Annual Treasury Management Review 2012/13

Midlothian Council
June 2013

Contents

Annual Treasury Management Review 2012/13

Purpose

This Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2012/13. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2012/13 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 28/02/2012)
- a mid year (minimum) treasury update report (Council 06/11/2012)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, 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.

This 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 the full Council.

Executive Summary

During 2012/13, 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:

Prudential and treasury indicators	2011/12 Actual £000	2012/13 Budget £000	2012/13 Actual £000
Capital expenditure:-			
General Fund	21,037	35,901	29,525
HRA	25,343	23,075	17,723
Total	**46,380**	**58,976**	**47,248**
Borrowing Required			
General Fund	5,014	13,557	7,109
HRA	20,582	14,655	11,072
Total	**25,596**	**28,212**	**18,181**
Capital Financing Requirement:-			
General Fund	100,849	115,760	103,255
HRA	125,447	143,690	134,500
Total	**226,296**	**259,451**	**237,755**
External debt	**224,801**	**246,695**	**230,020**
Net borrowing	**182,103**	**211,536**	**191,176**
Investments:-			
Under 1 year	42,698	35,159	38,844
Longer than 1 year	-	-	-
Total	**42,698**	**35,159**	**38,844**

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 Council continues to maintain a nominal under-borrowed position, reflecting a strategy to continue to cash-back the majority of the Council's balance sheet reserves (ensuring the security of these funds through the utilisation of fixed term deposits with only UK-government backed counterparties).

The Council has sought to source new long-term borrowing from PWLB, taking advantage of the historically low rates on offer and the current 0.20% discount, whilst maintaining an element of shorter-dated temporary borrowing on offer at less than base rate (<0.50%).

Prudential and treasury indicators are to be found in the main body of this report. The Head of Finance & Human Resources also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit), was not breached.

Introduction and Background

This report summarises:

- **Section 1**: Capital activity during the year;
- **Section 2**: Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- **Section 3**: Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- **Section 4**: Treasury Management Strategy during 2012/13;
- **Section 5**: Summary of interest rate movements in the year;
- **Sections 6/7**: Detailed debt activity; and
- **Sections 8/9**: Detailed investment activity; and
- **Section 10**: Performance Measurement

1. The Council's Capital Expenditure and Financing 2012/13

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

Table 1: Capital Expenditure + Financing

	2011/12 Actual £000	2012/13 Budget £000	2012/13 Actual £000
General Fund			
Capital Expenditure	21,037	35,901	29,525
Available Funding	16,023	22,344	22,416
Borrowing Required	**5,014**	**13,557**	**7,109**
HRA			
Capital Expenditure	25,343	23,075	17,723
Available Funding	4,761	8,420	6,651
Borrowing Required	**20,582**	**14,655**	**11,072**
General Fund and HRA			
Capital Expenditure	46,380	58,976	47,248
Available Funding	20,784	30,764	29,067
Borrowing Required	**25,596**	**28,212**	**18,181**

2. The Council's Overall Borrowing Need

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 2012/13 unfinanced capital expenditure (see above table), plus prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

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.

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 Scheduled Debt Amortisation (or loans repayment), 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. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

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 minimum loan repayment each year through an additional revenue charge.

The Council's CFR for the year is shown below, and represents a key prudential indicator.

Table 2: Council's Capital Financing Requirement

CFR:	31-Mar-12 Actual £000	2012/13 Budget £000	31-Mar-13 Actual £000
Opening balance	**£ 207,736**	**£ 238,173**	**£ 226,296**
Add Borrowing Required	£ 25,595	£ 28,212	£ 18,181
Less scheduled debt amortisation	£ (7,036)	£ (6,934)	£ (6,722)
Closing balance	**£ 226,296**	**£ 259,451**	**£ 237,755**

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

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 2012/13 plus the expected changes to the CFR over 2013/14 and 2014/15 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2012/13. The table below highlights the Council's net borrowing position against the CFR. The Council has therefore complied with this prudential indicator.

It should be noted that this indicator is changing to compare gross borrowing to the CFR with effect from 2013/14; this is expected to provide a more appropriate indicator; therefore the Council's gross borrowing is also shown against the CFR in the table below.

Table 3: Council's Net Borrowing Position			
	31-Mar-12	2012/13	31-Mar-13
	Actual	Budget	Actual
	£000	£000	£000
Gross Borrowing	£ 224,801	£ 246,695	£ 230,020
Net Borrowing	£ 182,103	£ 227,195	£ 191,176
CFR	£ 226,296	£ 259,451	£ 237,755

The authorised limit – this Council has kept within its authorised external borrowing limit as shown by the table below.

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.

Table 4: Gross Borrowing against Authorised Limit / Operational Boundary	
	2012/13
Authorised limit (CFR in 2013/14)	£ 266,920
Operational boundary	£ 253,574
Maximum gross borrowing position	£ 250,473
Average gross borrowing position	£ 227,955

3. Treasury Position as at 31 March 2013

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 Purpose section of this report, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2012/13 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Table 5: Treasury Position

