ARGYLL AND BUTE COUNCIL	COUNCIL
HEAD OF STRATEGIC FINANCE	22 NOVEMBER 2012

TREASURY MANAGEMENT MONITORING REPORT – 30 SEPTEMBER 2012

1 INTRODUCTION

1.1 This report summarises the monitoring as at 30 September 2012 of the Council's:

- Overall Borrowing Position
- Borrowing Activity
- Investment Activity
- Economic Forecast
- Prudential Indicators.

2 RECOMMENDATIONS

2.1 The treasury management monitoring report is noted.

3 DETAIL

Overall Borrowing Position

3.1 The table below details the estimated capital financing requirement (CFR) and compares this with the estimated level of external debt at the 31 March 2013. The CFR represents the underlying need for the Council to borrow to fund its fixed assets and accumulated capital expenditure.

	Forecast 2012/13 £000's	**Budget 2012/13 £000's**	**Forecast 2013/14 £000's**	**Forecast 2014/15 £000's**
CFR at 1 April	256,617	254,791	272,021	281,522
Net Capital Expenditure	34,353	32,988	27,525	13,534
Less Loans Fund Principal Repayments	(18,949)	(18,949)	(18,024)	(17,592)
Estimated CFR 31 March	**272,021**	**268,830**	**281,522**	**277,464**
Less Funded by NPDO	(82,576)	(80,674)	(81,152)	(79,728)
Estimated Net CFR 31 March	**189,445**	**188,156**	**200,370**	**197,736**
Estimated External Borrowing at 31 March	160,407	160,365	160,407	160,407
Gap	**29,038**	**27,791**	**39,963**	**37,329**

3.2 Borrowing is currently estimated to be below the CFR for the period to 31 March 2013. This reflects the approach taken to minimise surplus cash on deposit in order to avoid overdue exposure to investment / credit worthiness risks. However if it becomes clear that longer term interest rates are due to increase significantly the position will be reviewed to ensure the Council locks in funding at low interest rates.

3.3 The Council's estimated net capital financing requirement at the 30 September 2012 is £189.445m. The table below shows how this has been financed. Whilst borrowing is less than CFR there are substantial internal balances (mainly the General Fund) of which £53.8m is currently invested.

	at 30/6/2012 £000's	**at 30/9/2012 £000's**
Loans	160,404	160,341
Internal Balances	79,333	82,909
Less Investments & Deposits	(51,657)	(53,805)
Total	188,080	189,445

Borrowing Activity

3.4 The table below summarises the borrowing and repayment transactions in the period 1 July 2012 to 30 September 2012.

	Actual £000's
External Loans Repaid 1 July to 30 September 2012	63
Borrowing undertaken 1 July to 30 September 2012	0
Net Movement in External Borrowing	**(63)**

3.5 No local bonds were repaid in the period 1 July 2012 to 30 September 2012.

3.6 No new loans were taken out in the period 1 July 2012 to 30 September 2012.

3.7 The table below summarises the movement in level and rate of temporary borrowing at the start and end of the quarter. Owing to the levels of internal balances and surplus costs temporary borrowing has been minimal.

	£000s	% Rate
Temp borrowing at 1 July 2012	534	0.18
Temp borrowing at 30 September 2012	470	0.18

Investment Activity

3.8 The average rate of return achieved on the Council's investments to 30 September 2012 was 1.442% compared to the average LIBID rate for the same period of 0.387% which demonstrates that the Council is achieving a reasonable rate of return on its cash investments. At the 30 September 2012 the Council had £53.8m of short term investment at an average rate of 1.545%. The table below details the counterparties that the investments were placed with, the maturity date, the interest rate and the credit rating applicable for each of the counterparties.

