| | | |
|---|---|---|
| **Report No. RES13151** | **London Borough of Bromley** | **Agenda Item No.** |

**PART 1 - PUBLIC**

---

| | |
|---|---|
| **Decision Maker:** | **Resources Portfolio Holder**<br>**Council** |
| **Date:** | **For pre-decision scrutiny by Executive and Resources PDS Committee on 4th September 2013**<br>**Council meeting 23rd September 2013** |
| **Decision Type:** | Non-Urgent Non-Executive Non-Key |
| **Title:** | **TREASURY MANAGEMENT - ANNUAL REPORT 2012/13 & PERFORMANCE Q1 2013/14** |
| **Contact Officer:** | Martin Reeves, Principal Accountant (Technical & Control)<br>Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk |
| **Chief Officer:** | Peter Turner, Director of Finance |
| **Ward:** | All |

---

1. <u>Reason for report</u>

1.1 This report includes the Treasury Management Annual Report for 2012/13, which is required to be reported to full Council, and also contains details of investment performance in the 1st quarter of 2013/14. The report also includes an update on the Council's investment with Heritable Bank (paragraphs 3.14 and 3.15) and proposes changes to the Council's Annual Investment Strategy in the form of an increase in the maximum duration for loans to other local authorities from 2 years to 3 years and the inclusion of collective (pooled) investment schemes as eligible investment vehicles (see paragraphs 3.18 to 3.24). These changes will require the approval of full Council. Investments as at 31st March 2013 totalled £201.1m (excluding the balance of the Heritable investment) and £259.1m as at 30th June 2013. There was no external borrowing in the whole of 2012/13 or in the 1st quarter of 2013/14.

---

**RECOMMENDATION(S)**

**The PDS Committee and the Portfolio Holder are requested to:**

**(a) Note the Treasury Management Annual Report for 2012/13;**

**(b) Approve the actual prudential indicators within the report; and**

**(c) Recommend to Council that the limit for investments with other local authorities be increased from 2 years to 3 years and that collective (pooled) investment schemes be included as eligible investment vehicles in the Council's Investment Strategy with an**

**overall limit of £25m and a maximum duration of 5 years (see paragraphs 3.18 to 3.24); and**

**(d) Subject to approval of (c) above, any investment in a collective (pooled) investment scheme will require the approval of the Director of Finance in consultation with the Resources Portfolio Holder.**

**Council is requested to:**

**(a) Note the Treasury Management Annual Report for 2012/13;**

**(b) Approve the actual prudential indicators within the report;**

**(c) Consider comments from the PDS Committee; and**

**(d) Approve an increase in the limit for investments with other local authorities from 2 years to 3 years and agree that collective (pooled) investment schemes be included as eligible investment vehicles in the Council's Investment Strategy with an overall limit of £25m and a maximum duration of 5 years.**

Corporate Policy

1. Policy Status: Existing policy. To maintain appropriate levels of risk, particularly security and liquidity, whilst seeking to achieve the highest rate of return on investments.

2. BBB Priority: Excellent Council.

---

Financial

1. Cost of proposal: N/A

2. Ongoing costs: N/A.

3. Budget head/performance centre: Interest on balances

4. Total current budget for this head: £2,691k (net) in 2012/13 (final outturn £2,673k); Budget £1,591k in 2013/14 (currently on target)

5. Source of funding: Net investment income

---

Staff

1. Number of staff (current and additional): 0.25 fte

2. If from existing staff resources, number of staff hours: 9 hours per week

---

Legal

1. Legal Requirement: Non-statutory - Government guidance.

2. Call-in: Call-in is applicable

---

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a

---

Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A.

2. Summary of Ward Councillors comments: N/A

## 3. COMMENTARY

### General

3.1 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required, as a minimum, to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year comparing actual activity to the strategy. In practice, the Director of Finance has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year-end. This report includes details of investment performance in the final quarter of 2012/13 and in the 1st quarter of 2013/14, as well as the annual report for 2012/13. It also proposes changes to the investment criteria that form part of the Council's Annual Investment Strategy in the form of an increase in the maximum duration for loans to other local authorities from 2 years to 3 years and the inclusion of collective (pooled) investment schemes as eligible investment vehicles (see paragraphs 3.18 to 3.24).

3.2 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 Council's policies previously approved by members. The Director of Finance confirms that he has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Executive and Resources PDS Committee before they were reported to the full Council.