	31 March 2012 Principal	Rate/ Return	Average Life (Yrs)	31 March 2013 Principal	Rate/ Return	Average Life (Yrs)
Debt						
Fixed Rate Debt						
PWLB	£ 148,043	4.00%	22.29	£ 178,018	3.89%	21.79
Market	£ 61,758	0.72%	5.35	£ 37,003	0.86%	8.81
Total Fixed Rate Debt	**£ 209,801**	**3.02%**	**17.31**	**£ 215,020**	**3.37%**	**19.56**
Variable Rate Debt						
PWLB	£ -	n/a	n/a	£ -	n/a	n/a
Market	£ 15,000	4.63%	38.74	£ 15,000	4.63%	37.72
Total Variable Rate Debt	**£ 15,000**	**4.63%**	**38.74**	**£ 15,000**	**4.63%**	**37.72**
Total debt/gross borrowing	**£ 224,801**	**3.14%**	**18.74**	**£ 230,020**	**3.45%**	**20.74**
CFR	**£ 226,296**			**£ 237,755**		
Over/ (under) borrowing	**£ (1,495)**			**£ (7,735)**		
Investments						
Fixed Rate Investments						
In House	£ 24,900	2.78%	0.67	£ 28,900	2.13%	0.53
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Fixed Rate Investments	**£ 24,900**	**2.78%**	**0.67**	**£ 28,900**	**2.13%**	**0.53**
Variable Rate Investments						
In House	£ 17,798	0.88%	0.03	£ 9,944	0.75%	0.00
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Variable Rate Investments	**£ 17,798**	**0.88%**	**0.08**	**£ 9,944**	**0.75%**	**0.00**
Total Investments	**£ 42,698**	**1.99%**	**0.40**	**£ 38,844**	**1.78%**	**0.39**
Net Borrowing	**£ 182,103**			**£ 191,176**		

The maturity structure of the debt portfolio was as follows:

Table 6: Maturity Structure of Debt Portfolio

	31-Mar-12		2012/13			31-Mar-13	
	Actual		Original Limits			Actual	
	£000	%	%			£000	%
Under 12 months	£ 66,781	30%	0%	to	50%	£ 32,027	14%
12 months and within 24 months	£ 27	0%	0%	to	50%	£ 20,024	9%
24 months and within 5 years	£ 27,079	12%	0%	to	75%	£ 17,086	7%
5 years and within 10 years	£ 37,635	17%	0%	to	75%	£ 28,300	12%
10 years and above	£ 93,280	41%	40%	to	98%	£ 132,584	58%
Total	**£ 224,801**	**100%**				**£ 230,020**	**100%**

The maturity structure of the investment portfolio was as follows:

Table 7: Maturity Structure of Investment Portfolio		
	31-Mar-12	31-Mar-13
	£000	£000
Investments		
Under 1 Year	£ 42,698	£ 38,844
Over 1 Year	£ -	£ -
Total	**£ 42,698**	**£ 38,844**

The exposure to fixed and variable interest rates on debt was as follows:-

Table 8: Fixed/Variable Interest Rate Exposure of Debt Portfolio					
	31-Mar-12		2012/13	31-Mar-13	
	Actual		Original Limits	Actual	
	£000	%	%	£000	%
Fixed Interest Rate Exposure	£ 209,801	93%	0% to 100%	£ 215,020	93%
Variable Interest Rate Exposure	£ 15,000	7%	0% to 30%	£ 15,000	7%
Total	**£ 224,801**	**100%**		**£ 230,020**	**100%**

4. The Strategy for 2012/13

The expectation for interest rates within the strategy for 2012/13 anticipated low but rising Bank Rate (starting in quarter 4 of 2014) with similar gradual rises in medium and longer term fixed borrowing rates over 2012/13. 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 counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

The actual movement in gilt yields meant that PWLB rates fell during the first quarter of the year to historically low levels. This was caused by a flight to quality into UK gilts from EU sovereign debt, and from shares, as investors became concerned about the potential for a Lehman's type crisis of financial markets, if the Greek debt crisis were to develop into a precipitous default and exit from the Euro. During the second and third quarters, rates rose gradually and agreement of a second bail out for Greece in December saw the flight to quality into gilts reverse somewhat, as confidence rose that the Eurozone crisis was finally subsiding. However, gilt yields then fell back again during February and March as Eurozone concerns returned, with the focus now shifting to Cyprus, and flight to quality flows into gilts resumed. This was a volatile year for PWLB rates, driven by events in the Eurozone which oscillated between crises and remedies.

With that in mind, the general strategy for any new borrowings required was to balance savings from the utilisation of short-term market money from other UK public sector bodies at rates often available at less than base rate (0.5%), with borrowing from PWLB at historically low rates, particularly at the short-medium end of the curve.

Special tranche rates on offer from low risk UK Government backed banks (Lloyds, RBS) were expected to continue to offer value at upwards of 3.00%, although these dropped markedly in the mid-latter part of the year as a result of The Funding for Lending Scheme.

5. The Economy and Interest Rates

Sovereign debt crisis. The EU sovereign debt crisis was an ongoing saga during the year. However, the ECB statement in July that it would do “whatever it takes” to support struggling Eurozone countries provided a major boost in confidence that the Eurozone was (at last) beginning to get on top of its problems. This was followed by the establishment of the Outright Monetary Transactions Scheme in September. During the summer, a €100bn package of support was given to Spanish banks. The crisis over Greece blew up again as it became apparent that the first bailout package was insufficient. An eventual very protracted agreement of a second bailout for Greece in December was then followed by a second major crisis, this time over Cyprus, towards the end of the year. In addition, the Italian general election in February resulted in the new Five Star anti-austerity party gaining a 25% blocking vote; this has the potential to make Italy almost ungovernable if the grand coalition formed in April proves unable to agree on individual policies. This could then cause a second general election – but one which could yield an equally ‘unsatisfactory’ result! This result emphasises the dangers of a Eurozone approach heavily focused on imposing austerity, rather than promoting economic growth, reducing unemployment, and addressing the need to win voter support in democracies subject to periodic general elections. This weakness leaves continuing concerns that this approach has merely postponed the ultimate debt crisis, rather than provide a conclusive solution. 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. 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.

UK growth. 2012/13 started the first quarter with negative growth of -0.4%. This was followed by an Olympics boosted +0.9% in the next quarter, then by a return to negative growth of -0.3% in the third quarter and finally a positive figure of +0.3% in the last quarter. This weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing (QE) by £50bn in July to a total of £375bn 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. In the March 2013 Budget, the Office of Budget Responsibility yet again slashed its previously over optimistic growth forecasts, for both calendar years 2013 and 2014, to 0.6% and 1.8% respectively.

