Title:	**Treasury Management Outturn 2011/12**		
Wards Affected:	**All Wards in Torbay**		
To:	**Audit Committee** **Council**	On:	**27 June 2012** **12 July 2012**
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1. What we are trying to achieve

1.1 This report informs the Council/Committee of the performance of the Treasury Management function in supporting the provision of Council services in 2011/12 through management of cash flow, debt and investment operations and the effective control of the associated risks.

1.2 Recommendation

(i) That the Treasury Management decisions made during 2011/12 as detailed in the submitted report be endorsed; and

(ii) That the Prudential and Treasury Indicators as set out at Annex 1 of the submitted report be approved.

2. Key Points

2.1 The key points arising from Treasury Management operations in 2011/12 are:

- Challenging interest rate conditions with a static bank rate and poor borrowing rates in terms of opportunities to repay loans (see sections A7 & A9)
- Concerns over counterparty quality limiting investment opportunities (see sections A9 & A10 and Annex 3)
- Repayment of £9 million of borrowing with ongoing revenue savings of £205k (see section A8)
- An average rate of interest paid on borrowing in 2011/12 of 4.25% (see section A8)
- An overall return on investments of 1.43% exceeding the benchmark rate of 0.49% (see paragraphs A4.1 and A10.7).
- Revenue budget outturn within target (see paragraph A11.1)

3. Background

3.1 The Council is required through regulations issued under the Local Government Act 2003 to produce an annual outturn report reviewing treasury management activities and the actual prudential and treasury indicators for 2011/12.

3.2 This report also meets the requirements of the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

3.3 Treasury management is defined by the Code as:

"The management of the authority's investments and cash flows, it's 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".

3.4 During 2011/12 the minimum reporting requirements were that full Council should receive the following reports:

- An annual treasury strategy in advance of the year (Council 2^{nd} February 2011)
- A mid-year review report (distributed to Members on 30th November 2011)
- An annual report following the year describing the activity compared to the strategy (this report)

3.5 Recent changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the policies previously approved by Members.

3.6 The Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to full Council.

3.7 A major element of the Treasury Management function is the implementation and control of the Council's borrowing decisions. Like all local authorities Torbay Council uses borrowing as a key source of funding for enhancing, purchasing or building assets within the approved capital plan.

3.8 Borrowing allows the repayment costs of capital expenditure to be spread over future years which means that the costs of roads, schools etc are more likely to be met by those who use the assets than would be the case if the full cost of providing these facilities were met by taxpayers at the time of their construction.

3.9 As part of the annual budget process the Council sets limits for the total amount of borrowing that it considers is affordable in terms of revenue resources available to make repayments. Treasury Management officers are tasked with maintaining borrowing within these levels and obtaining best value for the Council in terms of repayment rates and length of loans.

3.10 The Treasury Management team also carry out management of the Council's surplus cash balances arising from, for example:

- Short term revenue balances (working capital)
- Cash backed reserves
- Capital funding received in advance of commencement of schemes

Balances are invested with approved financial institutions and other local authorities to obtain the best return for periods which ensure cash is available when needed. Security of cash and liquidity are the absolute priorities in all investment decisions.

3.11 Treasury Management strategies were planned and implemented in conjunction with the Council's appointed advisors, Sector Treasury Services although the Council officers were the final arbiters of the recommended approach.

Paul Looby
Executive Head of Finance

Appendices and Annexes

Appendix 1	Treasury Management Activities in 2011/12
Annex 1	Prudential and Treasury Indicators 2011/12
Annex 2	The Economy and Interest Rates in 2011/12
Annex 3	Counterparties with which funds have been deposited in 2011/12

Documents available in members' rooms
None

Appendix 1

Treasury Management Activities in 2011/12

A1. Introduction

A1.1 This Appendix covers:

- Capital Expenditure and Financing 2011/12;
- Capital Financing Requirement;
- Treasury Position at year End;
- The Strategy for 2011/12;
- The Economy and Interest rates 2011/12;
- Borrowing Rates in 2011/12;
- Borrowing Outturn for 2011/12;
- Investment Rates in 2011/12;
- Investment Outturn for 2011/12;
- Revenue Budget Performance;
- Reporting Arrangements and Management Evaluation

A2 Capital Expenditure and Financing 2011/12

A2.1 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 (though the timing of borrowing may be delayed through the application of cash balances held by the Council).