### Treasury Performance in the quarter and year ended 31st March 2013 and in the quarter ended 30th June 2013

3.3 <u>Borrowing:</u> The Council's healthy cashflow position continued through the whole of 2012/13 and into 2013/14, as a result of which no borrowing has been required at all since 2010/11, when one small overnight loan (for £800k) was taken out (in March 2011).

3.4 <u>Investments:</u> The following table sets out details of investment activity during the March and June quarters and during the whole of 2012/13:-

| | Qtr ended 31/3/13 | | Year ended 31/3/13 | | Qtr ended 30/6/13 | |
|---|---|---|---|---|---|---|
| **Main investment portfolio** | **Deposits** | **Ave Rate** | **Deposits** | **Ave Rate** | **Deposits** | **Ave Rate** |
| | **£m** | **%** | **£m** | **%** | **£m** | **%** |
| Balance of "core" investments b/f | 150.00 | 1.93 | 152.50 | 2.23 | 167.50 | 1.88 |
| New investments made in period | 120.00 | 0.64 | 321.50 | 1.12 | 32.50 | 0.73 |
| Investments redeemed in period | -102.50 | 1.62 | -306.50 | 1.50 | -35.00 | 0.73 |
| "Core" investments at end of period | 167.50 | 1.88 | 167.50 | 1.88 | 165.00 | 1.00 |
| Money Market Funds | 6.10 | para xxx | 6.10 | para xxx | 64.10 | para xxx |
| RBS 95 day notice account | 12.50 | para xxx | 12.50 | para xxx | 15.00 | para xxx |
| Payden Sterling Reserve Fund | 15.00 | para xxx | 15.00 | para xxx | 15.00 | para xxx |
| **Total investments at end of period** | **201.10** | **n/a** | **201.10** | **n/a** | **259.10** | **n/a** |
| | | | | | | |
| Heritable deposit - frozen (para xxxx) | | | | | 5.00 | 6.42 |

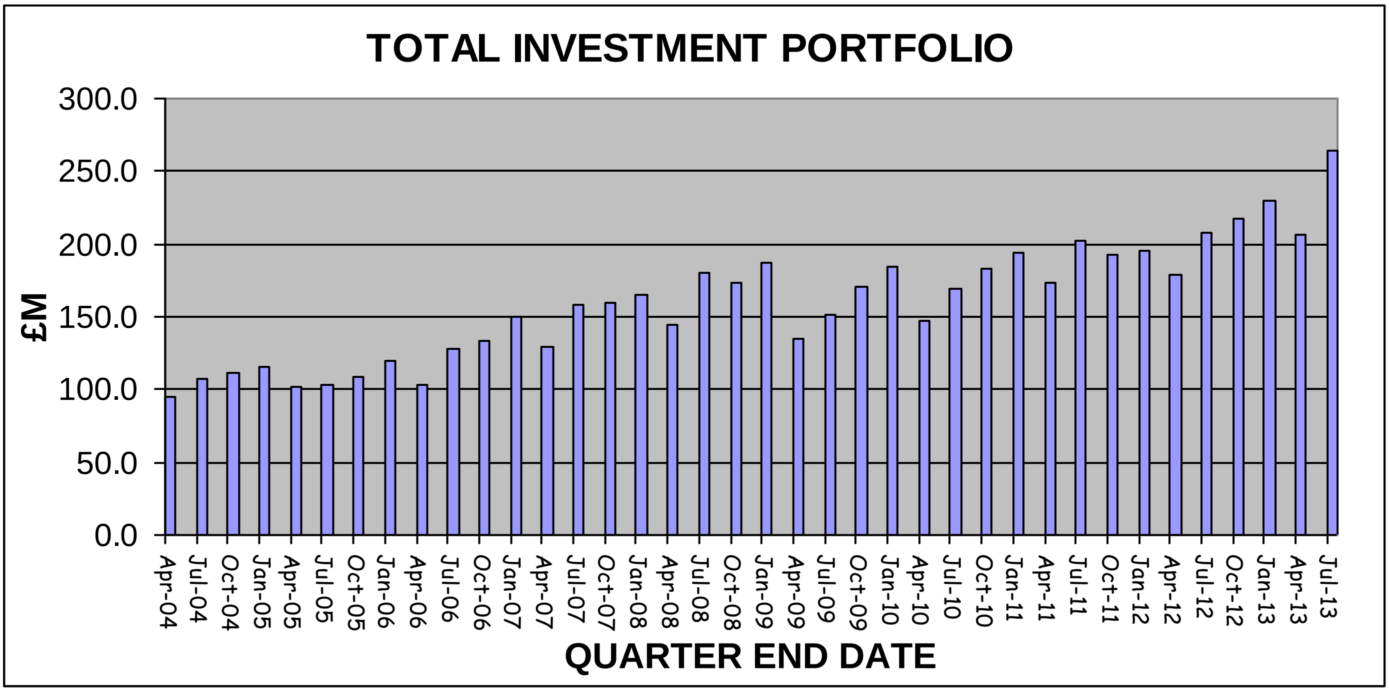
3.5 Details of the outstanding investments at 31st March 2013 are shown in maturity date order in Appendix 1 and by individual counterparty in Appendix 2. The average return on all new "core" investments during the March quarter was 0.64% which may be compared with the average 3 month LIBID rate of 0.38% and the average 7 day rate of 0.36%. The average return on new investments placed in the year 1st April to 31st March 2013 was 1.12% compared to the average 3 month rate of 0.56% and the average 7 day rate of 0.39%. In the latest quarter (ended 30th June 2013), the average return on new investments was 0.73%, compared to the average 3 month and 7 day rates of 0.38% and 0.36% respectively. Investments held as at 30th June 2013 are shown in Appendices 3 and 4.