Counterparty	Maturity	Amount £000s	Interest Rate	Rating
Bank of Scotland	Instant Access	4,000	0.75%	Short Term A-1, Long Term A
Bank of Scotland	14/12/2012	20,000	2.50%	
Royal Bank of Scotland	Instant Access	17,000	0.75%	Short Term A-1, Long Term A
Royal Bank of Scotland	95 Days Notice	10,000	1.25%	
Clydesdale Bank	Instant Access	2,805	0.50%	Short Term A-2, Long Term BBB+
Total		**53,805**		

3.9 All investments and deposits are in accordance with the Council's approved list of counterparties and within the limits and parameters defined in the Treasury Management Practices. The counterparty list is constructed based on assessments by leading credit reference agencies adjusted for additional market information available in respect of the counterparties.

3.10 The current market conditions have made investment decisions more difficult as the number of counterparties which meet the Council's parameters has reduced making it harder to achieve reasonable returns while limiting the exposure to any one institution.

3.11 In response to the low investment returns available in the market and the reduced likelihood of increases in base rate it has been decided to place fixed deposits with the part nationalised banks for periods up to 12 months to increase returns without significantly increasing the risks associated with the investments.

Economic Forecast

3.12 The economic background for the period to 30 September 2012 is shown in appendix 1.

Prudential Indicators

3.13 The prudential indicators for 2012-13 are attached in appendix 2.

For further information please contact Bruce West, Head of Strategic Finance 01546-604220

Bruce West
Head of Strategic Finance
18 October 2012

Appendix 1

Economic background:

Economic sentiment, in respect of the prospects for the UK economy to recover swiftly from recession, suffered a major blow in August when the Bank of England substantially lowered its expectations for the speed of recovery and rate of growth over the coming months and materially amended its forecasts for 2012 and 2013. It was noted that the UK economy is heavily influenced by worldwide economic developments, particularly in the Eurozone, and that on-going negative sentiment in that area would inevitably permeate into the UK's economic performance.

With regard to the Eurozone, investor confidence remains weak because successive "rescue packages" have first raised, and then disappointed, market expectations. However, the uncertainty created by the continuing Eurozone debt crisis is having a major effect in undermining business and consumer confidence not only in Europe and the UK, but also in America and the Far East/China.

In the UK, consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on real incomes from high inflation and low pay rises, all taking a toll. Whilst inflation has fallen considerably (CPI @ 2.6% in July), UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession. This means that the UK's recovery from the initial 2008 recession has been the worst and slowest of any G7 country apart from Italy (G7 = US, Japan, Germany, France, Canada, Italy and UK). It is also the slowest recovery from a recession of any of the five UK recessions since 1930 and total GDP is still 4.5% below its peak in 2008.

This weak recovery has caused social security payments to remain elevated and tax receipts to be depressed. Consequently, the Chancellor's plan to eliminate the annual public sector borrowing deficit has been pushed back further into the future. The Monetary Policy Committee has kept Bank Rate at 0.5% throughout the period while quantitative easing was increased by £50bn to £375bn in July. In addition, in June, the Bank of England and the Government announced schemes to free up banking funds for business and consumers.

On a positive note, despite all the bad news on the economic front, the UK's sovereign debt remains one of the first ports of call for surplus cash to be invested in and gilt yields, prior to the ECB bond buying announcement in early September, were close to zero for periods out to five years and not that much higher out to ten years.

3.2 Outlook for the next six months of 2012/13

The risks in economic forecasts continue unabated from the previous treasury strategy. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while America is hamstrung by political deadlock which prevents a positive approach to countering weak growth. Whether the presidential election in November will remedy this deadlock is debatable but urgent action will be required early in 2013 to address the US debt position. However, on 13 September the Fed. announced an aggressive stimulus programme for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, and this time with no time limit. They also announced that it was unlikely that there would be any increase in interest rates until at least mid 2015.