A2.2 The overall need to borrow has remained fairly neutral with new capital approvals in 2011/12 offset by a reduction in the Office Rationalisation Programme.

A2.3 The actual capital expenditure forms one of the required prudential indicators and is shown in the table below. Other Prudential and Treasury Indicators are presented at Annex 1 to this report.

	2010/11 Actual £m	2011/12 Estimate £m	2011/12 Actual £m
Total capital expenditure	44	25	22

A3 Capital Financing Requirement

A3.1 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 net 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 2011/12 unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not yet been financed by revenue or other resources.

A3.2 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 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.

A3.3 **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. The Council's 2011/12 MRP Policy (as required by CLG Guidance) was approved as part of the Treasury Management Strategy Report for 2011/12 on 2nd February 2011.

A3.4 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).

A3.5 Following the transfer of Local Government reorganisation debt from Devon County Council in 2010/11 the Council now budgets £500,000 per annum to reflect a provision for the repayment of this debt on maturity (similar to MRP). In light of the approved 2012/13 Treasury Management Strategy to maximise flexibility the funds have been paid into a reserve at the end of 2011/12.

A3.6 The Council's CFR for the year represents a key prudential indicator analysed at Annex 1 and summarised below. This includes PFI schemes on the balance sheet, which increase the Council's long term liabilities. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

CFR (£m)	31 March 2011 Actual	31 March 2012 Revised Indicator	31 March 2012 Actual
CFR at Year End	137.6	137.8	137.1

A3.6 The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit presented at Annex 1 to this report.

A4 Treasury Position at Year End

A4.1 The Council's funding and investment positions at the beginning and end of year was as follows:

	31 March 2011 Principal		Rate/ Return	Average Life yrs	31 March 2012 Principal		Rate/ Return	Average Life yrs
Fixed rate funding:								
-PWLB	£147.5m				£143.5m			
-Market	£10.0m	£157.5m	4.31%	26.9	£10.0m	£153.5m	4.31%	27.0
Variable rate funding:								
-PWLB	£5.00m				£0.0m			
-Market	£0.00	£5.00m	0.69%	14.3	£0.0m	£0.0m	0%	
Total debt		***£162.5m***	***4.20%***	***26.4***		***153.5m***	***4.31%***	***27.0***
CFR		***£137.6m***				***£136.4m***		
Borrowing in excess of CFR*		***£24.9m***				***£17.1m***		
Investments*:								
- in house		£80.7m	1.28%			£67.6m	1.41%	
- with managers**		£35.5m	1.20%			£35.5m	1.51%	
Total investments		***£116.2m***	***1.25%***			***£103.1m***	***1.43%***	

* The Capital Investment Plan approved in February 2012 requires £22m to support approved schemes over the next four years.

** Rates for investments reflect the average rate achieved over the full year.

*** The principal for external management of funds reflects the original amount applied to the contract on 21st June 2007 and subsequent additions in 2009/10

A4.2 The total debt figure at year end of £153.5m includes borrowing supported by central government. The Local Government Finance Settlement for 2011/12 (available on the Communities and Local Government website) recognises a figure of £95m on which central funding is based for interest payments and MRP.

A4.3 The outturn against approved treasury limits is analysed at Annex 1 to this report.

A5. The Strategy for 2011/12

A5.1 The expectation for interest rates within the strategy for 2011/12 anticipated low but rising Bank Rate (starting in quarter 4 of 2011) with similar gradual rises in medium and longer term fixed borrowing rates over 2011/12.

