APPENDIX 1

Lewes District Council

Annual Treasury Management Report 2011/2012

Contents

1. Background

1.1 The Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury management report. The report must review treasury management activities and set out the final position of the Council's Treasury Prudential Indicators. This report meets the requirements of both the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

1.2 The Council defines its Treasury Management activities as:

> *"the management of the Council'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."*

1.3 The Council agreed its Treasury Management Strategy Statement and Investment Strategy 2011/2012 to 2013/2014 at its meeting in February 2011. At that time, the Government had not yet finalised its plans for the reform of Housing finance, which would have a profound affect on the amount that the Council would have to borrow. In February 2012, the Council agreed updates to the Strategy in response to the final plans for Housing finance reform which were to be implemented in March 2012. This Report compares actual performance with the revised Strategy for 2011/2012.

2. Overall Summary of Activity 2011/2012

2.1 The table below lists the key elements of the 2011/2012 Strategy and records actual performance against each one of them.

Key Element	Required by Strategy	Actual Performance	
Borrowing			
Underlying need to borrow (CFR) at year end	£70.612 million *	£70.221 million	✓
Internal borrowing at year end	£12.923 million *	£13.548 million	✓
New long-term borrowing in year	£52.689 million	£51.673 million	✓
Debt rescheduling in year	Review options but not anticipated	Options kept under review, none undertaken	✓
Interest paid in year	£0.225 million *	£0.242 million	✓
Investments			
Minimum counterparty credit ratings for investments of up to 1 year	Long-term A+/ Short-term F1 (does not apply to Government and other local authorities)	At least Long-term A+/ Short-term F1 where required	✓
Minimum counterparty credit ratings for investments of 1 to 3 years	Long-term AA-/ Short-term F1+	No investments of 1 to 3 years	✓
Sovereign status of counterparties	UK plus 9 specified nations	Only UK counterparties	✓

Key Element	Required by Strategy	Actual Performance	
		used	
Money Market Funds	AAA rated with Constant Net Asset Value	AAA rated with Constant Net Asset Value	✓
Overnight exposure guideline for deposits with Cooperative	Maximum £1 million	Maximum £1 million	✓
Interest received in year	£0.135 *	£0.106	✓
Reporting and Training			
Reports to be made to Audit Committee and Cabinet	Every meeting	Every meeting	✓
Briefing sessions for Councillors and Staff	Arlingclose to provide	Arlingclose provided	✓
* indicates revised budget for year shown in 2012/2013 Treasury Strategy			

2.2 For those who are looking for more than this overall confirmation that all treasury management and investment activity in 2011/2012 has been carried out in accordance with the Council's agreed Strategy, the remainder of this report explores each of the key elements in more depth. Appendix A gives details of the final position on each of the Prudential Indicators, and Appendix B explores the Economic Background to the year's activity. A Glossary appears at the end of the document to explain the technical terms which could not be avoided when writing this report.

3. Detailed Analysis - Borrowing

3.1 The underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) are, together with Balances and Reserves, the core drivers of Treasury Management Activity. The CFR is, in simple terms, the amount of capital expenditure which has been incurred by the Council but which has not yet been paid for (by using, for example, grants, capital receipts, reserves or revenue income) and in the meantime is covered by internal or external borrowing. External borrowing is where loans are raised from the Public Works Loans Board or banks. Alternatively it is possible to use the significant levels of cash which have been set aside in Balances and Reserves and which would otherwise need to be invested with banks or other borrowers as a means to avoid taking on external loans. This is known as internal borrowing.

3.2 The CFR is calculated each year in accordance with a statutory formula. As noted above, the level of CFR increases each year by the amount of unfinanced capital expenditure and is reduced by the amount that the Council sets aside for the repayment of borrowing. No unfinanced expenditure took place in 2011/2012 with the exception of the payment of £56.7m to the Government made at the end of March and which was required as a result of the national transition to self-financing for housing.

	2011/12 Estimate £m	2011/12 Outturn £m
Opening CFR	13.616	13.616
Capital expenditure in year	66.035	61.898
Less financed	(8.971)	(5.225)
Less amount set aside for debt repayment	(0.068)	(0.068)
Closing CFR	70.612	70.221
NB the CFR calculation above excludes technical accounting entries relating to contractual arrangements which in accordance with International Financial Reporting Standards (IFRS) are deemed to contain a lease. These accounting items have no impact on the Council's treasury management.		

3.3 The following table compares the CFR with the amount that the Council holds in balances and reserves.

	31/3/12 Estimate £m	31/3/12 Outturn £m
(a) Capital Financing Requirement	70.612	70.221
(b) Actual external borrowing	(57.689)	(56.673)
(c) Use of Balances and Reserves as alternative to borrowing (a)–(b)	12.923	13.548
(d) Total Balances and Reserves	13.970	14.193
(e) Amount used as an alternative to borrowing (c) above	(12.923)	(13.548)
(f) Balances and Reserves available for investment (d)-(e)	1.047	0.645
(g) Total investments	Not stated	4.264

3.4 In the table above, the difference between total investments (line g) and the amount of Balances and Reserves available for investment (line f) is accounted for by day-to-day cash movements as well as s106 developer contributions. Line (g) excludes the Icelandic Bank deposit which is not readily available (see para 5).

3.5 As noted above, the Council was required to pay the Government £56.7m in March 2012. Three principal options were available to finance this transaction:

Option 1 Maximum repayment schedule: The debt is profiled so that debt matures naturally to match the anticipated repayment capacity. The main risk associated with this option is the risk of refinancing if the repayment schedule cannot be met in any year because of other priorities falling on the HRA at the time. The resulting refinancing would be likely to be at increased interest rates.

