APPENDIX 1

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE 2011/12 (INCORPORATING OUTTURN PRUDENTIAL INDICATORS)

1. The Council's Capital Activity During 2011/12

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 2011/12.

2. Reporting of the Required Prudential and Treasury Indicators

- During 2011/12, 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	2010/11 Actual	2011/12 Actual
Actual capital expenditure	£10.311m	£10.066m
Total Capital Financing Requirement:	£3.340m	£2.974m
Net borrowing	-£31.874m	-£29.112m
External debt	£0.000m	£0.000m
Investments - under 1 year	£31.874m	£29.112m

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

Actual Capital Expenditure and Financing	2010/11 Actual £000	2011/12 Estimate £000	2011/12 Actual £000
Capital expenditure	10.311	9.967	10.066
Total Capital Expenditure			
Resourced by:			
• Capital receipts	8.747	8.285	8.384
• Capital grants and other contributions	1,564	1,632	1,682
• Other contributions and MRP	0.044	0.050	0.366
Overfinanced Capital Expenditure	**-0.044**	**0.000**	**-0.366**

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. The Council's CFR for the year was zero.

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 2011/12 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.

Gross Borrowing Within Authorised Limit	2010/11 Actual	2011/12 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	-4.34%	-1.82%

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 2011/12 the Council's treasury position was as follows:

Treasury Position	31 March 2011 Principal	Rate / Return	31 March 2012 Principal	Rate / Return
Total debt	Nil		Nil	
CFR	Nil		Nil	
Investments - in house	£31.874m	1.24%	£29.112m	1.22%
Total investments	***£31.874m***	***1.24 %***	***£29.112m***	***1.22%***

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

The exposure to fixed and variable rates was as follows:

Exposure to Fixed and Variable Rates	31 March 2011 Actual	31 March 2012 Actual
Fixed rate (principal)	£24.000m	£18.970m
Variable rate (principal)	£7.874m	£10.142m

5. **The Economy and Interest Rates (Overall synopsis provided by the Council's Treasury Advisers (Sector)**

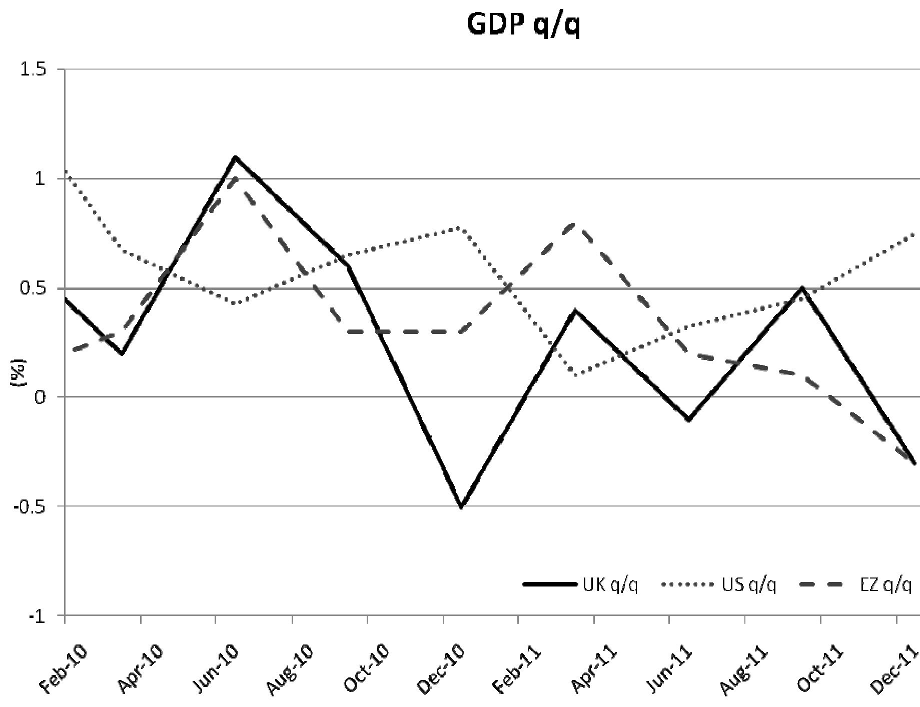
Sovereign Debt Crisis - 2011/12 was the year when financial markets were apprehensive, fearful of the potential of another Lehman's type financial crisis, prompted by a precipitous Greek Government debt default. At almost the last hour, the European Central Bank (ECB) calmed market concerns of a liquidity crisis among European Union (EU) banks by making available two huge three year credit lines, totalling close to €1 trillion at 1%. This also provided a major incentive for those same banks to then use this new liquidity to buy EU sovereign debt yielding considerably more than 1%.