A5.2 Events in the early part of the year gave rise to a significant shift in the outlook for interest rates with expectations of static Bank Rate extended to 2013 and borrowing rates revised down by around 80 basis points (a change of 20% on the previous forecast).

A5.3 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.

A5.4 The general aim of the treasury strategy for 2011/12 and following years was to bring down the difference between gross and net debt levels (see para A4.1) in order to reduce the credit risk and cost incurred by holding high levels of investments.

A6 The Economy and Interest Rates 2011/12

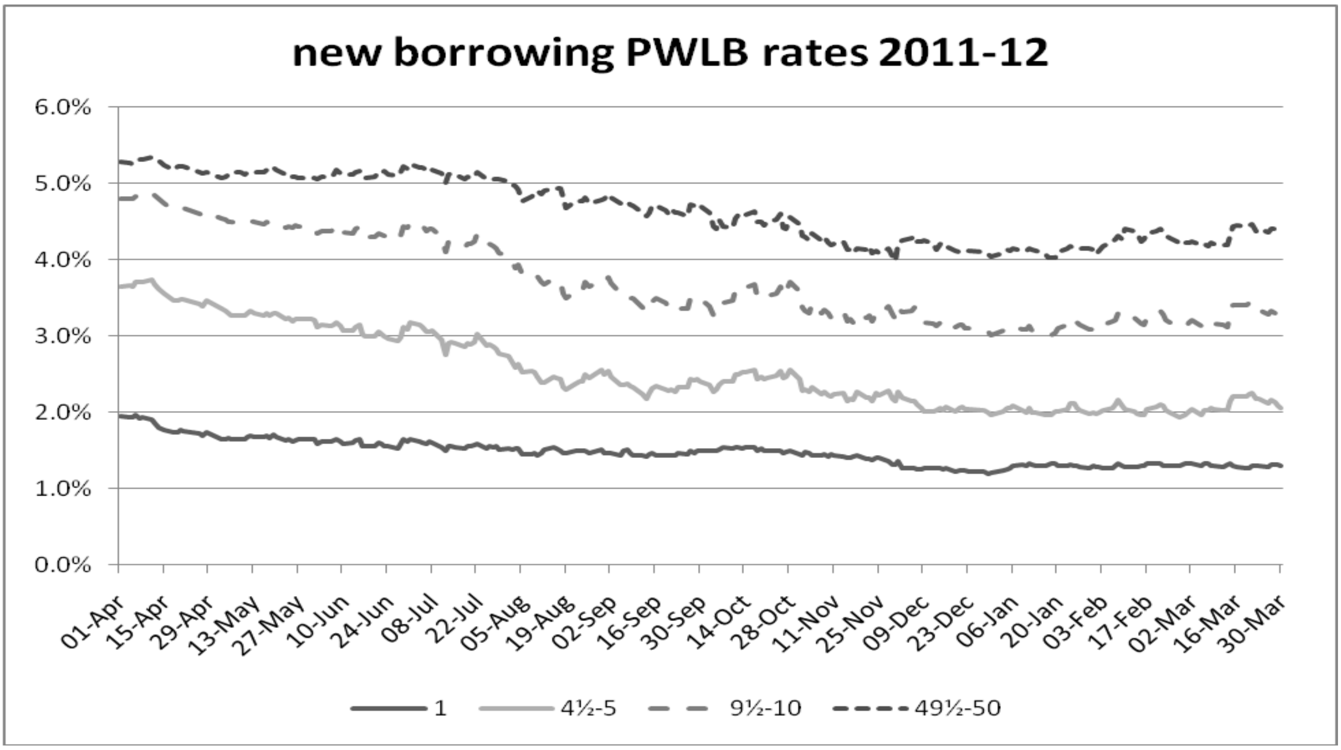
A6.1 A commentary of the economic factors prevalent in 2011/12 is given at Annex 2.

