ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE 2010/11 APPENDIX 1
(INCORPORATING OUTTURN PRUDENTIAL INDICATORS)

1. The Council's Capital Activity during 2010/11

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 Council did not borrow during 2010/11.

2. Reporting of the Required Prudential and Treasury Indicators

- During 2010/11, 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:

Actual prudential and treasury indicators	2009/10 Actual	2010/11 Actual
Actual capital expenditure	£8.887m	£10.311m
Total Capital Financing Requirement:	£3.000m	£3.000m
Net borrowing	-£34.827m	-£31.874m
External debt	Nil	Nil
Investments - under 1 year	£34.827m	£31.874m

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2009/10 Actual	2010/11 Estimate	2010/11 Actual
Capital expenditure	£8.887m	£10.192m	£10.311m
Total capital expenditure			
Resourced by:			
• Capital receipts	£7.721m	£8.577m	£9.007m
• Capital grants and other contributions	£0.938m	£1.369m	£1,564m
• Other contributions and MRP	£0.079m	£0.200m	£0.214m
Unfinanced capital expenditure	**£0.149m**	**£0.046m**	**-£0.474m**

3. Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);

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 2010/11 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.

The Council's CFR for the year was -£474k. This includes leasing schemes on the balance sheet, which increase the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

The authorised limit - the authorised limit is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2010/11 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.

	2009/10 Actual	2010/11 Actual
Authorised limit	£7m	£7m
Maximum gross borrowing position	£5m	£5m
Operational boundary	£5m	£5m
Average gross borrowing position	Nil	Nil
Financing costs(+) / income (-) as a proportion of net revenue stream	-3.18%	-4.34%

4. Overall treasury position and the impact on investment balances

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 2010/11 the Council's treasury position was as follows:

	31 March 2010 Principal	Rate/ Return	31 March 2011 Principal	Rate/ Return
Total debt	Nil		Nil	
CFR	Nil		Nil	
Investments - in house	£34.827m	1.57%	£31.874m	1.24%
Total investments	***£34.827m***	***1.57%***	***£31.874m***	***1.24%***

The maturity structure of the investment portfolio was all under one year.

The exposure to fixed and variable rates was as follows:

	31 March 2010 Actual	31 March 2011 Actual
Fixed rate (principal)	£29.000m	£24.000m
Variable rate (principal)	£5.827m	£7.874m

5. Summary of the Economy and Interest Rates

The expectation for interest rates within the strategy for 2010/11 anticipated low but rising Bank Rate (starting in quarter 4 of 2011) with similar gradual rises in medium and longer term fixed interest rates over 2010/11. 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.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and reduce counterparty risk.

The actual movement in interest rates broadly followed the expectations in the strategy, as detailed in the following section.

2010/11 proved to be another watershed year for financial markets. Rather than a focus on individual institutions, market fears moved to sovereign debt issues, particularly in the peripheral Euro zone countries. Local authorities were also presented with changed circumstances following the unexpected change of policy on Public Works Loan Board (PWLB) lending arrangements in October 2010. This resulted in an increase in new borrowing rates of 0.75 – 0.85%, without an associated increase in early redemption rates. This made new borrowing more expensive and repayment relatively less attractive.

UK growth proved mixed over the year. The first half of the year saw the economy outperform expectations, although the economy slipped into negative territory in the final quarter of 2010 due to inclement weather conditions. The year finished with prospects for the UK economy being decidedly downbeat over the short to medium term while the Japanese disasters in March, and the Arab Spring, especially the crisis in Libya, caused an increase in world oil prices, which all combined to dampen international economic growth prospects.

The change in the UK political background was a major factor behind weaker domestic growth expectations. The new coalition Government struck an aggressive fiscal policy stance, evidenced through heavy spending cuts announced in the October Comprehensive Spending Review, and the lack of any “giveaway” in the March 2011 Budget. Although the main aim was to reduce the national debt burden to a sustainable level, the measures are also expected to act as a significant drag on growth.

Gilt yields fell for much of the first half of the year as financial markets drew considerable reassurance from the Government’s debt reduction plans, especially in the light of Euro zone sovereign debt concerns. Expectations of further quantitative easing also helped to push yields to historic lows. However, this positive performance was mostly reversed in the closing months of 2010 as sentiment changed due to sharply rising inflation pressures. These were also expected (during February / March 2011) to cause the Monetary Policy Committee to start raising Bank Rate earlier than previously expected.

The developing Euro zone peripheral sovereign debt crisis caused considerable concerns in financial markets. First Greece (May), then Ireland (December), were forced to accept assistance from a combined EU / IMF rescue package. Subsequently, fears steadily grew about Portugal, although it managed to put off accepting assistance till after the year end. These worries caused international investors to seek safe havens in investing in non-Euro zone government bonds.

