ANNUAL TREASURY REPORT 2012/13

1. INTRODUCTION AND BACKGROUND

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 was adopted by this Council on 24 February 2010.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy*)* for the year ahead and an annual review report of the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of the treasury management strategy to a specific named body which in this Council is the Transformation and Resources Overview and Scrutiny Committee.
6. Delegation by the Council of the role of scrutiny of treasury management performance to a specific named body which in this Council is the Audit and Risk Committee, a midyear and year end review report is received by this Committee.

Treasury management in this context is defined as:

"The management of the local authority'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. "

The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2012/13.

2. THIS ANNUAL TREASURY REPORT COVERS

- The Council's treasury position as at 31st March 2013;
- The strategy for 2012/13;
- The economy in 2012/13;
- Investment rates in 2012/13;
- Compliance with treasury limits and Prudential Indicators;
- Investment outturn for 2012/13;
- Involvement of Elected Members;
- Other issues.

3. TREASURY POSITION AS AT 31 MARCH 2013

The Council's investment position at the beginning and the end of the year was as follows:

	At 31/3/13	Return	Average Life (Days)	At 31/3/12	Return	Average Life (Days)
Total Debt	*£0m*	*N/A*	*N/A*	*£0m*	*N/A*	*N/A*
Total Investments	*£4.900m*	*0.99%*	*16*	*£10.475m*	*1.03%*	*43*

It should be noted that the above table is only a snapshot of the Total Investments as at 31 March. Large fluctuations in cash inflows and outflows that occur throughout the month can have an impact on the figure reported.

The decline in total investments has been due to a combination of few capital receipts being received due to the economic downturn and capital expenditure being incurred on projects including:

- HIP Disabled Facilities
- Newcastle Town Centre Partnership Scheme
- Beasley Place Housing Scheme
- The Wammy Neighbourhood Park

4. THE STRATEGY FOR 2012/13

The strategy agreed by Council on 22 February 2012 was that:

- There would be no long term borrowing for capital purposes;

- Short term borrowing would be required in the event to cover any temporary shortfalls in revenue income or to temporarily fund capital expenditure during the interim period before a permanent means of finance became available;

- All borrowing would be kept absolutely within the Authorised Limit of £15m and would not normally exceed the Operational Boundary of £5m (although it could for short periods of time be permitted to rise to a figure between £5m and £15m due to variations in cash flow);

- Temporary surpluses which might arise would be invested, either in short term deposits with the Council's bankers or in money market investments (cash deposits) if the size warranted this and for an appropriate period in order that these sums would be available for use when required;

- The proportions of loans and investments to be at fixed or variable rates were: fixed rate loans to be between 0% and 100% of the total and fixed rate investments to be between 0% and 100% of the total;

- Long term investments to be permitted as follows: maturing beyond 31/03/13 £10m, maturing beyond 31/03/14 £10m, maturing beyond 31/03/15, £10m;

- The overriding consideration in determining where to place the Council's surplus funds was to safeguard the Council's capital. Within this constraint the aim was to maximise the return on capital; and,

- Forward commitment of funds for investment is permitted in respect of in house investments.

Changes in strategy and credit Policy during the year

There have been no changes to the Treasury Management Strategy during the year. As approved by Council on 30 July 2008 we continue to use the lowest common denominator methodology in respect of determining suitable counterparties. This methodology 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.).

This, and the downgrading of numerous Banks and Building Societies, has led to a severely restricted counterparty listing remaining. Consequently, difficulty has been found in placing investments with counterparties that meet our criteria.