A7. Borrowing Rates in 2011/12

A7.1 The following table below shows, for a selection of PWLB maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and end of the financial year applicable for new borrowing. The following graph illustrates the path of rate movements during the year.

PWLB New Borrowing Rates 2011/12 for 1 to 50 Years

	1 Year	1½ - 2 Years	2½ - 3 Years	3½ - 4 Years	4½ - 5 Years	9½ -10 Years	24½ - 25 Years	49½ - 50 Years	1 month variable
01/04/11	1.950%	2.420%	2.870%	3.280%	3.650%	4.800%	5.360%	5.280%	1.570%
31/03/12	1.290%	1.420%	1.590%	1.810%	2.050%	3.200%	4.310%	4.350%	1.560%
High	1.970%	2.470%	2.930%	3.350%	3.730%	4.890%	5.430%	5.340%	1.590%
Low	1.190%	1.320%	1.500%	1.710%	1.940%	3.010%	3.940%	3.980%	1.560%
Average	1.466%	1.693%	1.958%	2.243%	2.533%	3.702%	4.610%	4.635%	1.561%
Spread	0.780%	1.150%	1.430%	1.640%	1.790%	1.880%	1.490%	1.360%	0.030%
High date	06/04/11	06/04/11	06/04/11	06/04/11	11/04/11	11/04/11	11/04/11	11/04/11	05/04/11
Low date	29/12/11	30/12/11	30/12/11	27/12/11	27/12/11	30/12/11	18/01/11	30/11/11	15/04/11



A7.2 A separate tier of rates applies to early repayment of loans which is around 1% lower than new borrowing levels. Repayment rates need to be as high as possible (matching or exceeding the individual loan rate) to make debt rescheduling economic. Given the overriding aim to reduce borrowing the rate environment during the year restricted opportunities for loan repayment.

A8 Borrowing Outturn for 2011/12

A8.1 The Borrowing strategy for 2011/12 anticipated no new borrowing with current year requirements having previously been taken in advance of expected rises in rates.

A8.2 In line with the overall strategy of reducing borrowing levels, £9million of PWLB loans were prematurely repaid with breakage costs of £242,657 partially funded by resultant in-year interest savings.

A8.3 ***Borrowing Performance*** – Total borrowing was reduced from £162.4 million to £153.4 million during the year generating ongoing annual savings of £205k The average rate of interest paid on loans in 2011/12 was 4.25%.