3.6 Base rate has now been 0.5% since March 2009 and the recently updated forecast by Sector is for it to remain at that level until 2016. This is clearly also the view of the Bank of England, whose governor, Mark Carney, has said that the Bank will not consider raising interest rates until the jobless rate has fallen to 7% or below. This would require the creation of around 750,000 jobs and could take 3 years or more. The estimated date for the next increase in base rate has slipped back significantly in the last two years and it is possible that it will slip further. Reports to previous meetings, most recently to the January meeting, have highlighted the fact that options with regard to the reinvestment of maturing deposits have become seriously limited due to bank credit rating downgrades. Changes to lending limits and eligibility criteria have in the past been temporarily successful in alleviating this, but we are now back in the position of not having many investment options other than placing money with instant access accounts at relatively low interest rates. Active UK banks on our list now comprise only Lloyds TSB, RBS, HSBC, Barclays, Santander UK and Nationwide and all of these have reduced their interest rates significantly.

3.7 Our external advisers, Sector, have continued to recommend caution and, between September 2011 and January 2013, were recommending that no investment be placed for longer than 3 months with any bank other than Lloyds and RBS (a maximum of 1 year was recommended in their case). In January 2013, however, they lifted their temporary investment duration cap due to a perceived improvement in market conditions, namely a reduction in some of the excess fears surrounding the continued existence of the Eurozone and improvements in liquidity in financial markets. This enabled us to invest in the final quarter of 2012/13 with some of our eligible UK counterparties for up to 6 months instead of 3, which will have had a small beneficial impact on interest earnings. In the final quarter of 2012/13, we also placed investments with three other local authorities: two for two years at 0.85% and one for one year at 0.50%. In July, we dealt forward with another local authority for two years out of April 2014 at a rate of 1.14%. While these rates do not sound particularly attractive, they are better than we are currently able to obtain elsewhere in the market and are, in the view of Sector and other experts, likely to prove good deals in the fullness of time.

3.8 Lloyds TSB has consistently offered better rates than other UK banks, but has reduced its rates significantly in the last year and is currently offering 0.70% for 3 months up to 1.01% for 1 year (they were paying 3.00% for 1 year as recently as July 2012). All the other UK banks and building societies on our lending list are now paying around 0.45% for 3 months (the maximum period Sector have, until recently, been recommending) and around 0.53% for 6 months. The "core" investments placed during the last quarter of 2012/13 and the 1st quarter of 2013/14 were all placed for between 3 months and a year (in accordance with Sector's advice) or in instant access money market funds. The Director of Finance will continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.

3.9 The graph below shows total investments (including the Icelandic bank deposit with Heritable Bank) at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years, largely due to increased and earlier government funding. This has been a significant contributor to the over-achievement of investment income against budget in recent years, although this has now been fully factored into the revenue budget.