Deposit rates picked up modestly in the second half of the year as rising inflationary concerns, and strong first half growth, fed through to prospects of an earlier start to increases in Bank Rate. However, in March 2011, slowing actual growth, together with weak growth prospects, saw consensus expectations of the first UK rate rise move back from May to August 2011 despite high inflation. However, the disparity of expectations on domestic economic growth and inflation encouraged a wide range of views on the timing of the start of increases in Bank Rate in a band from May 2011 through to early 2013. This sharp disparity was also seen in MPC voting which, by year-end, had three members voting for a rise while others preferred to continue maintaining rates at ultra low levels.

Risk premiums were also a constant factor in raising money market deposit rates beyond 3 months. Although market sentiment has improved, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, mean that investors remain cautious of longer-term commitment. The European Commission did try to address market concerns through a stress test of major financial institutions in July 2010. Although only a small minority of banks “failed” the test, investors were highly sceptical as to the robustness of the tests, as they also are over further tests now taking place with results due in mid-2011.

Chart 1: Bank Rate v LIBID investment rates

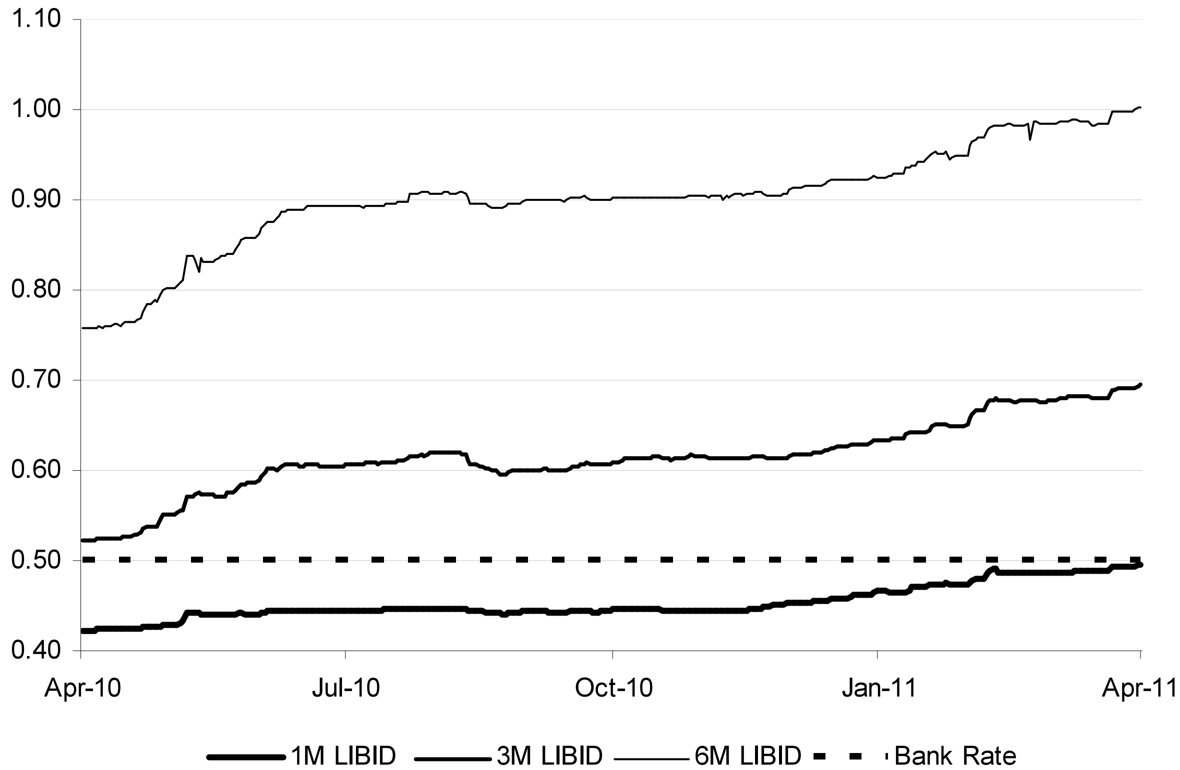
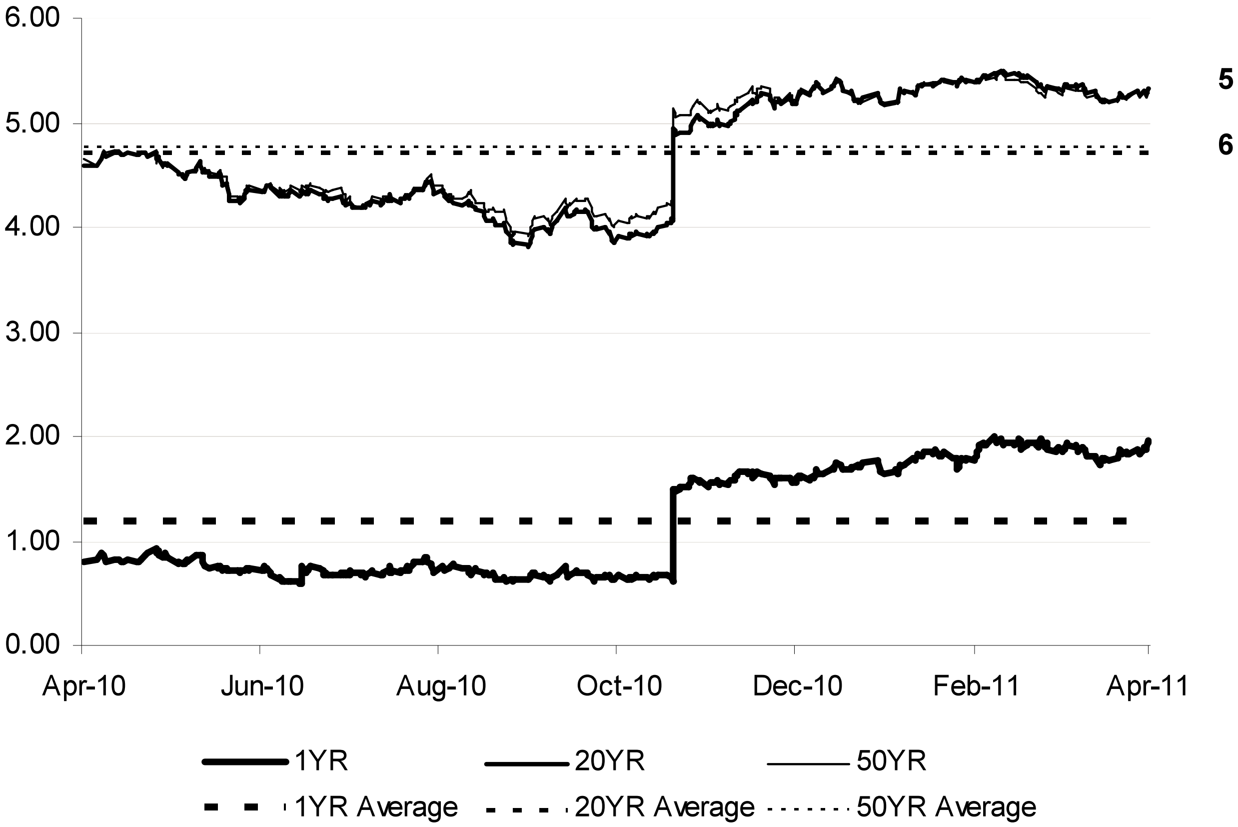


