ARGYLL AND BUTE COUNCIL	PERFORMANCE REVIEW AND SCRUTINY COMMITTEE
HEAD OF STRATEGIC FINANCE	27 FEBRUARY 2014

TREASURY MANAGEMENT MONITORING REPORT – 31 DECEMBER 2013

1 SUMMARY

1.1 This report summarises the monitoring as at 31 December 2013 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 2014. The CFR represents the underlying need for the Council to borrow to fund its fixed assets and accumulated capital expenditure.

	Forecast 2013/14 £000's	Budget 2013/14 £000's	Forecast 2014/15 £000's	Forecast 2015/16 £000's
CFR at 1 April	258,398	271,150	256,373	269,280
Net Capital Expenditure	16,016	19,586	30,499	27,160
Less Loans Fund Principal Repayments	(18,041)	(18,041)	(17,592)	(12,123)
Estimated CFR 31 March	**256,373**	**272,695**	**269,280**	**284,317**
Less Funded by NPDO	(79,218)	(79,218)	(77,968)	(76,718)
Estimated Net CFR 31 March	**177,155**	**193,477**	**191,312**	**207,599**
Estimated External Borrowing at 31 March	161,250	170,407	175,407	180,407
Gap	**15,905**	**23,070**	**15,905**	**27,192**

3.2 Borrowing is currently estimated to be below the CFR for the period to 31 March 2014. 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 31 December 2013 is £176.380m. 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 £53m is currently invested.

	Position at 30/9/2013 £000's	**Position at 31/12/2013 £000's**
Loans	160,598	161,211
Internal Balances	78,597	68,232
Less Investments & Deposits	(59,167)	(53,063)
Total	180,028	176,380

Borrowing Activity

3.4 The table below summarises the borrowing and repayment transactions in the period 1 October 2013 to 31 December 2013.

	Actual £000's
External Loans Repaid 1 October to 31 Dcember 2013	58
Borrowing undertaken 1 October to 31 December 2013	671
Net Movement in External Borrowing	**613**

3.5 No local bonds were repaid in the period 1 October 2013 to 31 December 2013.

3.6 No new local bonds were taken out in the period 1 October 2013 to 31 December 2013.

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 cash temporary borrowing has been minimal. The increase includes an additional £620k received for the Section 75 Agreement in respect of the Waitrose development which has been placed on temporary deposit.

	£000s	**% Rate**
Temp borrowing at 1 October 2013	727	0.49%
Temp borrowing at 31 December 2013	1,340	0.53%

Investment Activity

3.8 The average rate of return achieved on the Council's investments to 31 December 2013 was 0.784% compared to the average LIBID rate for the same period of 0.348% which demonstrates that the Council is achieving a reasonable rate of return on its cash investments. At the 31 December 2013 the Council had £53m of short term investment at an average rate of 0.784%. 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	5,500	0.40%	Short Term A-1, Long Term A
Bank of Scotland	31/10/2014	5,000	0.98%	
Bank of Scotland	16/12/2014	5,000	0.98%	
Royal Bank of Scotland	Instant Access	1,500	0.50%	Short Term A-2, Long Term A-
Royal Bank of Scotland	95 Days Notice	15,000	0.80%	
Clydesdale Bank	Instant Access	7,063	0.50%	Short Term A-2, Long Term BBB+
Handelsbanken	Instant Access	11,500	0.55%	Short Term A-1+, Long Term AA-
Handelsbanken	10 Day Notice	1,000	0.65%	
Handelsbanken	30 Day Notice	1,000	0.70%	
Santander	Instant Access	500	0.40%	Short Term A-1, Long Term A
Total		**53,063**		

3.9 The deposit with the Clydesdale Bank of £7.063m exceeded the limit of £5m due to the receipt of income during the Council closedown for the Christmas period, this increased to £9.998m on the 2nd of January when Council Tax income was received. Cash was transferred to another counterparty on the 3rd of January to bring the balance below the £5m limit but a further £803k of income was received after the cut off time for transferring funds outwith the Clydesdale Bank which was swept into the Instant Access Account in order to receive interest over the weekend. A further transfer was carried out of Monday the 6th of January to reduce the balance to under the £5m limit.