UK CPI inflation has remained stubbornly high and above the 2% target, starting the year at 3.0% and still being at 2.8% in March; however, it is forecast to fall to 2% in three years time. The MPC has continued its stance of looking through temporary spikes in inflation by placing more importance on the need to promote economic growth.

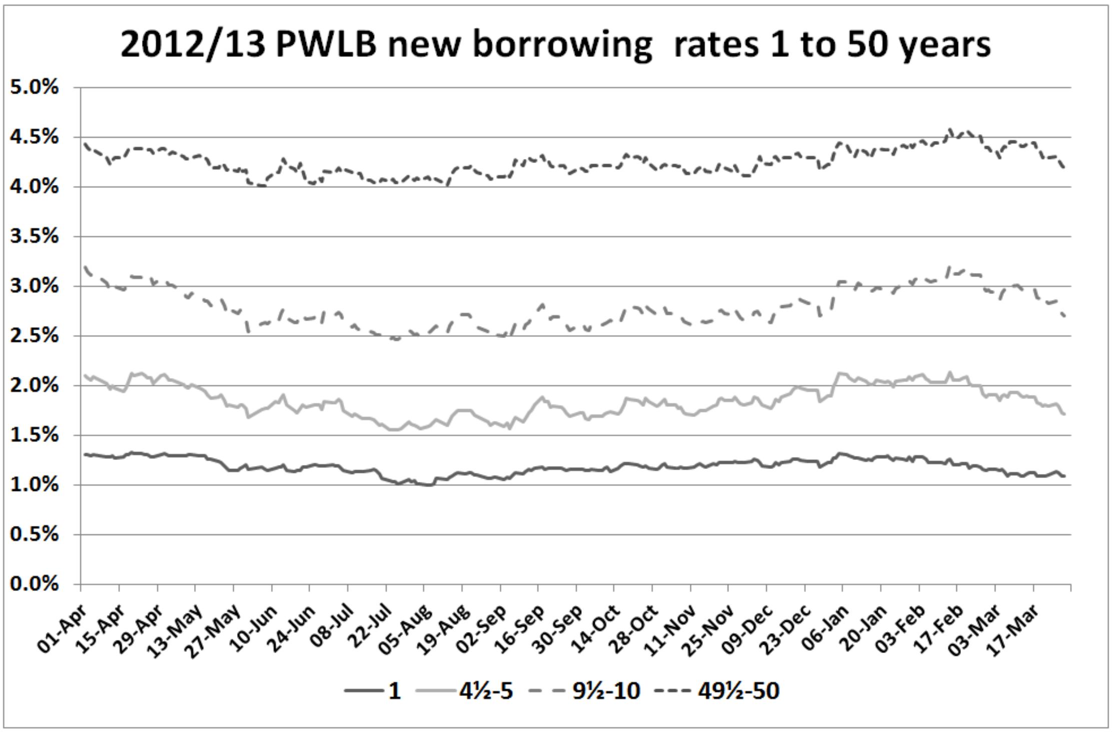
Gilt yields oscillated during the year as events in the ongoing Eurozone debt crisis ebbed and flowed, causing corresponding fluctuations in safe haven flows into / out of UK gilts. This, together with a further £50bn of QE in July and widely expected further QE still to come, combined to keep PWLB rates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

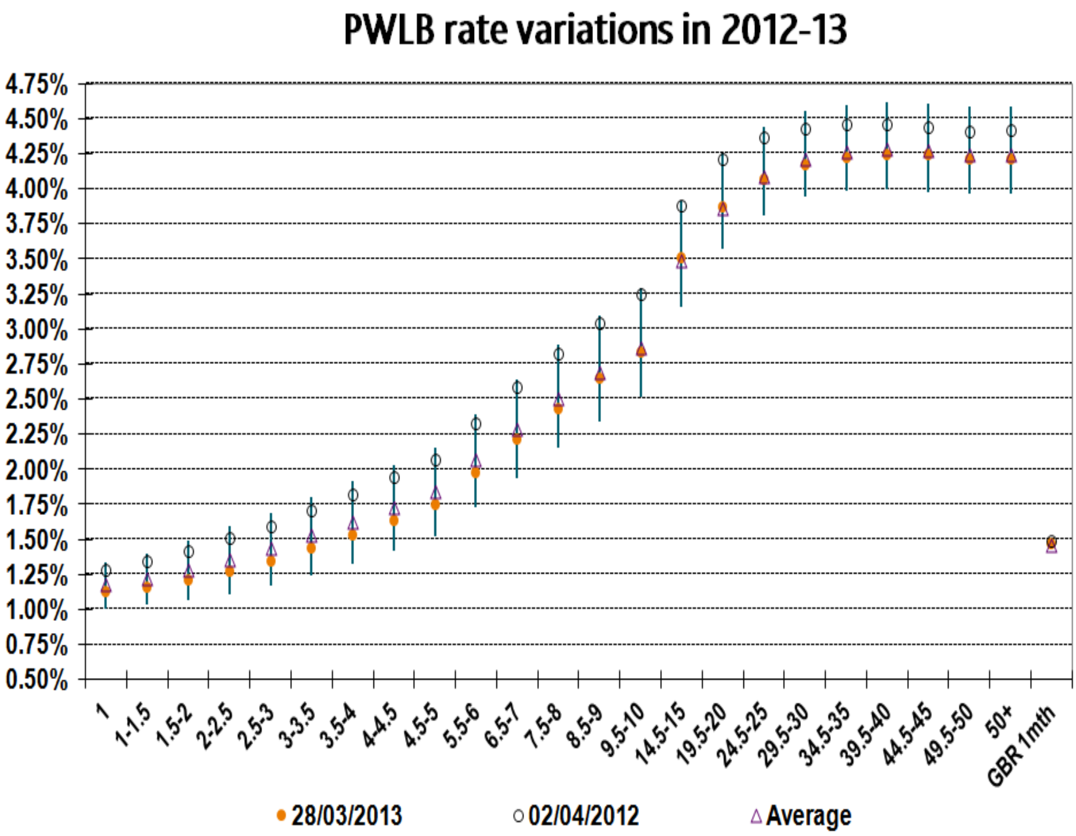
Bank Rate was unchanged at 0.5% throughout the year, while expectations of when the first increase would occur were pushed back to quarter 1 2015 at the earliest.