Chart 2: Average v new borrowing rates

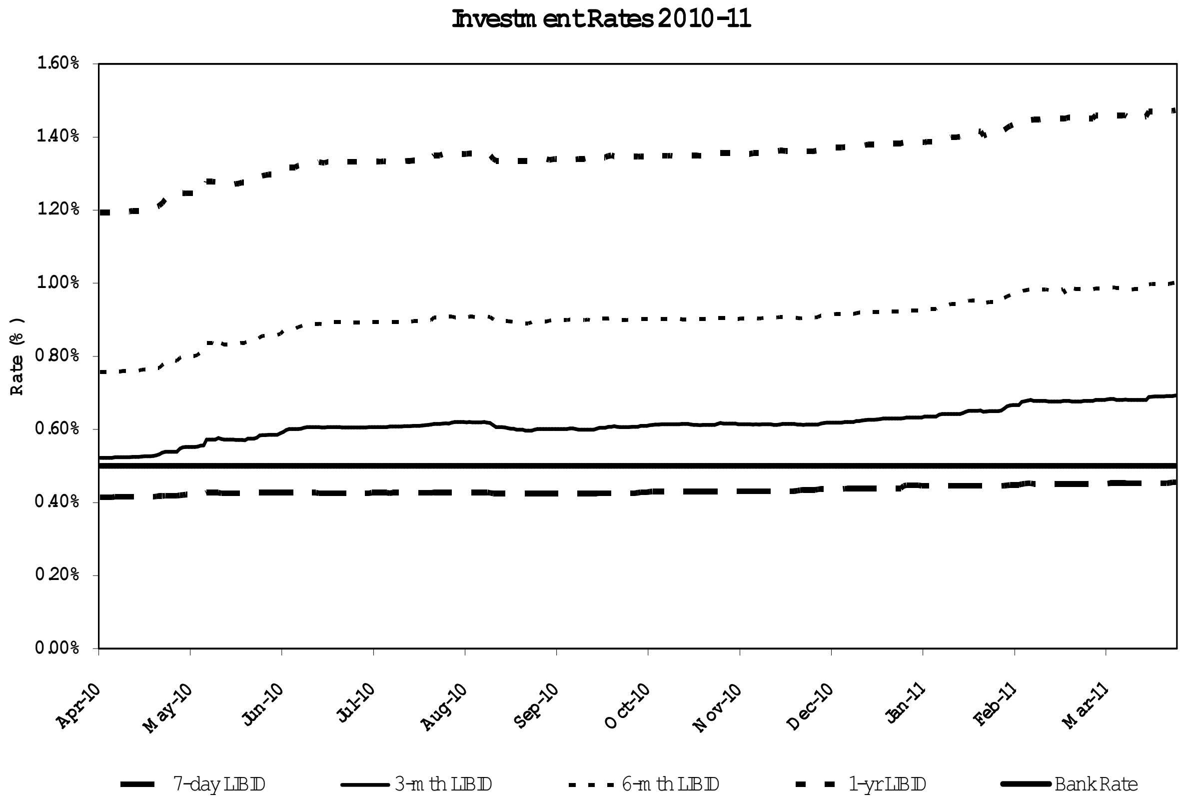


6. Investment Rates in 2010/11

The tight monetary conditions following the 2008 financial crisis continued through 2010/11 with little material movement in the shorter term deposit rates. Bank Rate remained at its historical low of 0.5% throughout the year, although growing market expectations of the imminence of the start of monetary tightening saw 6 and 12 month rates picking up.

Overlaying the relatively poor investment returns was the continued counterparty concerns, most evident in the Euro zone sovereign debt crisis which resulted in rescue packages for Greece, Ireland and latterly Portugal. Concerns extended to the European banking industry with an initial stress testing of banks failing to calm counterparty fears, resulting in a second round of testing currently in train. This highlighted the ongoing need for caution in treasury investment activity.

	Overnight	7 Day	1 Month	3 Month	6 Month	1 Year
01/04/2010	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
31/03/2011	0.44%	0.46%	0.50%	0.69%	1.00%	1.47%
High	0.44%	0.46%	0.50%	0.69%	1.00%	1.47%
Low	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
Average	0.43%	0.43%	0.45%	0.61%	0.90%	1.35%
Spread	0.03%	0.04%	0.07%	0.17%	0.24%	0.28%
High date	31/12/2010	30/03/2011	31/03/2011	31/03/2011	31/03/2011	31/03/2011
Low date	01/04/2010	01/04/2010	01/04/2010	01/04/2010	01/04/2010	01/04/2010



7. Investment Outturn for 2010/11

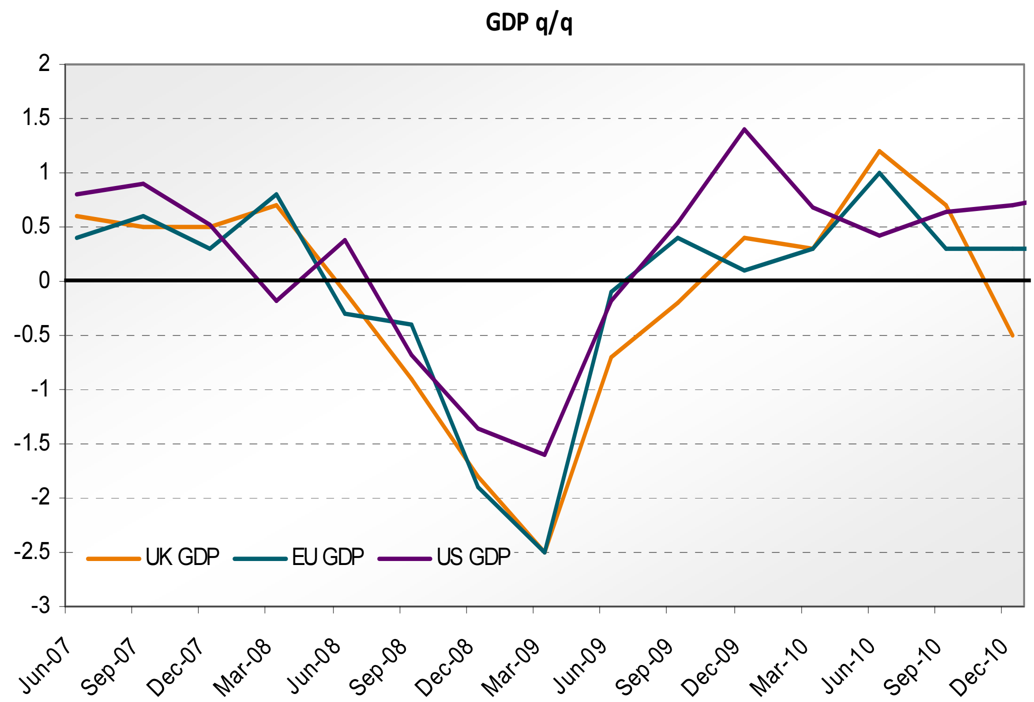
Investment Policy – the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 22 February 2011. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