**Other accounts**

3.10 Money Market Funds

The Council currently has 7 AAA-rated Money Market Fund accounts, with Prime Rate, Ignis, Insight, Morgan Stanley, Blackrock, Fidelity and Legal & General, all of which have a maximum investment limit of £15m. In common with market rates for fixed-term investments, interest rates on money market funds have fallen considerably in recent years. The Ignis, Prime Rate and Morgan Stanley funds currently offer the best rate (0.42% to 0.43%), which is around the level currently being offered for 3 months by most of our eligible UK banks and building societies. The total balance held in Money Market Funds (£64.1m as at 30th June 2013) has increased significantly in the past year as bank credit rating downgrades have restricted counterparty eligibility.

| Money Market Fund | Date Account Opened | Ave. Rate 2012/13 | Ave. Daily Balance 2012/13 | Actual Balance 31/03/13 | Actual Balance 30/06/13 | Ave. Rate Q1 2013/14 | Actual Balance 20/08/13 | Current Rate 20/08/13 |
|---|---|---|---|---|---|---|---|---|
| | | % | £m | £m | £m | % | £m | % |
| Prime Rate | 15/06/2009 | 0.61 | 14.7 | - | 15.0 | 0.44 | 15.0 | 0.42 |
| Ignis | 25/01/2010 | 0.62 | 14.0 | 6.1 | 15.0 | 0.43 | 15.0 | 0.43 |
| Insight | 03/07/2009 | 0.54 | 11.4 | - | 15.0 | 0.39 | - | 0.39 |
| Morgan Stanley | 01/11/2012 | 0.44 | 3.9 | - | 15.0 | 0.40 | 9.9 | 0.42 |
| Legal & General | 23/08/2012 | 0.46 | 4.5 | - | 4.1 | 0.34 | - | 0.34 |
| Blackrock | 16/09/2009 | 0.46 | 3.7 | - | - | 0.31 | - | 0.31 |
| Fidelity | 20/11/2002 | 0.41 | 0.3 | - | - | - | - | 0.31 |
| TOTAL | | | 52.5 | 6.1 | 64.1 | | 39.9 | |

3.11 Notice Accounts

In April 2012, the Council placed £15m in a 35-day notice account with Svenska Handelsbanken (Sweden). The total of £15m remained invested until mid-December when it was withdrawn following a reduction in the interest rate from 0.85% to 0.40% and then to 0.30%. The average daily balance from April to December 2012 was £10.1m. In March 2013, RBS announced a new 95-day notice account paying a rate of 0.80%. The Council made an initial deposit of £12.5m in

March and has since increased this to £15m, but notice has recently been received that the rate will reduce to 0.60% in October, at which point the deposit will be reviewed.

3.12 Payden Sterling Reserve Fund

At its meeting on 12th November 2012, the Council approved the addition of corporate bonds (minimum credit rating AA-, maximum period 5 years) and the Payden Sterling Reserve Fund to our lending list. To date, no corporate bond issues have been considered sufficiently attractive in consultation with our external advisers, Sector, but, later in November 2012, £15m was invested in the Payden Fund. The longer-term nature of the Payden Fund means that a better return will be secured by holding to maturity, although we could at any time withdraw our money by giving 3 days' notice. As at 31st March 2013, the value of the Council's investment had increased to £I5,086k and, as at 31st July 2013, to £15,097k. In a commentary on the Fund's performance to 30th June 2013, Payden states:

"The Fund remained invested in a diversified range of sterling-denominated, highly-rated and very liquid government agency securities and corporate fixed- and floating-rate and covered bonds. During the quarter, duration was reduced by about 0.3 years to 0.9 years. The portfolio's structure remained broadly unchanged as we continued to favour highly-rated quasi-government and corporate securities and covered bonds as they provide attractive yield pick-ups over Gilts and money market instruments. We reduced our exposure to government agency notes in favour of a higher allocation to covered bonds.
The Fund delivered a small negative return during the quarter, the first negative quarterly return since the Fund's inception. However, returns for 2013 are in excess of returns achievable by money market funds and bank deposits. The Fund performed well in April, supported by its duration positioning and the relatively attractive yields. However, the unexpectedly sharp rise in bond yields in May and June and the associated credit spread widening in all non-government bond market sectors more than offset these gains, resulting in minor losses in May and June".