Option 2 Extended repayment: Takes all new borrowing on a fixed rate, long-term basis to mature in 30 years' time (ie at the end of the initial

Housing Business Plan cycle). This option assumes no debt repayment until 2041/42 with annual HRA surpluses being invested in the interim. Although this option provides freedom with regard to the availability of surplus HRA resources for investment, there is the risk that investment returns remain below debt levels, with an associated net cost to the HRA. In addition, within a few years, the pool of cash to invest would be considerable, with increased exposure to volatility within the financial markets.

Option 3 Balanced Portfolio: this incorporates elements of both option 1 and option 2 above. This option also incorporates elements of "internal borrowing" and variable rate borrowing. The intention is to hedge against various risks, maintain funding flexibility and achieve a low rate portfolio.

3.6 Of the three options, the Balanced Portfolio (Option 3) was considered to be the most appropriate for the Council at this time and the new borrowing was structured on that basis. This approach reduces the risks associated with holding investments. As a result, the total amount of new borrowing required to fund the payment was £51.673m. All new borrowing was taken from the Government's PWLB at the reduced rates on offer for HRA self-financing arrangements.

3.7 The Council's loan portfolio at 31 March 2012 was:

Lender	Interest	Amount £m	Rate %	Maturity
PWLB	Fixed	4.00	2.7000	01/03/2024
PWLB	Fixed	5.00	3.3000	01/03/2032
PWLB	Fixed	2.00	3.0500	01/09/2027
PWLB	Fixed	2.00	2.7600	01/09/2024
PWLB	Fixed	4.00	2.9700	01/09/2026
PWLB	Fixed	5.00	3.2800	01/09/2031
PWLB	Fixed	4.00	2.6300	01/09/2023
PWLB	Fixed	5.00	3.4400	01/03/2037
PWLB	Fixed	6.67	3.5000	01/03/2042
PWLB	Fixed	5.00	3.4300	01/09/2036
PWLB	Variable	5.00	0.6200	28/03/2022
PWLB	Fixed	4.00	3.0100	01/03/2027
	Sub-total	51.67		
Barclays	LOBO	5.00	4.5000	06/04/2054
	Total	56.67		

3.8 In the table above the Lender's Options Borrower's Option (LOBO) loan was taken out in April 2004 with a term of 50 years. Every 4 years, the Lender has the option to increase the interest rate, and if it does so, the Council has the right to repay. The rate/terms of the loan were due to be reviewed shortly after the period covered by this Report (in April 2012) and there were no opportunities for it to be rescheduled in 2011/2012. (The LOBO remains in place following the April 2012 review).

3.9 Total interest paid on long-term borrowing in the year was £0.242m, 7.5% above the budget of £0.225m, the difference reflecting the timing of the Housing reform payment to the Government. The Council established 2 separate Loans Pools in 2011/2012 for the General Fund and HRA respectively. At 31 March 2012 the General Fund had advanced a internal loan of £10.94m to the HRA.

4. Detailed Analysis - Investments

4.1 The Council held an average of £12.2m as cash during the year. This comprised working cash balances, capital receipts, earmarked reserves and developer contributions held pending use.

4.2 The Council's general policy objective is to invest its surplus funds prudently. Throughout 2011/2012, the Council's investment priorities were:

highest priority - security of the invested capital;
followed by - liquidity of the invested capital;
finally - an optimum yield commensurate with security and liquidity.

4.3 All of the Council's investments were managed in-house. Security of capital was maintained by following the counterparty policy set out in the Investment Strategy for 2011/2012. Investments during the year included:

- Deposits with the Debt Management Office (total £78.56m)
- Deposits with other Local Authorities (total £72.46m)
- Investments in AAA-rated Constant Net Asset Value Money Market Funds (MMFs) (average balance held in year £0.93m)
- Deposit accounts with UK Banks (average balance held in year £1.95m)
- Overnight deposits with the Council's banker, Cooperative Bank (average balance held in year £0.31m)