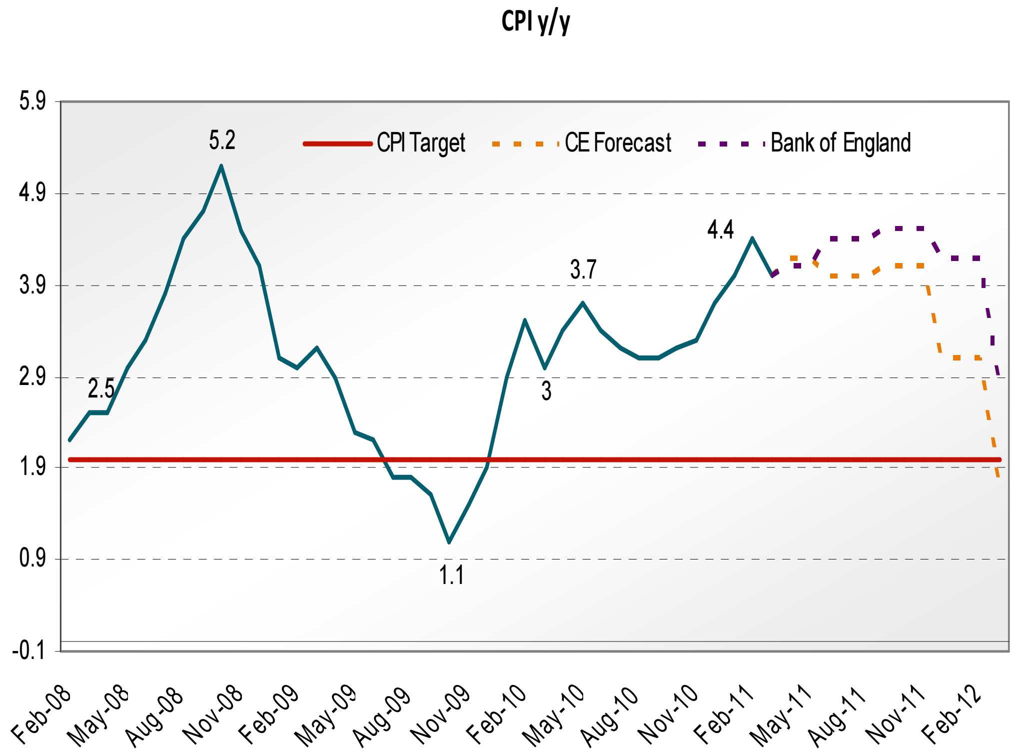
The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources	31 March 2010	31 March 2011
General Fund	£1.696m	£1.350m
Earmarked reserves	£9.295m	£11.655m
Housing Revenue Surplus Reserve	£1.251m	£0.000m
Usable capital receipts	£26.646m	£19.413m
Total	**£38.888m**	**£32.418m**

Investments held by the Council - the Council maintained an average balance of £33.350m of internally managed funds. The internally managed funds earned an average rate of return of 1.24%. The comparable performance indicator is the average 3 month LIBID rate, which was 0.61%.


GDP q/q
2
1.5
1
0.5
0
-0.5
-1
-1.5
-2
-2.5
-3
UK GDP
EU GDP
US GDP
Jun-07
Sep-07
Dec-07
Mar-08
Jun-08
Sep-08
Dec-08
Mar-09
Jun-09
Sep-09
Dec-09
Mar-10
Jun-10
Sep-10
Dec-10


CPI y/y
5.9
4.9
3.9
2.9
1.9
0.9
-0.1
CPI Target
CE Forecast
Bank of England
5.2
2.5
4.4
3.7
3
1.1
Feb-08
May-08
Aug-08
Nov-08
Feb-09
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12