THE ECONOMY AND INTEREST RATES - narrative supplied by the Council's Treasury Management Advisors – Sector Treasury Services Limited

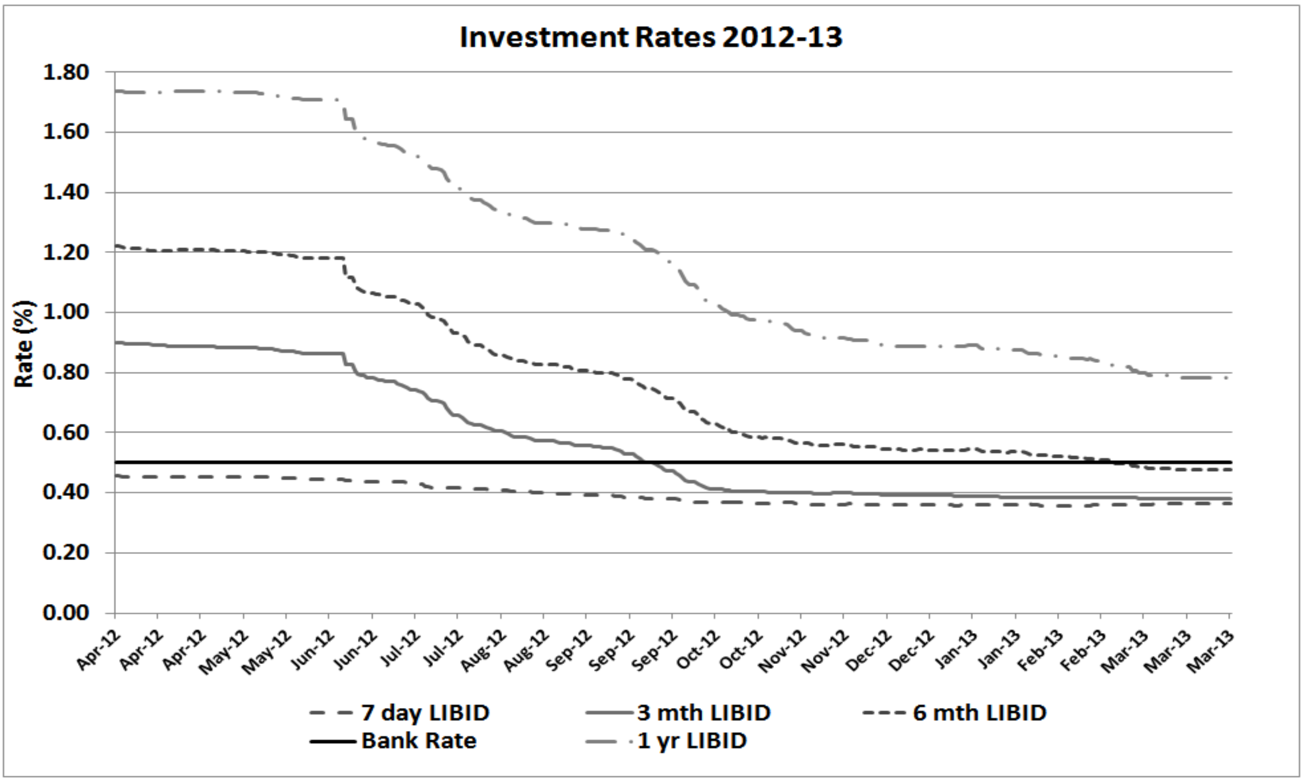
The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2012/13 was that Bank Rate would start gently rising from quarter 4 2014. However, economic growth did not materialise 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. Moodys 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 moved up and down 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 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.

5. INVESTMENT RATES IN 2012/13 – narrative and graph supplied by the Council's Treasury Management Advisors – Sector Treasury Services Limited

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.



6. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Annex 1.

7. INVESTMENT OUTTURN FOR 2012/13

Internally Managed Investments
The Council manages its investments in-house and invests with the institutions listed on the Council's approved lending list. The Council invested for a range of periods from overnight to up to three months dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Four of the seven fixed investments made in 2012/13 were for a period of three months, with the remaining three fixed investments being for less than three months.

Investment Outturn for 2012/13
During 2012/13 an average rate of return of 0.99% was achieved on an average individual investment of £1.393m. This compared with the target of 1% included in the departmental business plan.