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.

6. Borrowing Rates in 2012/13

PWLB borrowing rates - the graphs and table for PWLB maturity rates below show, for a selection of maturity periods, the high and low points in rates, the average rates, spreads and individual rates at the start and the end of the financial year.





		PWLB borrowing rates 2012/13 for 1 to 50 years							
	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
2/4/12	1.290%	1.350%	1.600%	1.820%	2.070%	3.250%	4.370%	4.410%	1.490%
28/3/13	1.130%	1.160%	1.350%	1.540%	1.750%	2.840%	4.070%	4.220%	1.470%
High	1.330%	1.400%	1.690%	1.910%	2.150%	3.290%	4.440%	4.590%	1.500%
Low	1.000%	1.030%	1.170%	1.320%	1.520%	2.520%	3.810%	3.960%	1.440%
Average	1.185%	1.229%	1.440%	1.631%	1.847%	2.871%	4.094%	4.250%	1.467%
Spread	0.330%	0.370%	0.520%	0.590%	0.630%	0.770%	0.630%	0.630%	0.060%
High date	20/4/12	20/4/12	20/4/12	20/4/12	20/4/12	20/2/13	20/2/13	20/2/13	18/4/12
Low date	2/8/12	2/8/12	23/7/12	23/7/12	23/7/12	23/7/12	18/7/12	1/6/12	24/10/12

Short-dated market money:- sourced from other UK public bodies, rates fluctuated throughout the year from 0.26%-0.50% for 1 to 12 month maturities.

7. Borrowing Outturn for 2012/13

New Treasury Borrowing:-

New loans were drawn to fund the net unfinanced capital expenditure and naturally maturing debt.

The loans drawn were:-

Table 9: New Loans Taken in Financial Year 2012/13						
Lender	**Date Taken**	**Principal £000's**	**Interest Rate**	**Fixed/ Variable**	**Maturity Date**	**Term (Yrs)**
PWLB	10 Jul 2012	£ 10,000	3.63%	Fixed	15 Nov 2030	18.35
PWLB	13 Nov 2012	£ 10,000	3.44%	Fixed	13 Nov 2031	19.00
PWLB	13 Nov 2012	£ 10,000	3.29%	Fixed	13 Nov 2029	17.00
PWLB	26 Mar 2013	£ 10,000	3.71%	Fixed	25 Sep 2032	19.50
Market	Various	£173,350	0.26%-0.40%	Variable interest rate	Various	0.04-1.00
Total		**£213,350**				

Market loans of £173,350 reflects an average carrying value of £50m of Temporary Borrowing drawn on average every 3.5 months.

This compares with a budget assumption of new medium term (PWLB) borrowing at an interest rate of 3.90%, and new short-term market borrowing at an interest rate of 0.60%.

Maturing Debt:-

The following table gives details of treasury debt maturing during the year:-

Table 10: Maturing Debt in Financial Year 2011/12						
Lender	**Date Repaid**	**Principal £000's**	**Interest Rate**	**Fixed/ Variable**	**Date Originally Taken**	**Original Term (Yrs)**
PWLB	25 Sep 2012	£ 5,000	3.96%	Fixed	10 Oct 2008	3.96
PWLB	25 Sep 2012	£ 5,000	4.00%	Fixed	13 Oct 2008	3.95
PWLB	Various (Annuities)	£ 26	8.92%	Fixed	Various	60.00
EIB	Various	£ 5	8.75%	Fixed	05 Apr 1997	16.00
Market	Various	£198,100	0.26%-0.50%	Variable interest rate	Various	0.04-0.37
Total		**£208,131**				

Market loans of £173,350 reflects an average carrying value of £50m of Temporary Borrowing maturing on average every 3.0 months.