A secondary benefit of this initiative was the bringing down of sovereign debt yields, for the likes of Italy and Spain, below unsustainable levels. The final aspects in the calming of the EU sovereign debt crisis were two eleventh hour agreements: one by the Greek Government of another major austerity package and the second, by private creditors, of a "haircut" (discount) on the value of Greek debt that they held, resulting in a major reduction in the total outstanding level of Greek debt. These agreements were a prerequisite for a second EU / IMF bailout package for Greece which was signed off in March.

Despite this second bailout, major concerns remain that these measures were merely a postponement of the debt crisis, rather than a solution, as they did not address the problem of low growth and loss of competitiveness in not only Greece, but also in other EU countries with major debt imbalances. These problems will, in turn, also affect the financial strength of many already weakened EU banks during the expected economic downturn in the EU. There are also major questions as to whether the Greek Government will be able to deliver on its promises of cuts in expenditure and increasing tax collection rates, given the hostility of much of the population.

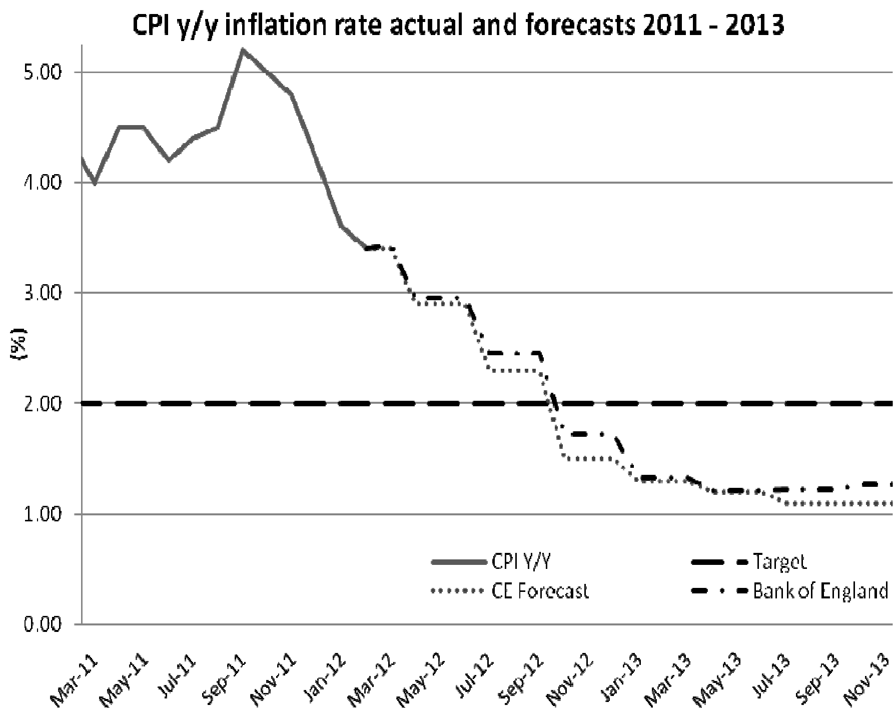
The UK Coalition Government - maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Key to retaining this rating will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within the austerity plan timeframe. The USA and France lost their AAA ratings from one rating agency during the year.

UK Growth - proved mixed over the year. In quarter 2, GDP growth was zero, but then quarter 3 surprised with a return to robust growth of 0.6% q/q before moving back into negative territory (-0.3%) in quarter 4. The year finished with prospects for the UK economy being decidedly downbeat due to a return to negative growth in the EU in quarter 4, our largest trading partner, and a sharp increase in world oil prices caused by Middle East concerns. However, there was also a return of some economic optimism for growth outside the EU and dovish comments from the major western central banks: the Fed in America may even be considering a third dose of quantitative easing to boost growth.



UK CPI Inflation - started the year at 4.5% and peaked at 5.2% in September. The fall out of the January 2011 VAT increase from the annual CPI figure in January 2012 helped to bring inflation down to 3.6%, finishing at 3.5% in March.

The Monetary Policy Committee agreed an increase in quantitative easing (QE) of £75bn in October on concerns of a downturn in growth and a forecast for inflation to fall below the 2% target. QE was targeted at further gilt purchases. The MPC then agreed another round of £50bn of QE in February 2012 to counter the negative impact of the EU debt and growth crisis on the UK.



Gilt Yields - fell for much of the year, until February, as concerns continued building over the EU debt crisis. This resulted in safe haven flows into UK gilts which, together with the two UK packages of QE during the year, combined to depress PWLB rates to historically low levels.

