	**0.473**
Usable capital receipts	**1.144**	**1.440**
Capital Grants Unapplied	**1.496**	**1.195**
Total	**16.384**	**16.507**

Investments held by the Council - the Council maintained an average balance of £12.8m of internally managed funds. The internally managed funds earned an average rate of return of 1.52% which compares favourably with both the 7 day LIBID rate of 0.394% and the 3 month LIBID rate of 0.564%. This compares with an original budget assumption of £10m investment balances earning an average rate of 1%. The variance in the average level of investment is primarily due to slippage on the capital programme.