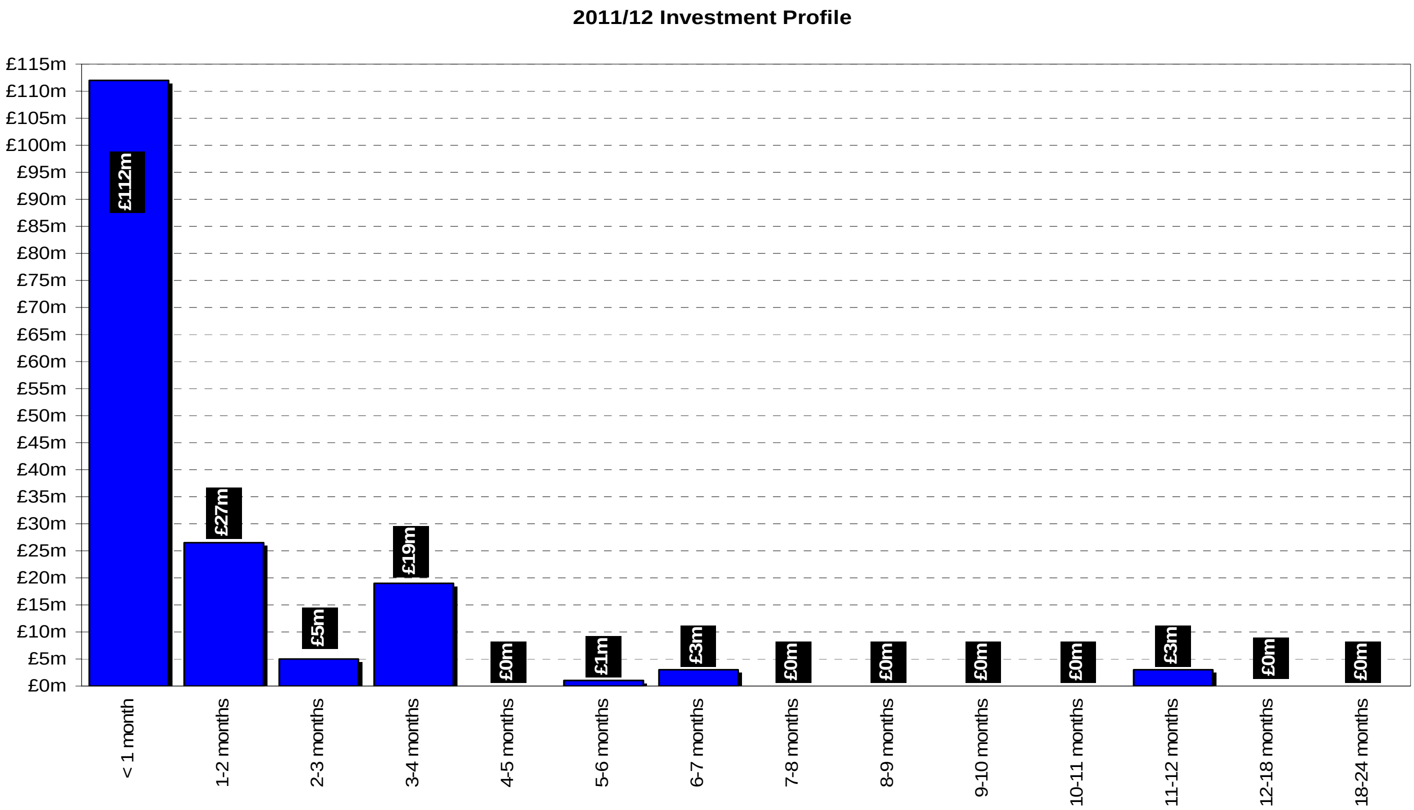
4.4 The guideline for use of the Cooperative Bank for overnight deposits is an overnight exposure limit of £1m. This was exceeded on four occasions when significant sums were received into the account without prior notice and late in the day, after the cut-off time for treasury management activity.

4.5 Counterparty credit quality was assessed and monitored with reference to credit ratings (a minimum long-term counterparty rating of A+ across all three rating agencies Fitch, Standard and Poors, and Moody's applied); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; any potential support mechanisms and share price.

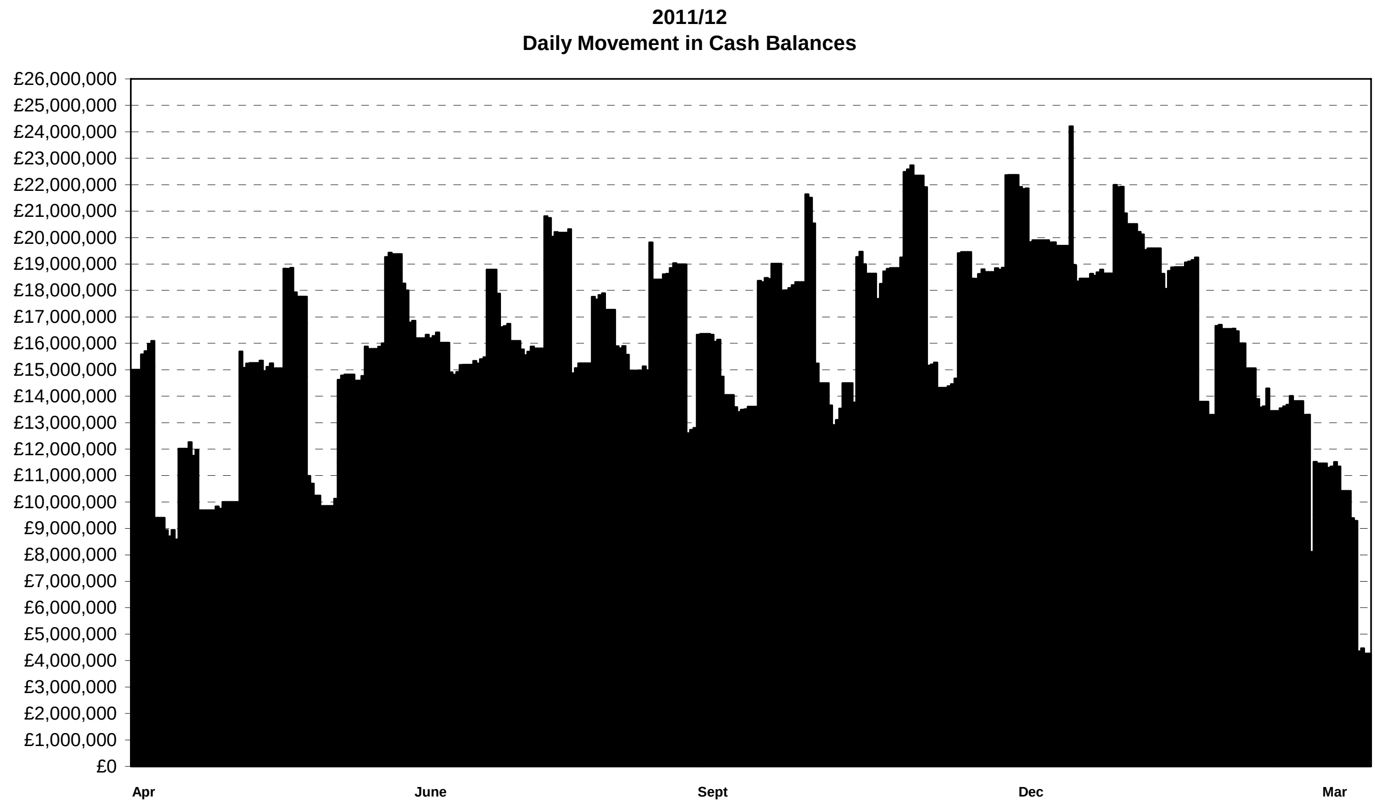
4.6 In keeping with Government guidance on investments, the Council maintained a sufficient level of liquidity through the use of MMFs, overnight deposits and the use of deposit accounts.