Eurozone growth will remain weak as austerity programmes in various countries curtail economic recovery. A crunch situation is rapidly developing in Greece as it has failed yet again to achieve deficit reduction targets and so may require yet another (third) bail out. There is the distinct possibility that some of the northern European countries could push for the ejection of Greece from the Eurozone unless its financial prospects improve, which does not seem likely at this juncture. A financial crisis was also rapidly escalating over the situation in Spain. However, in early September the ECB announced that it would purchase unlimited amounts of shorter term bonds of Eurozone countries which have formally agreed the terms for a bailout. Importantly, this support would be subject to conditions (which have yet to be set) and include supervision from the International Monetary Fund. This resulted in a surge in confidence that the Eurozone has at last put in place the framework for adequate defences to protect the Euro. However, it remains to be seen whether the politicians in charge of Spain and Italy will accept such loss of sovereignty in the light of the verdicts that voters have delivered to the politicians in other peripheral countries which have accepted such supervision and austerity programmes. The Eurozone crisis is therefore far from being resolved as yet. The immediate aftermath of this announcement was a rise in bond yields in safe haven countries, including the UK. Nevertheless, this could prove to be as short lived as previous "solutions" to the Eurozone crisis.

The Bank of England Quarterly Inflation Report in August pushed back the timing of the return to trend growth and also lowered its inflation expectations. Nevertheless, concern remains that the Bank's forecasts of a weaker and delayed robust recovery may still prove to be over optimistic given the world headwinds the UK economy faces. Weak export markets will remain a drag on the economy and consumer expenditure will continue to be depressed due to a focus on paying down debt, negative economic sentiment and job fears. The Coalition Government, meanwhile, is likely to be hampered in promoting growth by the requirement of maintaining austerity measures to tackle the budget deficit.

The overall balance of risks is, therefore, weighted to the downside:

- We expect low growth in the UK to continue, with Bank Rate unlikely to rise in the next 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB borrowing rates is for them to eventually rise, primarily due to the need for a high volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries. However, the current safe haven status of the UK may continue for some time, tempering any increases in yield.
- This interest rate forecast is based on an assumption that growth starts to recover in the next three years to a near trend rate (2.5%). However, if the Eurozone debt crisis worsens as a result of one or more countries having to leave the Euro, or low growth in the UK continues longer, then Bank Rate is likely to be depressed for even longer than in this forecast.

APPENDIX 2 : PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2012/13	2012/13	2013/14	2014/15
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	**£ p**	**£ p**		**£ p**
	Original Estimate	**Forecast Outturn**	**Forecast Outturn**	**Forecast Outturn**
Capital Expenditure	**£'000**	**£'000**	**£'000**	**£'000**
Non - HRA	32,988	32,988	27,525	13,534
TOTAL	32,988	32,988	27,525	13,534
Ratio of financing costs to net revenue stream				
Non - HRA	11.90%	11.90%	12.14%	13.40%
Net borrowing requirment				
brought forward 1 April *	254,791	279,431	268,830	278,131
carried forward 31 March *	268,830	282,122	278,131	274,073
in year borrowing requirement	14,039	2,691	9,301	(4,058)
In year Capital Financing Requirement				
Non - HRA	14,039	2,691	9,301	(4,058)
TOTAL	14,039	2,691	9,301	(4,058)
Capital Financing Requirement as at 31 March				
Non - HRA	268,830	282,122	278,131	274,073
TOTAL	268,830	282,122	278,131	274,073
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	70.71	70.71	58.58	29.01

PRUDENTIAL INDICATOR	2012/13	2013/14	2014/15
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
Authorised limit for external debt -			
borrowing	231,000	231,000	240,000
other long term liabilities	90,000	89,000	88,000
TOTAL	321,000	320,000	328,000
Operational boundary for external debt -			
borrowing	226,000	226,000	235,000
other long term liabilities	89,000	88,000	87,000
TOTAL	315,000	314,000	322,000
Upper limit for fixed interest rate exposure			
Principal re fixed rate borrowing	180%	180%	180%
Upper limit for variable rate exposure			
Principal re variable rate borrowing	90%	90%	90%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£10m	£10m	£10m

Maturity structure of new fixed rate borrowing during 2012/13	upper limit	lower limit
under 12 months	30%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	40%	0%
10 years and above	80%	0%