3.10 All other 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 counterparties.

3.11 The Council opened an Instant Access Account and 10 and 35 Day Notice Accounts with Svenska Handelsbanken AB a Swedish bank in October and November 2013 and placed cash on deposit with them on the 18th of December. The bank is well rated and meets the credit worthiness requirements for placing funds up to 100 days. The bank was chosen as it is offering reasonable rates of return and meets the requirements of the Annual Investment Strategy for the diversification of counterparties.

3.12 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.

3.13 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

3.14 The economic background for the period to 30 December 2013 is shown in appendix 1.

Prudential Indicators

3.15 The prudential indicators for 2013-14 are attached in appendix 2.

4 IMPLICATIONS

Policy -	None
Financial –	None
Legal -	None
HR -	None
Equalities -	None
Risk -	None
Customer Service -	None

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

Bruce West
Head of Strategic Finance
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Appendix 1

Economic background:

- The fourth quarter of 2013 saw:
    - Signs that GDP growth may have accelerated;
    - Evidence pointed to a moderation of household spending growth;
    - Inflation fell to its lowest level since November 2009;
    - Unemployment approached the MPC's 7% forward guidance threshold;
    - The MPC maintained the stance of monetary policy;
    - 10-year gilt yields rose to 3% and the FTSE 100 reach 6749;
    - The Federal Reserve decided to reduce the size of its monthly asset purchases by $10bn (from $85bn to $75bn).
- After growing at a healthy quarterly rate of 0.8% in Q3, some of the early signs are that GDP growth was even stronger in the final quarter of last year. On the basis of past form, the CIPS/Markit business activity surveys point to quarterly GDP growth of around 1.5% in the final quarter. The official data available for the fourth quarter so far have also been encouraging. For example, if October's 0.4% monthly expansion in industrial output was matched in the final two months of the year, quarterly growth in Q4 would have been almost 1%.
- Household spending growth, though, may have slowed. Numerous indicators of retail sales, including the official measure and those produced by the CBI and BRC, suggest that consumer spending growth was weak in the first two months of Q4. This is not to say the consumer recovery has run its course. Indeed, the CBI survey showed a strong pick-up in sales in December. And the official measure of retail sales in the same month will be boosted by the inclusion of 'Black Friday' (despite this actually falling in the last week of November) which more timely data suggests saw a strong surge in sales. But it would take monthly growth of 1.6% in December for retail sales just to flat line in Q4 as a whole.
- Nevertheless, growth in sales off the high street may not have done so badly. For instance, although growth in new car registrations slowed in Q4, it remained fairly strong, achieving 7% annual growth in December. So it still seems likely that overall household spending rose in the fourth quarter.

- Although it is still high, the unemployment rate has been falling quickly towards the Monetary Policy Committee's (MPC) 7% threshold for re-assessing the stance of monetary policy. Employment rose by 250,000 in the three months to October, the largest quarterly gain since mid-2010. This brought the unemployment rate down to 7.4%, compared to a rate of 7.7% in the three months to July. What's more, the ONS' experimental single-month estimate of unemployment reached 7% in October.
- The decline in unemployment, which has been faster than the MPC predicted in November, has prompted overnight index swap markets to price in a rate rise as soon as Q1 2015. But Committee members have increasingly emphasised that the 7% unemployment rate is a threshold for reconsidering policy, rather than a trigger for raising rates. Indeed, the Bank's Chief Economist Spencer Dale said that interest rates would remain low not just until unemployment had dropped, but also until the economy had "seen a prolonged period of strong growth...[and] real incomes are higher".
- The recent fall in, and improvement in the outlook for, inflation, suggests that interest rates will probably remain on hold even if the unemployment rate falls quickly to the 7% threshold. Indeed, CPI inflation has fallen quite sharply, reaching 2.1% in November. This was the lowest rate in four years. A number of factors contributed to this. Falling commodity prices put downward pressure on food and petrol prices, while sterling's 7% appreciation on a trade-weighted basis since its low point in July may have helped core inflation to fall. Admittedly, CPI inflation might have ticked up again in December when energy companies raised their prices. But inflation should continue to fall after that, given that commodity prices have been flat over the past year or so and sterling's recent strength has reduced import prices, which should begin feed into prices on the high street.
- The housing market continued to recover in Q4, supported by the earlier implementation of the mortgage guarantee element of the Government's Help to Buy Scheme. Prices rose at an annual rate of 8.4% and 6.4% in November according to the Halifax and Nationwide measures, respectively. And would-be buyers continue to enter the market more quickly than sellers, with the RICS survey pointing to further price rises. The cost of new mortgages remains low, too, with the quoted interest rate on a 5-year fixed mortgage at a 75% loan-to-value ratio at 3.36% in November, 2 basis points lower than the average in Q3 and 81 basis points lower than when the Funding for Lending Scheme (FLS) was introduced in July 2012. But talk of a housing bubble on the national level still seems to be wide of the mark, with prices well below their pre-crisis peak in real terms. Moreover, the FLS was adjusted so that it no longer provides cheap finance for mortgages.