Rescheduling:-

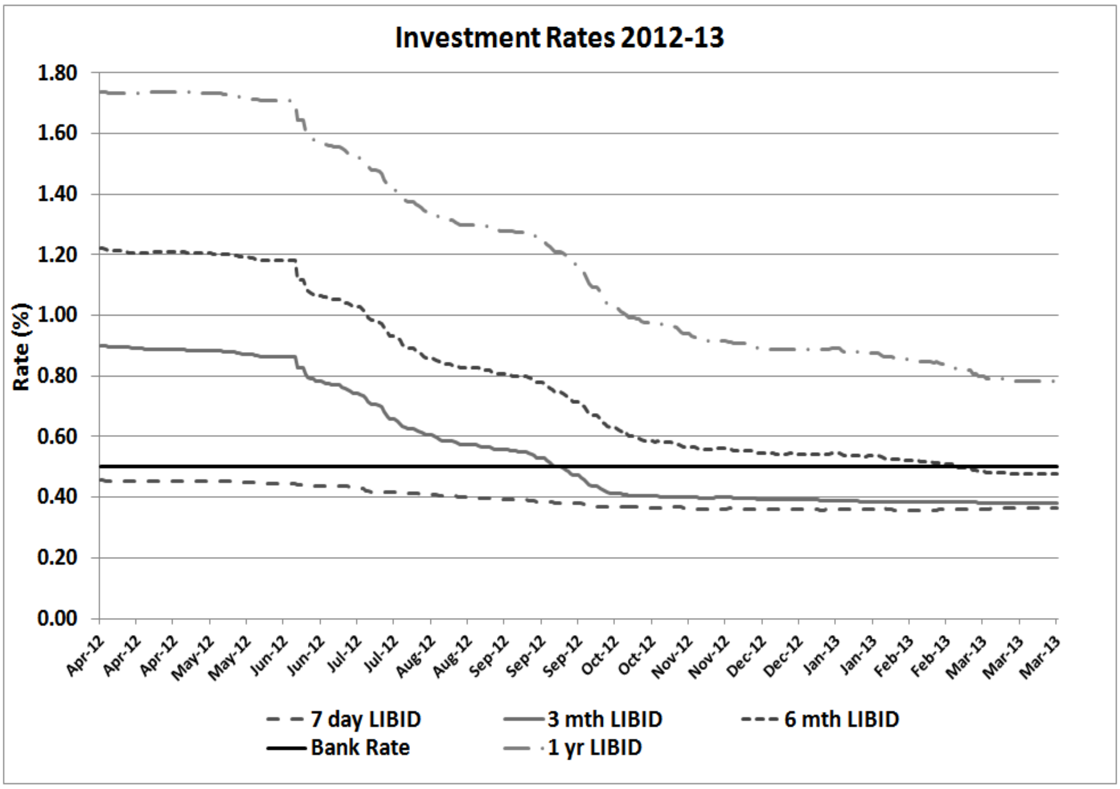
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Summary of debt transactions:-

Management of the debt portfolio resulted in a fall in the average interest rate on external debt of 0.28% (3.48% budget rate vs. 3.20% average external borrowing rate), representing net savings of £648,000 in 2012/13.

8. Investment Rates in 2012/13

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for four years. Market expectations of the start of monetary tightening were pushed back during the year to early 2015 at the earliest. The Funding for Lending Scheme resulted in a sharp fall in deposit rates in the second half of the year.



The Council were able to utilise the “Special tranche” rates on offer from the UK government backed banks to invest at 3.10% for 12 months, in the early part of the year. A further investment at 1.50%, again for a period of 12 months, was placed in December, this rate reflective of the general trend downwards as shown in graphical form above.

Money market fund rates began at a high of 0.75%-0.80% before dropping continuously to a low of 0.35%-0.45% at the end of the financial year. Call account rates were more sticky, remaining unchanged throughout the financial year, although the Council received notice in February 2013 that the call rate with the Bank of Scotland would fall from 0.75% to 0.40% with effect from mid-April 2013. This merely exacerbates the challenge to the Council of few approved counterparties for use (to ensure the security of the Council’s funds) along with historically low rates of return.

9. Investment Outturn for 2012/13

Investment Policy:-

The Council's investment policy is governed by Scottish Government Investment Regulations, which have been implemented in the annual investment strategy approved by the Council on 28/02/2012. 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 cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Table 11: Balance Sheet Resources		
	31-Mar-12	31-Mar-13
HRA Balances	£ 11,709	
General Fund Balances	£ 7,294	
Earmarked reserves	£ 6,926	
Provisions	£ 4,218	
Usable capital receipts	£ 9,435	
Total	**£ 39,582**	**£ -**

TABLE TO BE UPDATED

Investments held by the Council:-

The Council maintained an average balance of £46.8 million of internally managed funds. The internally managed funds earned an average rate of return of 2.09%. The comparable performance indicator is the average 6-month LIBID un-compounded rate, which was 0.78%. This compares with a budget assumption of £35.2 million of internally managed funds earning an average rate of 1.53%.

Summary of investment transactions:-

Management of the investment portfolio resulted in an increase in the average interest rate on internally managed investments of 0.56% (1.53% budget rate vs. 2.09% average investment rate), representing an increased return of £435,000 in 2012/13 compared with budget.

10. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities.

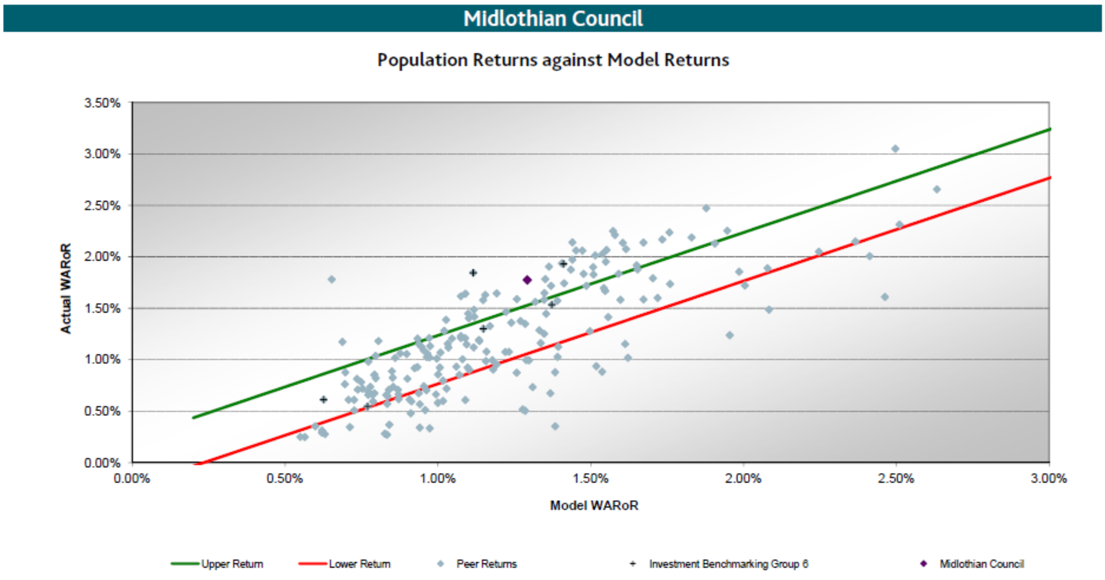
Loans Fund Rate

Combining the interest paid (earned) on external debt (investments) with charges for premiums written off and internal interest allowed into an average Loans Fund Rate, Midlothian's result of 3.29% for 2011/12 was the lowest Loans Fund Rate amongst all mainland authorities in Scotland (see Appendix 1).