3.13 External Cash Management

External cash managers, Tradition UK Ltd, currently manage £20m of our cash portfolio and provide useful advice and information on treasury management matters. In 2012/13, Tradition UK achieved a return of 1.53% (mainly as a result of two longer term investments placed with Lloyds TSB in August 2011 and July 2012, when rates were around 3%, both of which matured in the 2nd quarter of 2013/14). Tradition UK work to the same counterparty list as the Council's in-house team and so have also been constrained by strategy changes approved after the Icelandic Bank crisis and by recent ratings downgrades. Details of externally managed funds placed on deposit as at the time of writing this report are shown below.

| Bank | Sum | Start Date | Maturity | Period | Rate |
|---|---|---|---|---|---|
| HSBC | £12.5m | 26/03/13 | 26/03/14 | 1 year | 0.65% |
| Lloyds TSB | £2.5m | 04/07/13 | 04/07/14 | 1 year | 1.01% |
| Lloyds TSB | £5m | 16/08/13 | 18/08/14 | 1 year | 1.01% |

3.14 Investment with Heritable Bank

Members will be aware from regular updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the Icelandic bank, Landsbanki, when it was placed in administration in early-October 2008 at which time our investment was, and still is, frozen. An initial dividend was paid to the Council in July 2009 and, since then, a further 13 dividends have been received. To date, 94.0% (£4,783k) of our total claim (£5,087k) has been returned to us, leaving a balance of £304k (6.0%). Council officers and our external advisers remain hopeful of a full recovery.

3.15 For information, the claim we were obliged to submit consisted of the principal sum (£5m) plus interest due to the date on which Heritable was placed in administration (around £87,000). We were not able to lodge a claim for the full amount of interest (£321,000) that would have been due at the original investment maturity date (29/6/09). In accordance with proper accounting practice and guidance from CIPFA, we made provision in our 2008/09 accounts for an impairment loss of £1.64m and met this from the General Fund in that year. In line with revised guidance from CIPFA relating to the 2009/10 accounts, we were able to reduce the impairment by £300k and this sum was credited to the General Fund. An improvement in the administrator's recovery estimate in 2011 to between 86% and 90% (previously it was between 79% and 85%) enabled us to reverse a further £730k of the impairment in 2011/12. The Council's accounts include a provision for a net loss of £610k as at 31st March 2013 (12% of the claim, based on the midpoint of the administrator's estimate), but, as we have now recovered 94%, we will be able to reverse more of the impairment in 2013/14. We are currently waiting for an update from the administrator.

**Actual prudential indicators for 2012/13**

3.16 The old capital control system was replaced in April 2004 by a prudential system based largely on self-regulation by local authorities themselves. At the heart of the system is The Prudential Code for Capital Finance in Local Authorities, developed by CIPFA. The Code requires the Council to set a number of prudential indicators designed to monitor and control capital expenditure, financing and borrowing. The indicators for 2012/13 were approved by the Executive and the Council in February 2012 and Appendix 5 sets out the actual performance against those indicators.

**Economic Background (provided by Sector)**

3.17 Comments on the economic background during 2012/13 and the first quarter of 2013/14 are attached at Appendix 6.

**Proposed changes to the Annual Investment Strategy**

3.18 As outlined in paragraphs 3.6, counterparty credit rating downgrades in recent years have resulted in the removal of many of our established counterparties from our lending list and it has become increasingly difficult to identify institutions to place money with. The restrictions on our lending list have resulted in large sums being placed in low interest accounts (in instant access money market funds) and this has had a significant impact on the Council's interest earnings. Around £55m is currently invested in instant access accounts (including £40m in money market funds), £15m is invested in 95-day notice money and a further £15m in the Payden Sterling Reserve Fund. These are currently earning an overall average rate of around 0.53% (£450k in a full year).

3.19 A proposal to the Executive on 19th October 2011 to increase the lending limit for the two part-nationalised banks (Lloyds TSB and RBS) from £40m to £60m was approved, "subject to this being implemented after 3 months dependent on the prevailing financial position". This would currently enable an extra £40m to be invested with these two banks at around 1% for a year. The position has been kept under review since that decision was made and no further action is proposed at this time.

3.20 In order to provide a degree of extra flexibility and potentially to earn additional interest at no added risk, it is proposed that the Strategy be amended as follows:

- Increase the limit for local authorities from 2 years to 3 years.
- Include Collective (pooled) Investment Schemes as a specific category of approved investments.

3.21 Limits for investments with other local authorities

The 2013/14 Strategy includes deposits with other local authorities as approved investments with a total limit of £15m per authority and a maximum duration of 2 years. While most local authorities do not have a credit rating, they are considered to be very secure and investments with them are considered to be low risk. Historically, they have offered lower rates than banks and building societies, but the "gap" has narrowed in recent years. To give Members an idea of the current local authority market, we have recently dealt forward for 2 years out of April 2014 at 1.14% and have had an "offer" to invest for 5 years at 2.25%. It is proposed that the duration limit for investments with other local authorities be extended to 3 years to provide extra flexibility in future. Any potential deals will continue to be discussed in advance with Sector.