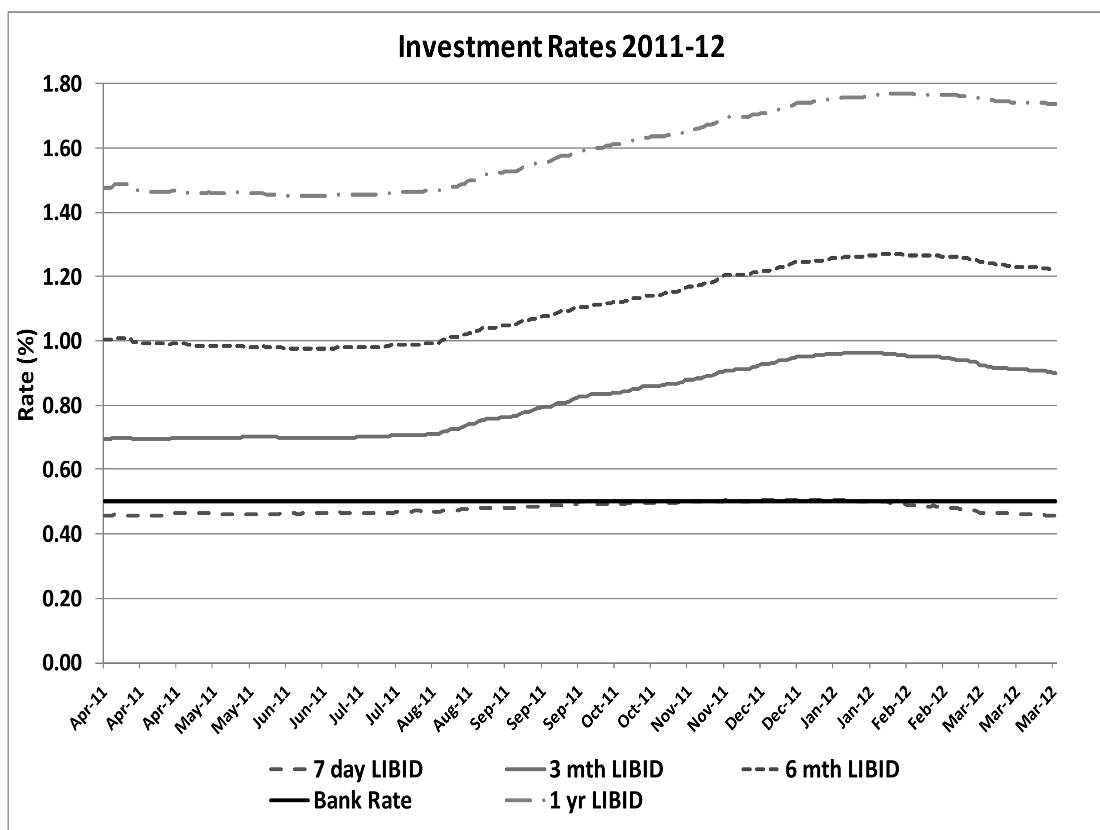
Bank Rate - was unchanged at 0.5% throughout the year while expectations of when the first increase would occur were steadily pushed back.

Deposit Rates - picked up in the second half of the year as competition for cash increased among banks.

Risk Premiums - were also a constant factor in raising money market deposit rates for periods longer than 1 month. Widespread and multiple downgrades of the credit ratings of many banks and sovereigns, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, meant that investors remained cautious of longer-term commitment.

6. Investment Rates in 2011/12 (Sector provided information)

The tight monetary conditions following the 2008 financial crisis continued through 2011/12 with little material movement in the shorter term deposit rates. However, one month and longer rates rose significantly in the second half of the year as the Eurozone crisis grew. The ECB's actions to provide nearly €1 trn of 1% 3 year finance to EU banks eased liquidity pressures in the EU and investment rates eased back somewhat in the quarter 1 of 2012. This action has also given EU banks time to strengthen their balance sheets and liquidity positions on a more permanent basis.



Overlaying the relatively poor investment returns were the continued counterparty concerns, most evident in the Euro zone sovereign debt crisis which resulted in a second rescue package for Greece in quarter 1 2012. Concerns extended to the potential fallout on the European banking industry if the crisis could have ended with Greece leaving the Euro and defaulting.

7. Investment Outturn for 2011/12

Investment Policy – the Council's investment policy is governed by CLG guidance, and the policy was approved by Council on 14 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 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 2011 £000	31 March 2012 £000
General Fund	1.350	1.350
Earmarked Reserves	11.655	13.306
Usable Capital Receipts	19.413	12.872
Total	**32.418**	**27.528**

Investments Held by the Council - the Council maintained an average balance of £30.493m of internally managed funds. The internally managed funds earned an average rate of return of 1.22%. The comparable performance indicator is the average 3 month LIBID rate, which was 0.82%.