4.7 The Council sought to optimise returns commensurate with its objectives of security and liquidity. As expected when setting the investment income budget for 2011/2012, the UK Bank Rate was maintained at 0.5% through the year. Short term money market rates remained at very low levels which had a significant impact on potential investment returns.

4.8 A full list of temporary investments made in the year is given at Appendix C. All investments were made with UK institutions, and no new deposits were made for periods in excess of one year. The chart below gives an analysis of aggregate fixed term deposits by duration.



4.9 The next chart shows how the total amount invested varied from day to day over the course of the year, with the movement largely reflecting the cycle of grant, council tax and business rate receipts and precept payments made.



4.10 The budget for investment income for 2011/2012 was £0.135 million. Actual interest generated was 21% lower at £0.106 million, reflecting the continuing low rate of interest available on the lowest risk investments, primarily the Government's Debt Management Office.

5. Icelandic Bank Investment

5.1 The Council lodged a formal claim against Landsbanki Island hf in respect of its deposit of £1m (plus accrued interest) which was not repaid following the failure of the bank in October 2008. The Council's interests have been represented by the solicitors Bevan Brittan who were appointed by the Local Government Association (LGA) on behalf of all local authorities who had deposited funds with Icelandic banks which failed at that time.

5.2 Local authorities with investments in Iceland's Landsbanki gained priority status as creditors, with the decision ratified by the Icelandic Supreme Court. As a result, full recovery of the amount claimed, £1.047m, is expected, although the timing of payments to the Council remains uncertain. An initial distribution of £0.3m was received in February 2012 (with a further £0.1m in May 2012).

6. Reporting and Training

6.1 The Director of Finance reported the details of treasury management activity to each meeting of the Audit Committee and Cabinet held in 2011/2012. In addition, a mid-term summary report was issued in November 2011.

6.2 All councillors tasked with treasury management responsibilities, including scrutiny of the treasury management function, were offered the opportunity to attend local briefing sessions led by the Council's appointed Treasury Management advisors, Arlingclose, on 26 May 2011 and 19 December 2011.

6.3 The training needs of the Council's treasury management staff were reviewed as part of the annual corporate staff appraisal/training needs assessment process for all Council employees. Members of staff attended Arlingclose workshops alongside colleagues from other local authorities during 2011/2012. In addition, staff attended several training events at which the treasury management implications of the Government's proposed housing financing reforms were explained.

7. Investment Consultants

The appointment of Arlingclose as the Council's financial adviser continued through 2011/2012, with review meetings being held on two occasions. Arlinglose was the primary source of information, advice and assistance relating to investment activity, with individual investment decisions being made by the Council. Under a separate arrangement, Arlingclose also supported the Council with specific advice in respect of the Treasury management implications of the reform of Housing finance.

Appendix A – Prudential Indicators 2011/2012

1. Background:

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators. Some of the Prudential Indicators relate directly to the Council's Capital Programme These Indicators are also included below for completeness of reporting.

2. Net Borrowing and the Capital Financing Requirement

2.1 This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

2.2 The Director of Finance reports that the Council has had no difficulty meeting this requirement in 2011/2012, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the budget for 2012/2013.

3. Estimates of Capital Expenditure (direct link to Capital Programme)

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 and in the case of the HRA, housing rent levels. For comparative purposes, HRA Capital Expenditure shown below excludes the housing reform payment of £56.673m to the Government.

No.	Capital Expenditure	2011/12 Original £m	2011/12 Revised £m	2011/12 Actual £m
1a	Non-HRA	1.361	6.222	2.799
1b	HRA	2.770	2.774	2.426
	Total	**4.131**	**8.996**	**5.225**

4. Ratio of Financing Costs to Net Revenue Stream (direct link to Capital Programme)

4.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs.

4.2 The ratio is based on costs net of investment income. Where investment income exceeds interest payments, the indicator is negative.

No.	Ratio of Financing Costs to Net Revenue Stream	2011/12 Original %	2011/12 Revised %	2011/12 Actual %
2a	Non-HRA	1.20	-0.57	-0.38
2b	HRA	1.55	1.49	1.47

5. Capital Financing Requirement

5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing. It is an aggregation of the amounts shown for Fixed and Intangible assets, the Revaluation Reserve, the Capital Adjustment Account, Government Grants Deferred and any other balances treated as capital expenditure. The CFR calculation presented below excludes technical accounting entries relating to contractual arrangements which in accordance with IFRS are deemed to contain a lease. These accounting items have no impact on the Council's treasury management activity.