3.22 Collective (pooled) investment schemes

These are currently included in our Strategy as "specified investments" – i.e. we are only permitted to invest for up to a year. The category includes money market funds and the Payden Sterling Reserve Fund. It is proposed that pooled investment funds that meet the definition of a collective investment scheme as defined in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 as amended by SI 2004 No 534, SI 2007 No 573 and SI 2012 No 265 (i.e. investments would not count as capital expenditure) be added to the list of permitted investments with a total monetary limit of £25m and a duration limit of 5 years. This could include property, equity and bond funds and would diversify the portfolio from pure cash investments, add value and spread risk over a variety of asset classes. Investment opportunities will be considered on a case-by-case basis, taking account of Sector's advice, and it is proposed that investments will be subject to the approval of the Director of Finance in consultation with the Resources Portfolio Holder.

3.23 Prior to the "credit crunch" period of 2007/08, the Council regularly placed investments for up to 5 years. The fragility of the banking sector has, however, resulted in shorter term lending of up to 1 year to reflect the risk to the capital sum.

3.24 In considering a Treasury Management Strategy, the key factors are security, liquidity and yield (in that order), which reflects CIPFA guidance. With current lending rates so low, there is effectively a capital risk as a result of the Council receiving returns lower than inflation. The Strategy has previously been revised to include corporate bonds and this report proposes the inclusion of additional collective investment vehicles that meet the following unique requirements:

- In recognition of the need to protect capital, a longer term period of 3 – 5 years will be required, where the capital risk is expected to be minimal;
- The returns will be expected to be higher than normal secured fixed term lending to eligible financial institutions by at least 2%;
- Investments must be able to be sold within 6 months (9 months for property), which provides more flexibility than lending to banks for longer periods;
- The investment vehicle must have a proven track record over a 3 – 5 year period, although it is accepted that looking back is no guarantee of returns for the future;
- Historically, volatility has been low; and
- The Council's external advisers, Sector, must support the proposals using their extensive financial expertise.

**Regulatory Framework, Risk and Performance**

3.25 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.26 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

## 4. POLICY IMPLICATIONS

4.1 In line with government guidance, the Council's policy is to seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

## 5. FINANCIAL IMPLICATIONS

5.1 These are contained in the body of the report. An average rate of interest of 1.31% was achieved in 2012/13, including 1.12% on all new "core" investments placed during the year (compared to the budget assumption of 1.5%). The final outturn for net interest on investments and borrowing in 2012/13 was £2,673k compared to the budget of £2,691k. In June 2012, the Executive agreed that the 2011/12 actual surplus of £1,185k be transferred into a new earmarked reserve, The Interest Rate Risk Reserve, with the intention of mitigating potential future interest losses.

5.2 With regard to 2013/14, an average rate of 1% has been assumed for interest on new investments in the 2013/14 revenue budget, in line with the estimates provided by the Council's external treasury advisers, Sector, earlier in the year and with officers' views. The Bank of England base rate is still expected to rise, but the expected start of the rise has been put back to 2016 and could be even later. The latest financial forecast assumes 1% for new investments in all years from 2013/14 to 2016/17. A variation of 0.25% in these assumptions would result in a variation in interest earnings of around £400k pa from 2013/14. At this stage in the year, it is forecast that the 2013/14 outturn will be broadly in line with the budget.

| | |
|---|---|
| **Non-Applicable Sections:** | Legal and Personnel Implications |
| Background Documents: (Access via Contact Officer) | CIPFA Code of Practice on Treasury Management<br>CIPFA Prudential Code for Capital Finance in Local Authorities<br>CLG Guidance on Investments<br>External advice from Sector Treasury Services |

# Prudential and Treasury Indicators – Actual 2012/13

Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy and require the approval of the Council. The table below shows the actual performance in relation to the indicators in 2011/12 and compares the actual in 2012/13 with the original estimates approved in February 2012 and the revised estimates ("probable") reported in the mid-year review in October 2012. Further details on capital expenditure outturn were reported to the Executive on 19th June 2013.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The revised Code (published in 2009) was adopted by full Council on 15th February 2010.