- Meanwhile, there were few surprises in the Autumn Statement. The Chancellor announced a fiscally neutral package of policies, with measures to ease the cost of households' utility bills offset by further spending cuts. More bullish forecasts from the OBR left expected public borrowing over the next five years £73 billion lower than projected in the March Budget. All this left Mr Osborne expected to meet his primary fiscal mandate to balance the cyclically adjusted current budget in five years a year early, though he still misses the supplementary target for the debt to GDP ratio to be falling in 2015/16.
- Internationally, the biggest news was the Federal Reserve's decision at its December meeting to begin tapering its asset purchases. Although the announcement that the Fed's monthly purchases would be reduced by $10bn was not the consensus view, which saw tapering beginning in the early part of 2014, it was not a big surprise. The decision reflected the relative strength of the US labour market, which on average added over 200,000 jobs per month in the four months up to November.
- Markets took the Fed's move in their stride, with equities and bond yields up slightly on the day. Over the quarter, equities performed well domestically and overseas as economic prospects improved. The FTSE 100 was up by 4.4% to 6749, while the S&P 500 rose by almost 10%. Gilt yields also rose, with the ten-year rate ending Q4 28 basis points higher at 3%, having closely tracked US Treasury yields. Sterling rose by 2.3% against the dollar to finish the year at 1.66, while it rose by 0.5% against the euro to 1.20.
- Activity indicators in the Eurozone point towards continued weak, albeit positive, economic growth in the fourth quarter of 2013 after a mere 0.1% quarterly expansion in Q3. And disinflationary pressures are intense. Although CPI inflation rose from 0.7% to 0.9% in November, it remains well below the ECB's target of below but close to 2%. This is despite the ECB cutting its main refinancing rate by 25 basis points to 0.25% in November.

APPENDIX 2 : PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2013/14	2013/14	2014/15	2015/16
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT				
	Original Estimate	**Forecast Outturn**	**Forecast Outturn**	**Forecast Outturn**
Capital Expenditure	**£'000**	**£'000**	**£'000**	**£'000**
Non - HRA	35,045	33,402	50,185	44,218
TOTAL	35,045	33,402	50,185	44,218
Ratio of financing costs to net revenue stream				
Non - HRA	10.69%	10.69%	10.45%	10.22%
Net borrowing requirment				
brought forward 1 April *	271,150	271,150	272,695	279,355
carried forward 31 March *	272,695	272,695	279,355	278,621
in year borrowing requirement	1,545	1,545	6,660	(734)
In year Capital Financing Requirement				
Non - HRA	1,545	1,545	6,660	(734)
TOTAL	1,545	1,545	6,660	(734)
Capital Financing Requirement as at 31 March				
Non - HRA	272,695	272,695	279,355	278,621
TOTAL	272,695	272,695	279,355	278,621
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	6.28	6.28	17.68	1.15

PRUDENTIAL INDICATOR	2013/14	2014/15	2015/16
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
Authorised limit for external debt -			
borrowing	231,000	240,000	240,000
other long term liabilities	95,000	95,000	95,000
TOTAL	326,000	335,000	335,000
Operational boundary for external debt -			
borrowing	226,000	235,000	235,000
other long term liabilities	94,000	94,000	94,000
TOTAL	320,000	329,000	329,000
Upper limit for fixed interest rate exposure			
Principal re fixed rate borrowing	180%	140%	140%
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)	£20m	£20m	£20m

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%