No	Capital Financing Requirement	2011/12 Original £m	2011/12 Revised £m	2011/12 Actual £m
3a	Non-HRA	2.606	2.606	2.606
3b	HRA	10.942	68.006	67.615
	Total CFR	**13.548**	**70.612**	**70.221**

5.2 The year-on-year change in the CFR is set out below. For clarity, the technical impact of a change to accounting practices based on IFRS is not included in the figures below, which differ, therefore, from those in the Council's formal accounting statements.

Capital Financing Requirement	2011/12 Original £m	2011/12 Revised £m	2011/12 Actual £m
Balance B/F	13.616	13.616	13.616
Capital expenditure financed from borrowing	0.000	57.064	56.673
Revenue provision for Debt Redemption.	(0.068)	(0.068)	(0.068)
Balance C/F	**13.548**	**70.612**	**70.221**

6. Actual External Debt

This indicator is obtained directly from the Council'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 (see 8 below). The values shown below exclude technical accounting items required under IFRS.

No.	Actual External Debt as at 31/03/2012	Original £m	Actual £m
4a	Borrowing	5.000	56.673
4b	Other Long-term Liabilities	0.000	0.000
4c	**Total**	**5.000**	**56.673**

7. Incremental Impact of Capital Investment Decisions Stream (direct link to Capital Programme)

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

No.	Incremental Impact of Capital Investment Decisions	2011/12 Original £	2011/12 Revised £	2011/12 Actual £
5a	Increase in Band D Council Tax	14.05	56.67	28.23
5b	Increase in Average Weekly Housing Rents	1.79	1.88	0.36

The increase in Band D council tax/average weekly rents reflects the funding of the capital programme: for example, new borrowing increases interest payable, and funding from reserves utilises resources which could have otherwise been used to fund revenue expenditure.

8. Authorised Limit and Operational Boundary for External Debt

8.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

8.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council’s existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

8.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

8.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit). The 2011/12 Actual values shown below (which exclude technical accounting items required under IFRS) are the maximum levels of borrowing experienced at any time during the year.

No.	Authorised Limit for External Debt	2011/12 Original £m	2011/12 Revised £m	2011/12 Actual £m
6a	Borrowing	19.45	72.00	56.67
6b	Other Long-term Liabilities	0.05	0.50	0.00
6c	**Total**	**19.50**	**72.50**	**56.67**

8.5 The **Operational Boundary** links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

8.6 The Director of Finance has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the immediately following meeting of the Cabinet. The 2011/12 Actual values shown below are the maximum levels of borrowing experienced at any time during the year.

No.	Operational Boundary for External Debt	2011/12 Original £m	2011/12 Revised £m	2011/12 Actual £m
7a	Borrowing	13.95	66.50	56.67
7b	Other Long-term Liabilities	0.05	0.50	0.00
7c	**Total**	**14.00**	**67.00**	**56.67**

9. Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Council has adopted the principles of best practice.

No.	Adoption of the CIPFA Code of Practice in Treasury Management
8	The Council approved the adoption of the CIPFA Treasury Management Code in 2002. Following revisions to the Code published in December 2009, reconfirmed its adoption of the Code in February 2010.

10. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

10.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums ie fixed rate debt net of fixed rate investments. The guidance notes to the updated Treasury Management Code allow the option for these indicators to be stated either in percentage or value terms. The decision has been taken to state these indicators as values which offers greater clarity.

10.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget.

No.		2011/12 Original £m	2011/12 Revised £m	2011/12 Actual £m
9	**Upper Limit for Fixed Interest Rate Exposure**	19.0	72.5	51.7
10	**Upper Limit for Variable Interest Rate Exposure**	(24.6)	(20.0)	0.2

10.3 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's Treasury Management Strategy.

10.4 Because the Council's borrowing is now substantially in excess of its investments, these calculations have resulted in a positive figure.

11. Maturity Structure of Fixed Rate borrowing

11.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

11.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

No.	Maturity structure of fixed rate borrowing	Lower Limit %	Upper Limit %	Actual %
11a	under 12 months	0	70	0
11b	12 months and within 24 months	0	70	0
11c	24 months and within 5 years	0	75	0
11d	5 years and within 10 years	0	75	0
11e	10 years and above	0	100	100

12. Upper Limit for total principal sums invested over 364 days

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested. No investments of more than 364 days were made during 2011/12.

No.	Upper Limit for total principal sums invested over 364 days	2010/11 Original %	2010/11 Revised %	2011/12 Actual %
12	Upper limit	50	50	0

Appendix B – Economic Background explained by Arlingclose

At the time of determining the 2011/12 strategy in *Jan/Feb* 2011, there were tentative signs that the UK was emerging from recession with the worst of the financial crisis behind it. Recovery in growth was expected to be slow and uneven as the austerity measures announced in the 2010 Comprehensive Spending Review were implemented in order to bring down the budget deficit and government borrowing and rebalance the economy and public sector finances. Inflation measured by the Consumer Price Index (CPI) had remained stubbornly above 3%> Unemployment was at a 16-year high at 2.5 million and was expected to rise further as the public and private sector contracted. There was a also high degree of uncertainty surrounding Eurozone sovereign debt sustainability.

Inflation : During 2011-12 inflation remained high with CPI (the official measure) and RPI rising in September to 5.2% and 5.6% respectively primarily due to escalating utility prices and the January 2011 increase in VAT to 20%. Inflation eased slowly as reductions in transport costs, food prices, intensifying competition amongst retailers and supermarkets and the VAT effect falling out in 2012, pushed February 2012's CPI down to 3.4% and RPI to 3.7%. This, however, was not enough to offset low wage growth and, as a result, Britons suffered the biggest drop in disposable income in more than three decades.