| PRUDENTIAL INDICATORS | 2011/12 | 2012/13 | 2012/13 | 2012/13 |
|---|---|---|---|---|
| | actual | estimate | probable | actual |
| Total Capital Expenditure | £48.8m | £31.8m | £31.7m | £28.4m |
| Ratio of financing costs to net revenue stream | -1.3% | -1.5% | -1.5% | -1.5% |
| Net borrowing requirement (net investments for Bromley) | | | | |
| brought forward 1 April | £163.1m | £143.0m | £170.3m | £170.3m |
| carried forward 31 March | £170.3m | £143.1m | £176.7m | £197.3m |
| in year borrowing requirement (movement in net investments for Bromley) | +£7.2m | £0.1m | £6.4m | £27.0m |
| Capital Financing Requirement as at 31 March | £3.6m | £6.9m | £3.3m | £3.8m |
| Annual change in Cap. Financing Requirement | -£3.9m | £3.3m | -£0.3m | £0.2m |
| Incremental impact of capital investment decisions | £ p | £ p | £ p | £ p |
| Increase in council tax (band D) per annum | - | - | - | - |

| TREASURY MANAGEMENT INDICATORS | 2011/12 | 2012/13 | 2012/13 | 2012/13 |
|---|---|---|---|---|
| | actual | estimate | probable | actual |
| | | | | |
| Authorised Limit for external debt - | | | | |
| borrowing | £30.0m | £30.0m | £30.0m | £30.0m |
| other long term liabilities | £30.0m | £30.0m | £30.0m | £30.0m |
| TOTAL | £60.0m | £60.0m | £60.0m | £60.0m |
| | | | | |
| Operational Boundary for external debt - | | | | |
| borrowing | £10.0m | £10.0m | £10.0m | £10.0m |
| other long term liabilities | £20.0m | £10.0m | £10.0m | £10.0m |
| TOTAL | £30.0m | £20.0m | £20.0m | £20.0m |
| | | | | |
| Actual external debt | £3.6m | £6.9m | £3.3m | £3.8m |
| | | | | |
| Upper limit for fixed interest rate exposure | 100% | 100% | 100% | 100% |
| Upper limit for variable rate exposure | 20% | 20% | 20% | 20% |
| | | | | |
| Upper limit for total principal sums invested for more than 364 days beyond year-end dates | £173.9m | £80.0m | £80.0m | £201.1m |

**APPENDIX 6**

## Economic Background (provided by Sector)

The year 2012/13

1. The financial year 2012/13 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2012/13 was that Bank Rate would start to slowly increase from quarter 4 2014. However, economic growth in the UK was disappointing during the year due to the UK austerity programme, weak consumer confidence and spending, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the European Union (EU). The UK coalition Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Moody's followed up this warning by actually downgrading the rating to AA+ in February 2013 and Fitch then placed their rating on negative watch, after the Budget statement in March. Key to retaining the AAA rating from Fitch and S&P will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within a reasonable timeframe. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £50bn in July to a total of £375bn. Bank Rate ended the year unchanged at 0.5% while CPI inflation fell from 3% at the start of the year to end at 2.8% in March, with an anticipated fall back to below 2% pushed back to quarter 1 2016. The EU sovereign debt crisis was an ongoing saga during the year with first Greece and then Cyprus experiencing crises which were met with bailouts after difficult and fraught negotiations.

2. Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB rates depressed for much of the year at historically very low levels.

3. Deposit rates: The Funding for Lending Scheme, announced in July, resulted in a flood of cheap credit being made available to banks and this has resulted in money market investment rates falling sharply in the second half of the year. However, perceptions of counterparty risk have improved after the ECB statement in July that it would do "whatever it takes" to support struggling Eurozone countries. This has resulted in some return of confidence to move away from only very short term investing.

Quarter ended 30th June 2013

4. During the quarter ended 30th June:

- Indicators suggested that the economy accelerated;
- Stronger household spending, both on and off the high street;
- Inflation remained stubbornly above the MPC's 2% target;
- The MPC remained in a state of limbo ahead of Mark Carney's arrival;
- 10-year gilt yields rose above 2.5% and the FTSE 100 fell below 6,100;
- The Federal Reserve discussed tapering the pace of asset purchases under Quantitative Easing 3 (QE3).