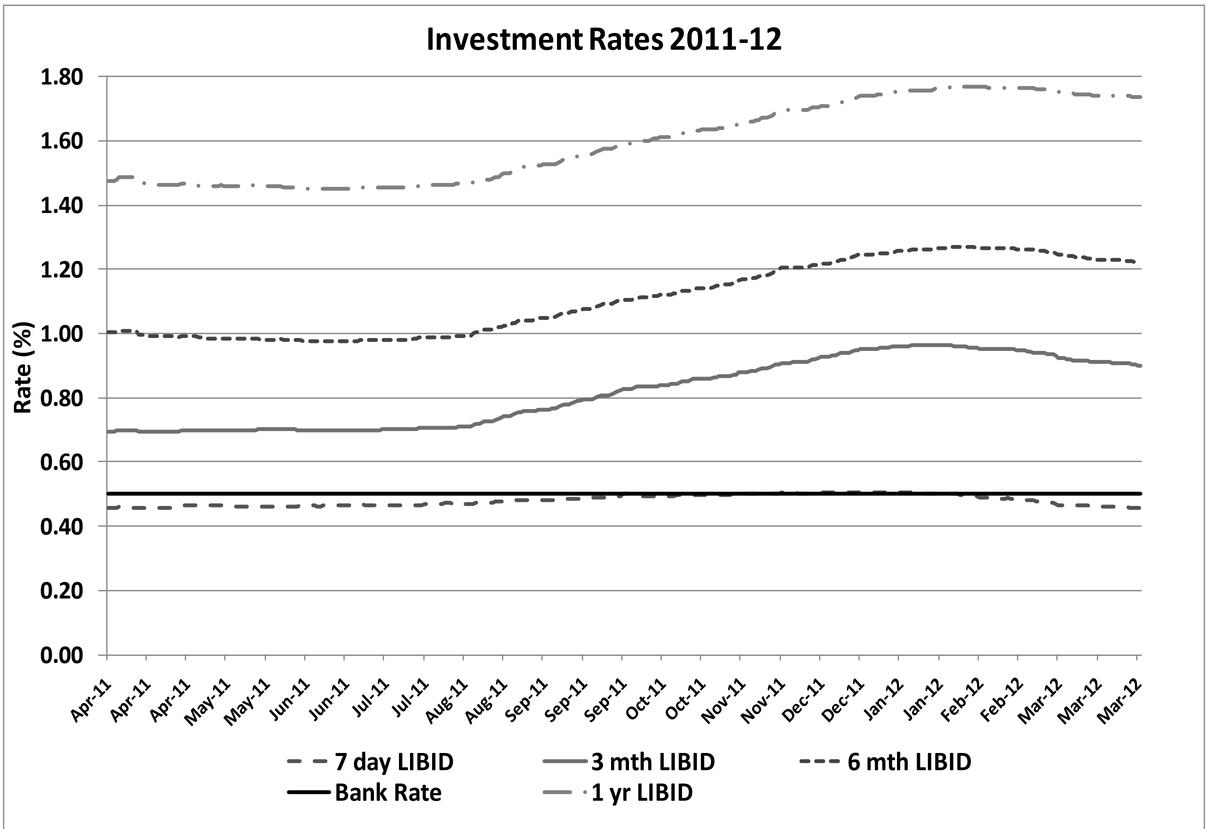
A9 Investment Rates in 2011/12

A9.1 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. Bank Rate remained at its historic low of 0.5% throughout the year while market expectations of rate rises were gradually pushed further and further back during the year to the second half of 2013 at the earliest.

A9.2 Overlaying the relatively poor investment returns were the continued counterparty concerns generated by the Eurozone sovereign debt crisis.

A9.3 The table below shows, for a range of investment durations, the range (high and low points) in rates, the average rates and individual rates at the start and end of the financial year. The following graph illustrates the path of market benchmark rates over the year

	Overnight	7 Day	1 Month	3 Month	6 Month	1 Year
01/04/2010	0.44%	0.46%	0.50%	0.70%	1.00%	1.48%
31/03/2011	0.43%	0.46%	0.57%	0.90%	1.22%	1.74%
High	0.55%	0.51%	0.65%	0.96%	1.27%	1.77%
Low	0.43%	0.46%	0.50%	0.69%	0.98%	1.45%
Average	0.45%	0.48%	0.56%	0.82%	1.11%	1.60%
Spread	0.12%	0.05%	0.15%	0.27%	0.29%	0.32%
High date	30/06/11	30/12/11	11/01/11	12/01/12	25/01/12	25/01/12
Low date	14/03/12	01/04/11	01/04/11	12/04/11	11/06/11	22/06/11



A10 Investment Outturn for 2011/12

A10.1 **Investment Policy** – the Council's investment policy is governed by CLG guidance which emphasises the priorities of security and liquidity of funds and requires Local Authorities to set out their approach for selecting suitable counterparties. The policy was approved by Council within the Annual Investment Strategy on 2nd February 2011 and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data.

A10.2 In line with the Strategy investments were made within a tight counterparty selection framework with predominantly short duration. A number of one-year deposits were made where additional margins over market levels were available to boost investment returns.

A10.3 The Euro zone sovereign debt crisis and its potential impact on banks prompted a decision by the Chief Finance Officer to reduce the maximum duration for new deposits to three months for all counterparties regardless of their individual credit quality (excluding UK part-nationalised Banks).