Growth, Employment, House Prices : Growth, on the other hand, remained elusive. The Bank's Quarterly Inflation Reports painted a bleak picture as the outlook was downgraded to around 1% in 2011 and 2012 alongside. The unresolved problems in the Eurozone weighed negatively on global economic prospects. UK GDP was positive in only the first and third calendar quarters of 2011; annual GDP to December 2011 registered just 0.5%. Unemployment rose to 2.68 million and, worryingly, youth unemployment broke through the 1 million barrier. House prices struggled to show sustained growth and consumer confidence remained fragile.

Monetary Policy : It was not surprising that the Bank of England's Monetary Policy Committee maintained the status quo on the Bank Rate which has now been held at 0.5% since March 2009, but increased asset purchases by £75bn in October 2011 and another £50bn in February 2012 taking the Quantitative Easing (QE) total to £325bn.

The policy measures announced in the March 2012 Budget statement were judged to be neutral. The government stuck broadly to its austerity plans as the economy was rebalancing slowly. The opinion of independent Office for Budget Responsibility (OBR) was that the government was on track to meet its fiscal targets; the OBR identified oil price shocks and a further deterioration in Europe as the main risks to the outlook for growth and in meeting the fiscal target.

US

The US economy continued to show tentative, positive signs of growth alongside a gradual decline in the unemployment rate. The US Federal Reserve (the Fed) committed to keeping policy rates low until 2014, although a modest shift in the Fed's language in March, alongside an improvement in economic activity, cast doubts about the permanence of the Fed's policy commitment.

Europe

In Europe, sovereign debt problems for some peripheral countries became critical. Several policy initiatives were largely ineffectual; two bailout packages were required for Greece and one for Portugal, and the contagion spread to Spain and Italy whose sovereign bonds came under increased stress in November. Standard & Poor's downgraded nine European sovereigns and the EFSF bailout fund. The successful Greek sovereign bond swap in March 2012 shortly after its second bailout package allowed it to avoid bankruptcy later that month, but it was not a long-term solution. The ECB's €1.3 trillion Long-Term refinancing Operations (LTROs) flooded the financial markets with ultra-cheap 3-year liquidity and relieved much of the immediate funding pressure facing European banks in 2012, but markets ultimately took the view the LTROs simply served to delay a resolution of, rather than addressed, the fundamental issues underpinning Euroland's problems.

Markets sentiment oscillated between ‘risk on’/’risk off’ modes, this swing becoming the norm for much of 2011/12 as investors shifted between riskier assets and the relative safety of higher quality government bonds. Gilts, however, were a principal beneficiary of the ‘risk-off’ theme which helped push yields lower. There was little market reaction to or impact on gilts by the decision by Fitch and Moody’s to change the outlook on the UK’s triple-A rating from stable to negative. Over the 12-month period from April 2011 to March 2012, 5-year gilt yields more than halved from 2.40% to 1.06%; 10-year gilt yields fell from 3.67% to 2.25%; 20-year yields fell from 4.30% to 3.20% and 50-year yields from 4.20% to 3.35%. PWLB borrowing rates fell commensurately (see table 2 in appendix 2), but the cost of carry associated with borrowing longer-term loans whilst investing the monies temporarily until required for capital financing remained high, in excess of 4.1 % for 20-year PWLB Maturity borrowing.

Credit

Europe’s banking sector was inextricably linked with the sovereign sector. Sharp moves in sovereign CDS and bond yields were fairly correlated with the countries’ banking sector performance. The deterioration in the prospects for real growth had implications for earnings and profit growth and banks’ creditworthiness. The European Banking Authority’s banking stress tests of 70 EU banks undertaken in October 2011 identified a collective €106 billion shortfall to banks’ Core Tier 1 ratio of 9%. The slowdown in debt and equity capital market activity also had implications for banks’ funding and liquidity. These principal factors, as well as a reassessment by the rating agencies of future sovereign support for banks, resulted in downgrades to the long-term ratings of several UK and non-UK financial institutions in autumn 2011.