5. After avoiding recession in the first quarter with a 0.3% quarterly expansion, it looks likely that the economy grew even more strongly in Q2. On the basis of past form, the CIPS/Markit business surveys for April and May point to 0.5% quarterly growth in the second quarter of 2013. Official

output data echoed the message from the business surveys. The 3m/3m change in industrial production reached 0.9% in April, the strongest pace since July 2010. Similarly, the service sector expanded by 0.8% on the same basis. And while output in the volatile construction sector in April was 1% lower than a year ago, it was the smallest annual fall since the end of 2011, raising the prospect that the sector supported the recovery in Q2.

6. There have been signs of renewed vigour in household spending in the second quarter. May's 2.1% monthly rise in retail sales overturned April's 1.1% fall. This tallied with information from the Bank of England agents, who reported a further pick-up in retail sales values in May. Non-high street spending looks to have been robust too, with new car registrations up by 20% in the year to May.

7. The pick-up in economic growth appears to have supported the labour market, with employment rising by 24,000 in the three months to April. Admittedly, this was a lot slower than the 113,000 quarterly gain in employment seen on average over the past twelve months. But the rise in employment was still strong enough to reduce the level of unemployment further. The ILO measure fell by 5,000 in the three months to April while the timelier claimant count measure reported an 8,600 fall in May. Meanwhile, pay growth rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the additional rate of income tax. Excluding bonuses, earnings rose by just 1.3% y/y, well below the rate of inflation at 2.7% in May.

8. Meanwhile, the Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with the quoted interest rate on a 2-year fixed rate mortgage at a 90% loan-to-value ratio now 4.6%, around 130 basis-points lower in May than when the FLS was introduced in August 2012.

9. Alongside the Government's Help to Buy scheme, which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. Mortgage approvals by high street banks, as measured by the BBA, rose from 33,000 to 36,100 in May. Excluding a stamp-duty holiday related spike in January 2012, this was the highest level for over three years. The rise in demand has helped to push up house prices, with both the Halifax and Nationwide measures reporting a 0.4% monthly gain in May. On an annual basis, measured prices were up by 3.7% and 1.1% respectively.

10. Turning to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in Q2 looked to be broadly in line with last year's figures, highlighting the government's difficulty in reducing borrowing while economic growth is relatively lacklustre.

11. Meanwhile, the 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan. Total expenditure was still forecast to be broadly flat in real terms in 2015/16 and the £50bn planned capital expenditure announced for that fiscal year was identical to the amount already outlined in March's Budget.

12. On the monetary policy front, June's MPC meeting, the last chaired by the outgoing Governor Mervyn King, showed that the Committee remained in limbo ahead of the arrival of his replacement, Mark Carney. The Committee voted 6-3 to keep the level of asset purchases unchanged at £375bn, with the majority judging that the current stimulus and Funding for Lending Scheme would be sufficient to support growth in the context of price stability.

13. Having fallen from 2.8% to 2.4% in April, CPI inflation rose to 2.7% in May. May's rise mostly reflected price changes due to the earlier timing of Easter, which depressed inflation in April. Even so, inflation is still likely to have risen further in June due to base effects, with last year's

fuel price falls providing an unfavourable annual comparison. That said, underlying price pressures do seem to be easing, with wages and producer prices both growing at subdued rates. Indeed, if anything, the inflation outlook brightened over the second quarter, with the price of oil falling from $108pb to $103pb while sterling appreciated by around 1.5% on a trade-weighted basis.

14. Having continued to rally over April and May, financial markets sold off in June following a Federal Reserve statement that suggested the central bank may ‘taper’ its asset purchases earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK, with 10 year gilt yields rising to 2.5% from 1.8% at the start of the quarter. Equities were hit too, with the FTSE 100 falling from 6,411 at the start of the quarter to below 6,100 before ending the quarter a bit higher at 6,240.

15. In the US, the statement from the Fed took the limelight. The Fed’s comments sparked a sharp sell-off in the Treasury market, with 10-year Treasury yields hitting 2.54%. The Fed move was a response to the improving economic outlook in the US. Indeed, payroll figures showed that the US added 175,000 new jobs in May, helping to pull the unemployment rate down to 7.6%, from 8.2% a year ago. In the housing market, house prices rose by 12% in the year to April, which helped to bring more households out of negative equity.

16. Meanwhile, tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a potential flare-up. For example, the Democratic Left party left the Greek governing coalition in June, causing 10 year Greek government bond yields to surge to 11.5% from around 8% a month ago. And while the economic survey data improved consistently over the first half of the year, the composite Eurozone PMI is still pointing to a further contraction in output in Q2. If this materialises, it would be the seventh quarter of Eurozone recession, the longest on record.