A10.4 The exception for UK part-nationalised Banks reflects officer's view that these institutions offer the safest domicile for Council cash with the implicit UK government guarantee overriding individual credit ratings. In light of this a number of one-year deposits were taken with these institutions at rates over the market level, to boost investment returns.

A10.5 A list of those institutions with which the in-house team invested funds during the year is provided at Annex 3. No institutions with which investments were made showed any difficulty in repaying investments and interest in full during the year.

A10.6 ***Externally Managed Investments*** – Scottish Widows Investment Partnership (SWIP) was appointed to manage £13,500,000 of the Council's cash on 21st June 2007. Additional funds were placed with SWIP during the 2009/10 financial year.

A10.7 During the year SWIP has made use of a diverse range of investment instruments to enhance returns with market conditions giving rise to particularly strong fund performance in the final quarter.

A10.8 ***Performance Analysis*** - Detailed below is the result of the investment strategy undertaken by the Council. Despite the continuing difficult operating environment the Council's investment returns remain well in excess of the benchmark.

	Average Investment Principal	Rate of Return (gross of fees)	Rate of Return (net of fees)	Benchmark/ Target Return
Internally Managed	£79,587,914	1.413%	1.413%	0.480%
Externally Managed	£35,500,000	1.510%	1.360%	0.529%

The benchmark for internally managed funds is the average 7-day LIBID rate (uncompounded).
The benchmark for externally managed funds is the 7-day LIBID rates, averaged for the week and compounded weekly.

A10.9 In interest terms, the in-house treasury function contributed an additional £742,000 to the General Fund over and above what would have been attained from the benchmark return. SWIP's net return achieved an additional £295,000 over their target return level of 10% above benchmark.

A11 Revenue Budget Performance

A11.1 The effect of the decisions outlined in Appendix 1 to this report on the approved revenue budget is outlined in the table below.

	Revised Budget 2011/12	Actual 2011/12	Variation
	£M	**£M**	**£M**
Investment Income	(1.2)	(1.7)	(0.5)
Interest Paid on Borrowing	6.7	6.7	0.0
Premium on early repayment of Borrowing	0.2	0.2	0.0
Net Position (Interest)	**5.7**	**5.2**	**(0.5)**
Minimum Revenue Provision	4.3	4.3	0.0
PFI Grant re: MRP	(0.4)	(0.4)	0.0
Net Position (Other)	**3.9**	**3.9**	**0.0**
Net Position Overall	**9.6**	**9.1**	**(0.5)**

A11.2 The Revenue Grant settlement 2011/12 includes funding of £8.8m for interest payments and MRP related to supported borrowing within the above figures.

A11.3 The changing position was regularly reported to OSB and Council throughout the year as part of the budget monitoring reports to Members

A12 Reporting Arrangements and Management Evaluation

A12.1 The management and evaluation arrangements identified in the annual strategy and followed for 2011/12 were as follows:

- Weekly monitoring report to Executive Lead for Finance and Chief Finance Officer
- Monthly meeting of the Treasury Manager and Chief Accountant to review previous months performance and plan following months activities
- Regular meetings with the Council's treasury advisors
- Regular meetings with the Council's appointed Fund Managers
- Membership and participation in the CIPFA Benchmarking Club

A12.2 Draft results for the 2011/12 CIPFA Benchmarking Club, show that the treasury management team achieved interest rate performance in the top 33% of participating Authorities for borrowing and in the top 25% for investments.

A12.3 An Internal Audit Review of Treasury Management assessed the function as Good Standard overall with a High Standard rating specifically for assurance against financial loss and undetected error or fraud. The draft report observed, *"As in previous years very high operational standards are maintained and it is pleasing to be able to report a number of improvements, particularly in regard to ensuring all procedural documentation is complete and up to date."*

Prudential and Treasury Indicators 2011/12

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 2011/12 plus the expected changes to the CFR over 2012/13 and 2013/14. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2011/12. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

CFR (£m)	31 March 2011 Actual	31 March 2012 Revised Indicator	31 March 2012 Actual
Opening balance	129.7	137.6	137.6
Capital expenditure in year funded from borrowing	12.3	4.2	3.4
Minimum Revenue Position	(4.0)	(4.0)	(3.9)
Repayment of Deferred Liabilities	(0.4)	0	0
CFR at Year End	**137.6**	**137.8**	**137.1**
Net borrowing position	**56**	**89**	**60**

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 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. Borrowing levels were below the operational boundary throughout the year.