Appendix C – List of Term Deposits made and/or maturing in 2011/2012

Deal	Counterparty	Value £	From	To	Rate
192110	Bank of Scotland	2,000,000	21/10/10	21/10/11	1.9800%
193310	Basildon District Council	1,000,000	01/12/10	01/06/11	0.8500%
193810	Santander UK Plc	1,000,000	17/01/11	18/04/11	1.0100%
194310	Thurrock Borough Council	1,000,000	31/01/11	04/04/11	0.4500%
195110	Conwy County Borough Council	1,000,000	31/03/11	05/04/11	0.5500%
195210	South Lakeland District Council	1,100,000	31/03/11	01/04/11	0.5001%
195311	Swindon Borough Council	4,000,000	01/04/11	08/04/11	0.4900%
195411	Calderdale MBC	1,000,000	01/04/11	08/04/11	0.4900%
195511	Plymouth City Council	1,000,000	04/04/11	11/04/11	0.3500%
195611	Santander UK Plc	1,000,000	04/04/11	04/07/11	1.0700%
195711	Plymouth City Council	1,000,000	07/04/11	21/04/11	0.3800%
195811	Debt Management Office	1,500,000	05/04/11	07/04/11	0.2500%
195911	Debt Management Office	1,000,000	07/04/11	08/04/11	0.2500%
196011	Nationwide Building Society	2,000,000	14/04/11	16/05/11	0.5000%
196111	Nationwide Building Society	1,000,000	15/04/11	26/04/11	0.3700%
196211	Nationwide Building Society	1,000,000	28/04/11	31/05/11	0.5000%
196311	Santander UK Plc	1,000,000	28/04/11	28/07/11	1.0700%
196411	Plymouth City Council	2,000,000	28/04/11	31/05/11	0.4000%
196511	Debt Management Office	1,700,000	03/05/11	10/05/11	0.2500%
196611	London Borough of Brent	1,750,000	10/05/11	23/05/11	0.3000%
196711	Nationwide Building Society	2,000,000	16/05/11	23/05/11	0.3700%
196811	Debt Management Office	1,000,000	16/05/11	19/05/11	0.2500%
196911	Debt Management Office	3,000,000	16/05/11	23/05/11	0.2500%
197011	Plymouth City Council	2,000,000	31/05/11	30/06/11	0.4000%
197111	Debt Management Office	1,000,000	01/06/11	10/06/11	0.2500%
197211	Debt Management Office	1,500,000	01/06/11	06/06/11	0.2500%
197311	Nationwide Building Society	2,000,000	01/06/11	01/12/11	1.0200%
197411	Nationwide Building Society	1,000,000	01/06/11	01/09/11	0.7500%
197511	Debt Management Office	1,000,000	06/06/11	13/06/11	0.2500%
197611	Plymouth City Council	2,000,000	10/06/11	11/07/11	0.3500%
197711	Debt Management Office	1,000,000	09/06/11	10/06/11	0.2500%
197811	Bridgend County Borough Council	1,000,000	13/06/11	05/07/11	0.3800%
197911	Plymouth City Council	2,000,000	16/06/11	01/07/11	0.3200%
198011	Plymouth City Council	2,000,000	14/06/11	15/06/11	0.3000%
198111	Debt Management Office	2,000,000	15/06/11	16/06/11	0.2500%
198211	Debt Management Office	1,000,000	15/06/11	20/06/11	0.2500%
198311	Debt Management Office	1,000,000	15/06/11	22/06/11	0.2500%
198411	Debt Management Office	2,000,000	30/06/11	07/07/11	0.2500%
198511	Plymouth City Council	2,000,000	07/07/11	18/07/11	0.3200%
198611	Debt Management Office	1,400,000	01/07/11	04/07/11	0.2500%
198711	Debt Management Office	1,000,000	05/07/11	12/07/11	0.2500%
198811	Debt Management Office	2,000,000	11/07/11	14/07/11	0.2500%
198911	Santander UK Plc	1,000,000	11/07/11	11/01/12	1.3500%

Deal	Counterparty	Value	From	To	Rate
199011	Debt Management Office	1,000,000	12/07/11	19/07/11	0.2500%
199111	Debt Management Office	2,000,000	14/07/11	21/07/11	0.2500%
199211	Barclays Bank plc	2,500,000	15/07/11	15/08/11	0.3500%
199411	Debt Management Office	2,000,000	18/07/11	25/07/11	0.2500%
199511	Plymouth City Council	3,000,000	25/07/11	25/10/11	0.4000%
199611	Debt Management Office	1,400,000	21/07/11	25/07/11	0.2500%
199711	Barnsley Metropolitan Borough Council	2,000,000	01/08/11	09/08/11	0.2800%
199811	Debt Management Office	3,000,000	01/08/11	09/08/11	0.2500%
199911	Debt Management Office	1,500,000	15/08/11	22/08/11	0.2500%
200011	Debt Management Office	1,000,000	15/08/11	25/08/11	0.2500%
200111	Debt Management Office	2,000,000	15/08/11	12/09/11	0.2500%
200211	Debt Management Office	1,500,000	01/09/11	02/09/11	0.2499%
200311	Debt Management Office	4,500,000	01/09/11	12/09/11	0.2500%
200411	Bournemouth Borough Council	2,000,000	13/09/11	13/10/11	0.2800%
200511	Bournemouth Borough Council	1,000,000	13/09/11	22/09/11	0.2700%
200611	Birmingham City Council	2,000,000	15/09/11	06/10/11	0.2900%
200711	Thurrock Borough Council	2,000,000	03/10/11	05/12/11	0.4000%
200811	Thurrock Borough Council	2,000,000	06/10/11	06/01/12	0.4500%
200911	Debt Management Office	1,000,000	07/10/11	10/10/11	0.2500%
201011	Debt Management Office	2,000,000	13/10/11	20/10/11	0.2500%
201111	Debt Management Office	1,000,000	14/10/11	19/10/11	0.2500%
201211	Debt Management Office	3,000,000	17/10/11	20/10/11	0.2500%
201311	Debt Management Office	1,500,000	21/10/11	24/10/11	0.2500%
201411	Birmingham City Council	2,500,000	25/10/11	25/11/11	0.3500%
201511	Thurrock Borough Council	2,000,000	05/12/11	28/03/12	0.4000%
201611	Plymouth City Council	3,000,000	28/10/11	04/11/11	0.2800%
201711	Debt Management Office	1,000,000	01/11/11	03/11/11	0.2500%
201811	Debt Management Office	2,500,000	01/11/11	22/11/11	0.2500%
201911	Birmingham City Council	2,000,000	03/11/11	05/12/11	0.3500%
202011	Birmingham City Council	1,500,000	04/11/11	05/12/11	0.3300%
202111	Birmingham City Council	1,000,000	08/11/11	08/02/12	0.4300%
202211	Birmingham City Council	1,000,000	08/11/11	08/12/11	0.3300%
202311	Debt Management Office	3,000,000	15/11/11	22/11/11	0.2500%
202411	Birmingham City Council	5,000,000	01/12/11	14/03/12	0.4000%
202511	Midlothian Council	2,000,000	12/12/11	12/03/12	0.4000%
202611	Debt Management Office	2,250,000	05/12/11	12/12/11	0.2500%
202711	Thurrock Borough Council	2,000,000	03/01/12	10/02/12	0.2900%
202811	Thurrock Borough Council	2,000,000	06/01/12	10/02/12	0.2900%
202911	Salford City Council	2,000,000	22/12/11	22/02/12	0.3100%
203011	Debt Management Office	1,000,000	08/12/11	22/12/11	0.2500%
203111	West Yorkshire Police Authority	1,000,000	15/12/11	06/01/12	0.2800%
203211	Debt Management Office	3,000,000	15/12/11	19/12/11	0.2500%
203311	Debt Management Office	1,000,000	19/12/11	22/12/11	0.2500%
203411	Debt Management Office	1,500,000	19/12/11	28/12/11	0.2500%
203511	Debt Management Office	2,400,000	23/12/11	04/01/12	0.2500%
203611	Debt Management Office	3,000,000	03/01/12	04/01/12	0.2500%