8. INVOLVEMENT OF ELECTED MEMBERS

Elected members have been involved in the treasury management process during 2012/13 including:

- Scrutiny of the treasury management strategy by the Transformation and Resources Overview and Scrutiny Committee prior to being submitted for approval by the Full Council.
- Scrutiny of treasury management performance by the Audit and Risk Committee through the receipt of a half yearly treasury management report and the annual report.
- The Portfolio Holder for Finance and Resources receives a monthly budget monitoring report which contains details of Treasury Management activity undertaken during the month; this is forwarded to all Members.
- A quarterly budget monitoring and performance report is reported to Cabinet, this contains details of Treasury Management activity undertaken during the quarter.

9. HERITABLE BANK DEFAULTS

This authority currently has the following investment frozen in the Heritable Bank:

- Investment 5092, £2.5m, maturity date 14 September 2009.

Payments up to 31 March 2013 totalled £1,937,728.

ANNEX 1: PRUDENTIAL INDICATORS

	Position/Prudential Indicator	2011/12 Actual	2012/13 Original Indicator	2012/13 Actual
1	Capital Expenditure	£14.796m	N/A	£2.532m
2	Capital Financing Requirement at 31st March	£0.031m	0.115m	(0.197m)
3	Treasury Position at 31st March Borrowing Other long term liabilities Total Debt Investments Net Borrowing	 £0.0m £0.0m (£0.0m) (£10.475m) (£10.475m)	 N/A N/A N/A N/A N/A	 £0.0m £0.0m (£0.0m) (£4.900m) (£4.900m)
4	Authorised Limit (against maximum position)	£0.0m	£15.0m	£0.0m
5	Operational Boundary (against maximum position)	£0.0m	£5.0m	£0.0m
6	Ratio of Financing Costs to Net Revenue Stream	(1.23%)	(0.56%)	(1.04%)
7	Upper Limits on Variable Interest Rates (against maximum position) Loans Investments	 0% 0%	 100% 100%	 0% 0%
8	Actual External Debt	£0.0m	N/A	£0.0m
9	Principal Funds Invested for Periods Longer than 364 days (against maximum position)	£0.0m	£10.0m	£0.0m

GLOSSARY

CPI – Consumer Price Index

The Consumer Price Index (CPI) is the main UK measure of inflation for macroeconomic purposes and forms the basis for the Government's inflation target. It is also used for international comparisons.

ECB – European Central Bank

The European Central Bank (ECB) is the central bank for the euro and administers the monetary policy of the EU member states which constitute the Eurozone, one of the largest currency areas in the world.

LIBID – London Interbank Bid Rate

Banks in the City of London tend to lend and borrow money from one another in the wholesale money markets. The rate at which a bank is willing to borrow money is called the London Interbank Bid Rate (LIBID).

LIBOR – London Interbank Offered Rate

This is the benchmark used by banks, securities houses and investors to gauge the cost of unsecured borrowing in the money markets. It is calculated each day by asking a panel of major banks what it would cost them to borrow funds for various periods of time and in various currencies, and then creating an average of the individual bank's figures.

MPC – Monetary Policy Committee

Interest rates are set by the Bank's Monetary Policy Committee (MPC). The MPC sets an interest rate it judges will enable the inflation target to be met. The Bank's MPC is made up of nine members – the Governor, the two Deputy Governors, the Bank's Chief Economist, the Executive Director for Markets and four external members appointed directly by the Chancellor. The appointment of external members is designed to ensure that the MPC benefits from thinking and expertise in addition to that gained inside the Bank of England.

PWLB – Public Works Loan Board

The Public Works Loan Board (PWLB) is a statutory body operating within the Debt Management Office and is responsible for lending money to local authorities and other prescribed bodies, as well as for collecting the repayments.

QE – Quantitative Easing

Quantitative Easing is an unconventional monetary policy used by central banks to stimulate the national economy when standard monetary policy has become ineffective. A central bank implements quantitative easing by buying financial assets from commercial banks and other private institutions, thus increasing the money supply by flooding financial institutions with capital, in an effort to promote increased lending and liquidity.