	2011/12
Authorised limit	£228m
Maximum gross borrowing position	£173m
Operational boundary	£201m
Average gross borrowing position	£168m

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 liabilities net of investment income) against the net revenue stream.

	2011/12
Total Financing Costs	**£10.7m**
Net Revenue Stream	£125.4m
Ratio – Including direct financing from Revenue	8.6%
Ratio - Excluding direct financing from Revenue	**7.8%**

Treasury Indicators:

Maturity Structure of the fixed rate borrowing portfolio - This indicator assists Authorities avoid large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time.

	31 March 2012 Actual	31 March 2012 Proportion	2011/12 Original Limits Upper-Lower
Under 12 months	£0	0%	3% - 0%
12 months and within 24 months	£0	0%	3% - 0%
24 months and within 5 years	£0	0%	12% - 0%
5 years and within 10 years	£15M	10%	20% - 3%
10 years and within 25 years	£36M	24%	50% - 12%
25 years and above	£102M	66%	95% - 60%

Principal sums invested for over 364 days - The purpose of this indicator is to contain the Council's exposure to the possibility of losses that might arise as a result of it having to seek early repayment or redemption of principal sums invested. The 2011/12 Actual applies to funds administered by the external Fund Manager.

	2010/11 Actual	2011/12 Limit	2011/12 Actual
Investments of 1 year and over	£12m	£69m	£9m

Exposure to Fixed and Variable Rates - The Prudential Code requires the Council to set upper limits on its exposure to the effects of changes on interest rates.

The fixed rate limit set allows for the Council's entire borrowing to be locked out at affordable levels. The variable limit reflects the use of Liquidity Accounts for investing cash. (The negative Actual value reflects the extensive use of these variable rate instruments (due to attractive rates and counterparty concerns), netted against a zero level of variable debt.)

	31 March 2011 Actual	2011/12 Limits	31 March 2011 Actual
Net principal re fixed rate borrowing / investments	£116m	£119m	£70m
Net principal re variable rate borrowing / investments	-£29m	£35m	-£15m

<u>The Economy and Interest Rates 2011/12</u>

By Sector Treasury Services 23rd April 2012

Sovereign debt crisis. 2011/12 was the year when financial markets were on tenterhooks throughout most of this period, fearful of the potential of another Lehmans type financial disaster occurring, sparked off by a precipitous Greek 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 panic levels. The final planks 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. In addition, an impending general election in April / May 2012 will deliver a democratic verdict on the way that Greece is being governed under intense austerity pressure from the northern EU states.

The UK coalition Government maintained its aggressive fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA 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, 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 (-0.2%) 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 hike from the annual CPI figure in January 2012 helped to bring inflation down to 3.6%, falling further to 3.4% in February. Inflation is forecast to be on a downward trend to below 2% over the next year.

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 until the second half of 2013 at the earliest. 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 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.

Annex 3

Counterparties with which funds were deposited (April 2011 – March 2012)

Banks and Building Societies

Bank of Scotland
Barclays Bank
Lloyds TSB
Nationwide Building Society
Oversea Chinese Banking Corporation (Singapore)
Royal Bank of Scotland/National Westminster
Santander UK
United Overseas Bank (Singapore)

Local Authorities

City of Newcastle upon Tyne
Corby District Council
Falkirk Council
Salford City Council

Other Approved Institutions

Royal Bank of Scotland Money Market Fund
Scottish Widows Investment Partnership