The comparative Loans Fund Rate for 2012/13, of 3.03%, is once again expected to be one of the lowest when benchmarked against all mainland authorities in Scotland (note that at present, these benchmark figures are not yet available).

Investment Benchmarking

The Council participates in the Scottish Investment Benchmarking Group set up by its Treasury Management Consultants, Sector. This service provided by Sector provides benchmarking data to authorities for reporting and monitoring purposes, by measuring the security, liquidity and yield within an individual authority portfolio. Based on the Council's investments as at 31 March 2013, the Weighted Average Rate of Return (WARoR) on investments of 1.78% against other authorities is shown in the graph below:-



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	1.78%	1.29%	0.48%	1.06%	1.53%	Above

** Models for 30 June 2012, 30 September 2012 and 31 December 2012 are attached as Appendix 2.*

As can be seen from the above graph, Midlothian is performing above the Sector model benchmarks (red to green lines), and is achieving one of the highest Weighted Average Rates of Return (WARoR) for the Weighted Average Credit Risk held, not only amongst peer Councils within the Benchmarking Group but also amongst the population of authorities across the UK.

This has been possible through a proactive investment policy whereby investments have been placed with UK government backed banks at attractive “special tranche” rates of up to 3.10%, whilst at the same time actively managing short-term cashflow to maximise returns.

Debt Performance

Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. In this respect, the relevant figures for Midlothian are incorporated in the table in Section 3.

11. Conclusion

The Council's overall cost of borrowing continues to benefit from proactive Treasury Management activity.

The cost of long term borrowing has been maintained by taking up opportunities to borrow from the PWLB at low interest rates whilst advantage has also been taken of the low rates available for temporary borrowing.

A better than average return on investments has been achieved for the tenth consecutive year and Midlothian continues to perform above the Sector model benchmarks and is achieving one of the highest Weighted Average Rates of Return (WARoR) for the Weighted Average Credit Risk held, not only amongst peer Councils within the Benchmarking Group but also amongst the population of authorities across the UK.

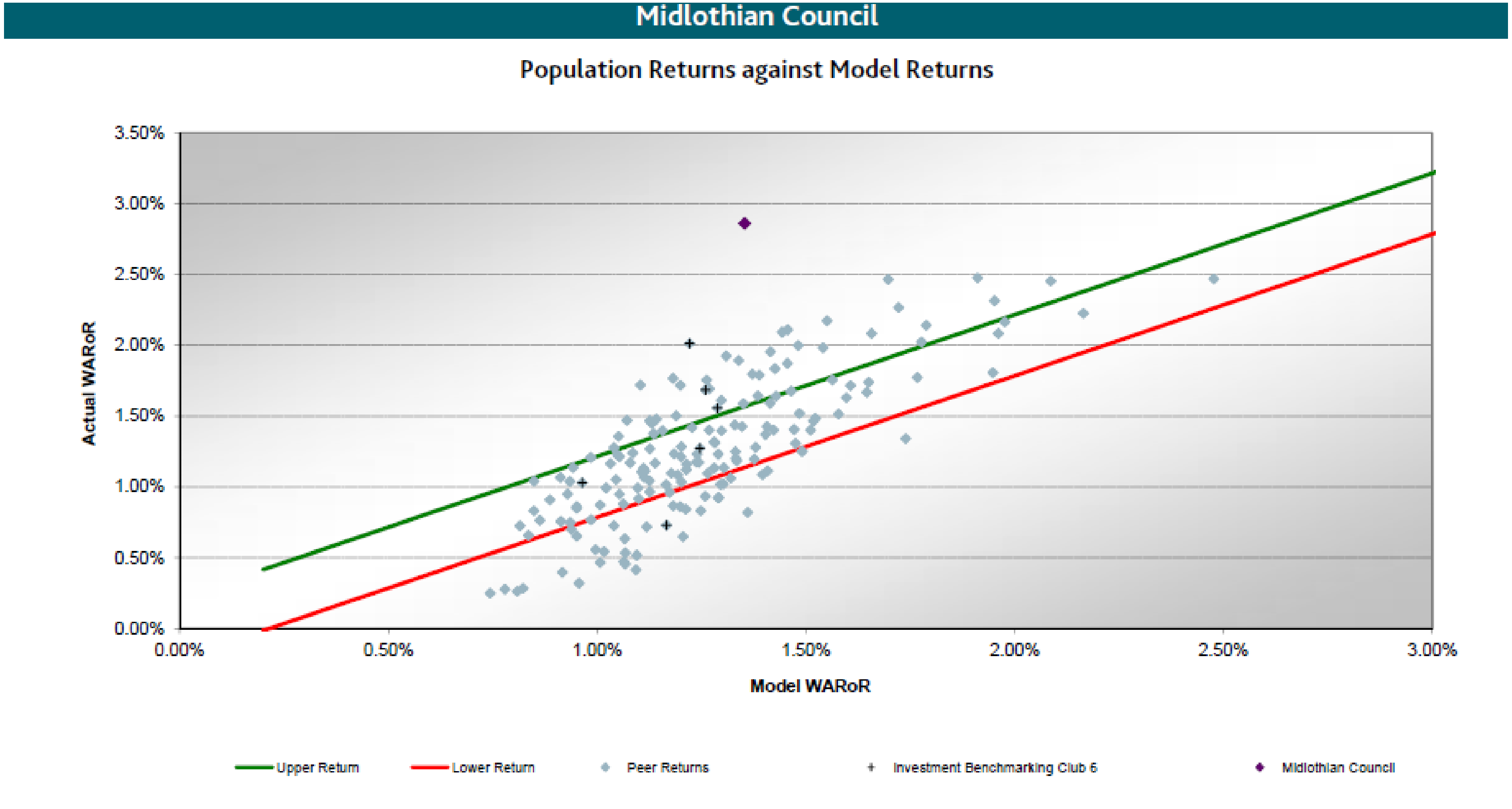
Overall Midlothian's Loans Fund Rate for the year is expected to be one of the lowest when benchmarked against all mainland Authorities in Scotland.