Deal	Counterparty	Value	From	To	Rate
203711	Debt Management Office	1,500,000	16/01/12	19/01/12	0.2500%
203811	Blaenau Gwent CBC	2,000,000	20/02/12	23/03/12	0.3200%
203911	Debt Management Office	2,000,000	15/03/12	22/03/12	0.2500%
204011	Debt Management Office	2,300,000	22/03/12	27/03/12	0.2500%
204111	Hinkley & Bosworth Borough Council	2,600,000	23/03/12	02/04/12	0.5000%
204211	West Yorkshire Fire & Rescue Service	1,000,000	30/03/12	16/04/12	0.3500%
204311	Debt Management Office	600,000	30/03/12	12/04/12	0.2500%

Glossary of Terms

Affordable Borrowing Limit	Each local authority is required by statute to determine and keep under review how much money it can afford to borrow. The Prudential Code (see below) sets out how affordability is to be measured.
Base Rate	The main interest rate in the economy, set by the Bank Of England, upon which others rates are based.
Bonds	Debt instruments issued by government, multinational companies, banks and multilateral development banks. Interest is paid by the issuer to the bond holder at regular pre-agreed periods. The repayment date of the principal is also set at the outset.
Capital Expenditure	Spending on the purchase, major repair, or improvement of assets eg buildings and vehicles
Capital Financing Requirement (CFR)	Calculated in accordance with government regulations, the CFR represents the amount of Capital Expenditure that it has incurred over the years and which has not yet been funded from capital receipts, grants or other forms of income. It represents the Council's underlying need to borrow.
Chartered Institute of Public Finance and Accountancy (CIPFA)	CIPFA is one of the leading professional accountancy bodies in the UK and the only one that specialises in the public services. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely local government.
Counterparty	Organisation with which the Council makes an investment
Credit Default Swaps	CDS are a financial instrument for swapping the risk of debt default and are effectively an insurance premium. Local authorities do not trade in CDS but trends in CDS prices can be monitored as an indicator of relative confidence about the credit rsik of counterparties.
Credit Rating	A credit rating is an independent assessment of the credit quality of an institution made by an organisation known as a rating agency. The rating agencies take many factors into consideration when forming their view of the likelihood that an institution will default on their obligations, including the institution's willingness and ability to repay. The ratings awarded typically cover the short term outlook, the long term outlook, as well as an assessment of the extent to which the parent company or the state will honour any obligations. At

	present, the three main agencies providing credit rating services are Fitch Ratings, Moody's and Standard and Poor's.
Fixed Deposits	Loans to institutions which are for a fixed period at a fixed rate of interest
Gilts	These are issued by the UK government in order to finance public expenditure. Gilts are generally issued for set periods and pay a fixed rate of interest. During the life of a gilt it will be traded at price decided in the market.
Housing Revenue Account (HRA)	There is a statutory requirement for local authorities to account separately for expenditure incurred and income received in respect of the dwellings that they own and manage.
International Financial Reporting Standards (IFRS)	The new set of accounting rules with which all local authorities will be required to comply from 1 April 2010.
Lenders' Option Borrower's Option (LOBO)	A long term loan with a fixed interest rate. On pred-determined dates (eg every five years) the lender can propose or impose a new fixed rate for the remaining term of the loan and the borrower has the 'option' to either accept the new imposed fixed rate or repay the loan.
LIBID	The rate of interest at which first-class banks in London will bid for deposit funds
Minimum Revenue Provision (MRP)	The minimum amount which must be charged to an authority's revenue account each year and set aside as provision for the repayment of debt.
Operational boundary	This is the most likely, prudent view of the level of gross external indebtedness. A temporary breach of the operational boundary is not significant.
Prudential Code/Prudential Indicators	The level of capital expenditure by local authorities is not rationed by central government. Instead the level is set by local authorities, providing it is within the limits of affordability and prudence they set themselves. The Prudential Code sets out the indicators to be used and the factors to be taken into account when setting these limits
Public Works Loan Board (PWLB)	A central government agency which provides long- and medium-term loans to local authorities at interest rates only slightly higher than those at which the Government itself can borrow.
Treasury Management Strategy Statement (TMSS)	Approved each year, this document sets out the strategy that the Council will follow in respect of investments and financing both in the forthcoming financial year and the following two years.