Appendix 1 – Loans Fund Rate Comparison 2011/12

Authority	Loans Fund Rate Comparison		
	Interest Rate	Expenses Rate	Loans Fund Rate
Scottish Local Authorities			
Midlothian	**3.25%**	**0.05%**	**3.29%**
Perth & Kinross	3.45%	0.07%	3.52%
Dumfries & Galloway	3.60%	0.05%	3.64%
Falkirk	3.64%	0.10%	3.74%
East Lothian	3.75%	0.03%	3.78%
West Lothian	4.10%	0.06%	4.16%
Inverclyde	4.21%	0.08%	4.29%
Fife	4.25%	0.08%	4.33%
East Renfrewshire	4.28%	0.08%	4.36%
Aberdeen City	4.42%	0.03%	4.45%
Renfrewshire	4.50%	0.05%	4.56%
Dundee City	4.63%	0.07%	4.70%
South Lanarkshire	4.68%	0.05%	4.73%
Glasgow City	4.71%	0.03%	4.74%
Angus	4.69%	0.06%	4.75%
Aberdeenshire	4.76%	0.04%	4.79%
Scottish Borders	4.79%	0.05%	4.84%
Clackmannanshire	4.80%	0.10%	4.90%
East Ayrshire	4.89%	0.08%	4.97%
Highland	4.96%	0.03%	4.99%
North Lanarkshire	5.07%	0.04%	5.11%
Moray	4.94%	0.25%	5.19%
East Dunbartonshire	5.12%	0.08%	5.20%
Stirling	5.31%	0.08%	5.39%
South Ayrshire	5.34%	0.08%	5.42%
West Dunbartonshire	5.48%	0.04%	5.52%
Argyll & Bute	5.47%	0.07%	5.54%
Edinburgh City	5.80%	0.04%	5.83%
North Ayrshire	tbc	tbc	tbc
Island Councils			
Comhairle Nan Eilean Siar	6.35%	0.06%	6.41%
Orkney	3.61%	0.10%	3.71%
Shetland	1.84%	0.08%	1.92%
Maximum	6.35%	0.25%	6.41%
Minimum	3.25%	0.03%	3.29%
Average	4.66%	0.07%	4.73%
Median	4.71%	0.06%	4.75%

The Loans Fund Rate combines the interest paid by the Council on money borrowed, with the interest earned by the Council on money invested, along with other charges such as internal interest allowed, premiums written off and treasury-related expenses to arrive at a weighted average "loans fund rate" figure for each authority, as noted in the final column above.

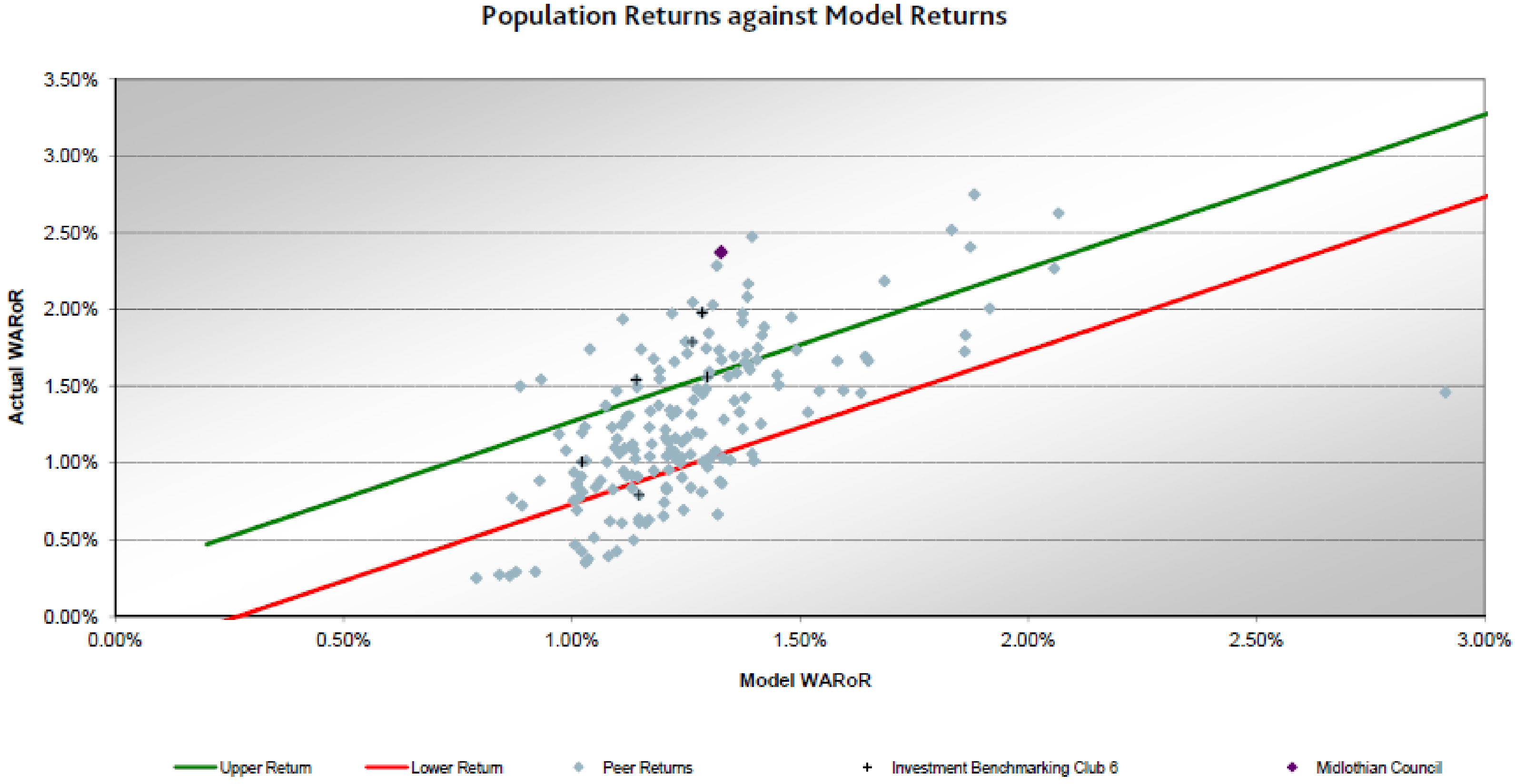
Appendix 2 – Midlothian Council Investment Portfolio return as at 30 June 2012



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	2.86%	1.35%	1.51%	1.14%	1.57%	Above

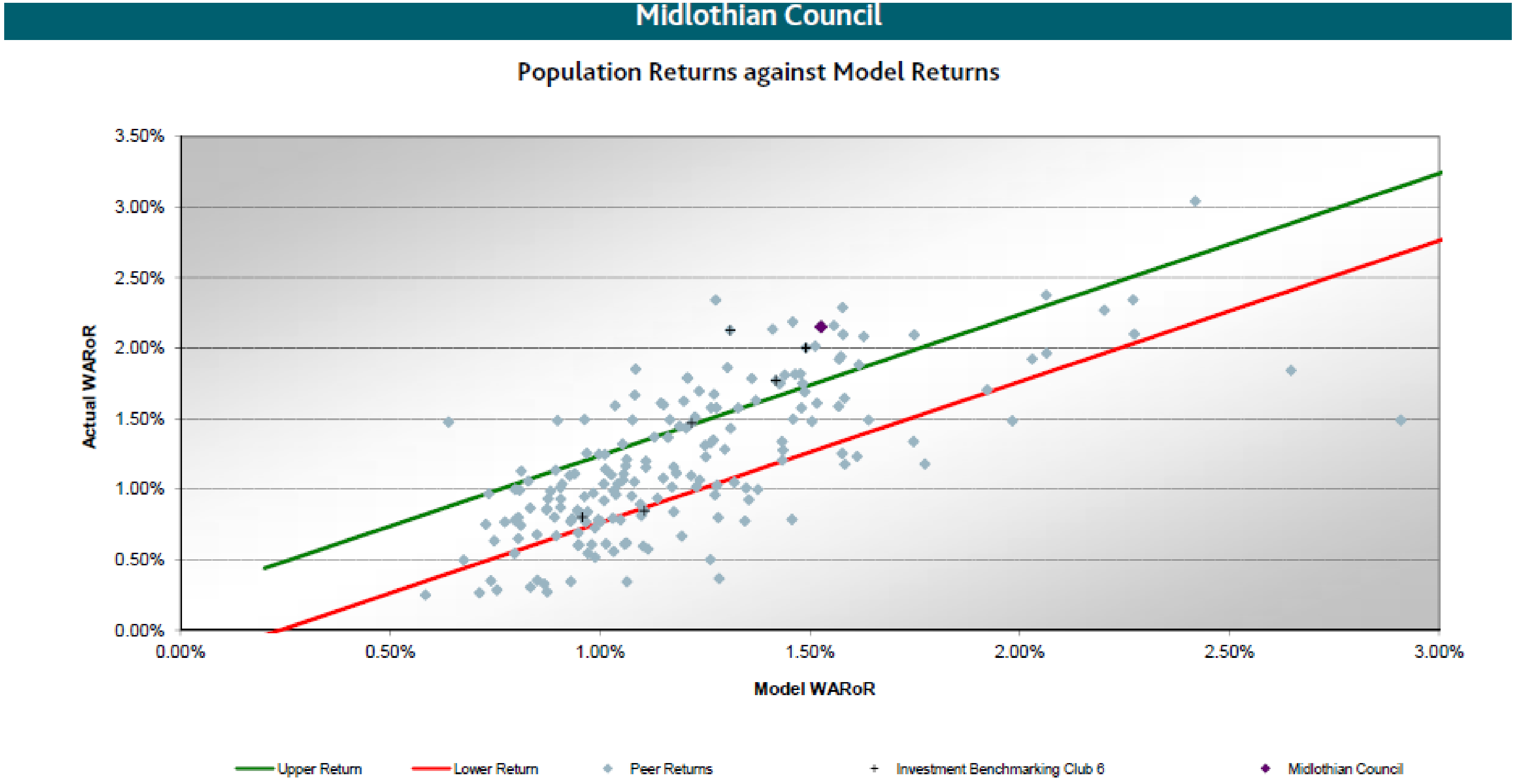
Appendix 2 – Midlothian Council Investment Portfolio return as at 30 September 2012

Midlothian Council



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	2.37%	1.33%	1.05%	1.06%	1.60%	Above

Appendix 2 – Midlothian Council Investment Portfolio return as at 31 December 2012



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	2.15%	1.53%	0.63%	1.29%	1.76%	Above