Appendix 1

Argyll
Bute
COUNCIL

ANNUAL TREASURY REPORT

2013-2014

Annual Treasury Management Review 2013/14

1. Introduction

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 2013/14. 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 2013/14 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 21/3/2013)
- a mid-year (minimum) treasury update report (Council 28/11/2013)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

In addition, the Council has received quarterly treasury management update reports on 29/8/2013 and 20/3/2014.

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 Performance Review and Scrutiny Committee before they were reported to the full Council.

2. The Economy and Interest Rates

The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns, although levels of counterparty risk had subsided somewhat. The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it only to start gently rising from quarter 1 2015. This forecast rise has now been pushed back to a start in quarter 3 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during the year. Consequently there was no additional quantitative easing during 2013/14 and Bank Rate ended the year unchanged at 0.5% for the fifth successive year. While CPI inflation had remained stubbornly high and substantially above the 2% target during 2012, by January 2014 it had, at last, fallen below the target rate to 1.9% and then fell further to 1.7% in February. It is also expected to remain slightly below the target rate for most of the two years ahead.

Gilt yields were on a sharply rising trend during 2013 but volatility returned in the first quarter of 2014 as various fears sparked a flight to quality (see paragraph 4.) The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing into 2013/14. That part of the Scheme which supported the provision of credit for mortgages was terminated in the first quarter of 2014 as concerns rose over resurging house prices.

The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth has led to a cumulative, (in the Autumn Statement and the March Budget), reduction in the forecasts for total borrowing, of £97bn over the next five years, culminating in a £5bn surplus in 2018-19.

The EU sovereign debt crisis subsided during the year and confidence in the ability of the Eurozone to remain intact increased substantially. Perceptions of counterparty risk improved after the ECB statement in July 2012 that it would do "whatever it takes" to support struggling Eurozone countries; this led to a return of confidence in its banking system which has continued into 2013/14 and led to a move away from only very short term investing. However, this is not to say that the problems of the Eurozone, or its banks, have ended as the zone faces the likelihood of weak growth over the next few years at a time when the total size of government debt for some nations is likely to continue rising. Upcoming stress tests of Eurozone banks could also reveal some areas of concern.

3. Overall Treasury Position as at 31 March 2014

At the beginning and the end of 2013/14 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

TABLE 1	31 March 2013 Principal	Rate/ Return	Average Life yrs	31 March 2014 Principal	Rate/ Return	Average Life yrs
Total debt	***£161m***	***6.1%***	***31***	***£161m***	***6.1%***	***30***
CFR	***£177m***			***£180m***		
Over / (under) borrowing	***£16m***			***£19m***		
Total investments	***£34m***	***1.4%***		***£44m***	***0.77%***	
Net debt	**£127m**			**£117m**		

4. The Strategy for 2013/14

The expectation for interest rates within the strategy for 2013/14 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2013/14. 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 low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

The actual movement in gilt yields meant that PWLB rates were on a sharply rising trend during 2013 as markets anticipated the start of tapering of asset purchases by the Fed. This duly started in December 2013 and the US FOMC (the Fed.), adopted a future course of monthly reductions of $10bn (from a starting position of $85bn), meaning that asset purchases were likely to stop by the end of 2014. However, volatility set in during the first quarter of 2014 as fears around emerging markets, various vulnerabilities in the Chinese economy, the increasing danger for the Eurozone to drop into a deflationary spiral, and the situation in the Ukraine, caused rates to dip down, reflecting a flight to quality into UK gilts.

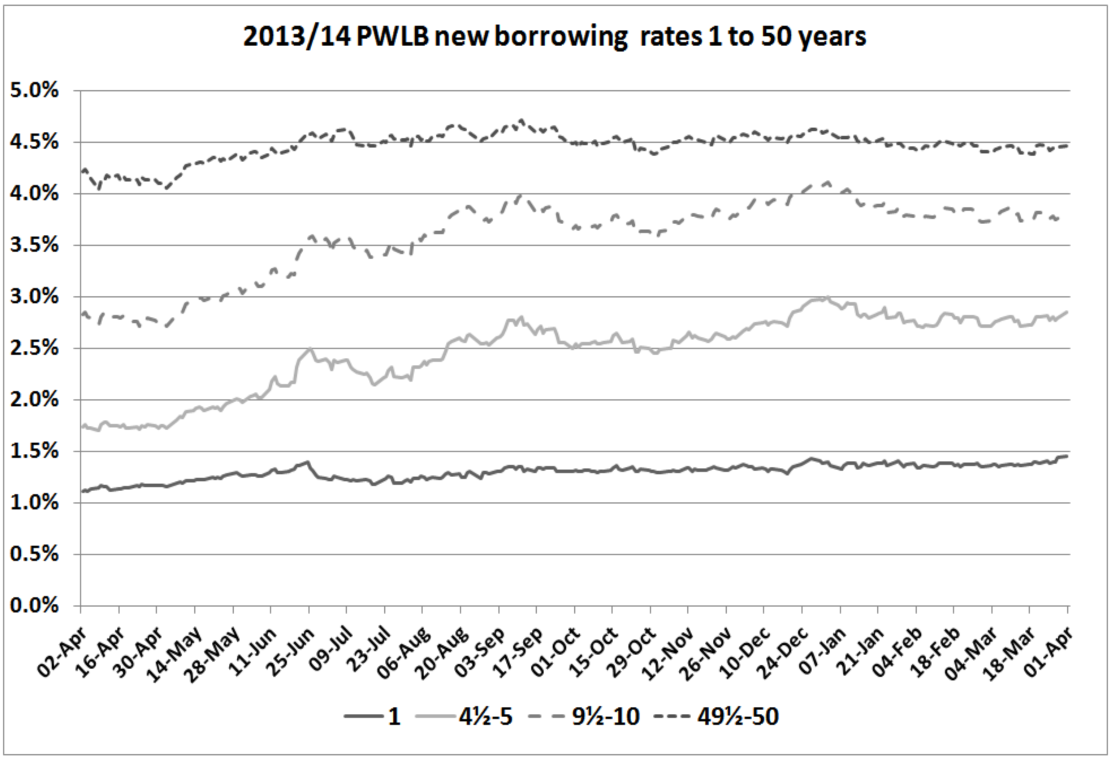
5. The Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

	31 March 2013 Actual	31 March 2014 Budget	31 March 2014 Actual
CFR General Fund (£m)	258	273	261
Less NPDO	81	81	81
Net CFR	177	192	180

6. Borrowing Rates in 2013/14

PWLB borrowing rates - the graph below shows how PWLB certainty rates have risen from historically very low levels during the year.



7. Borrowing Outturn for 2013/14

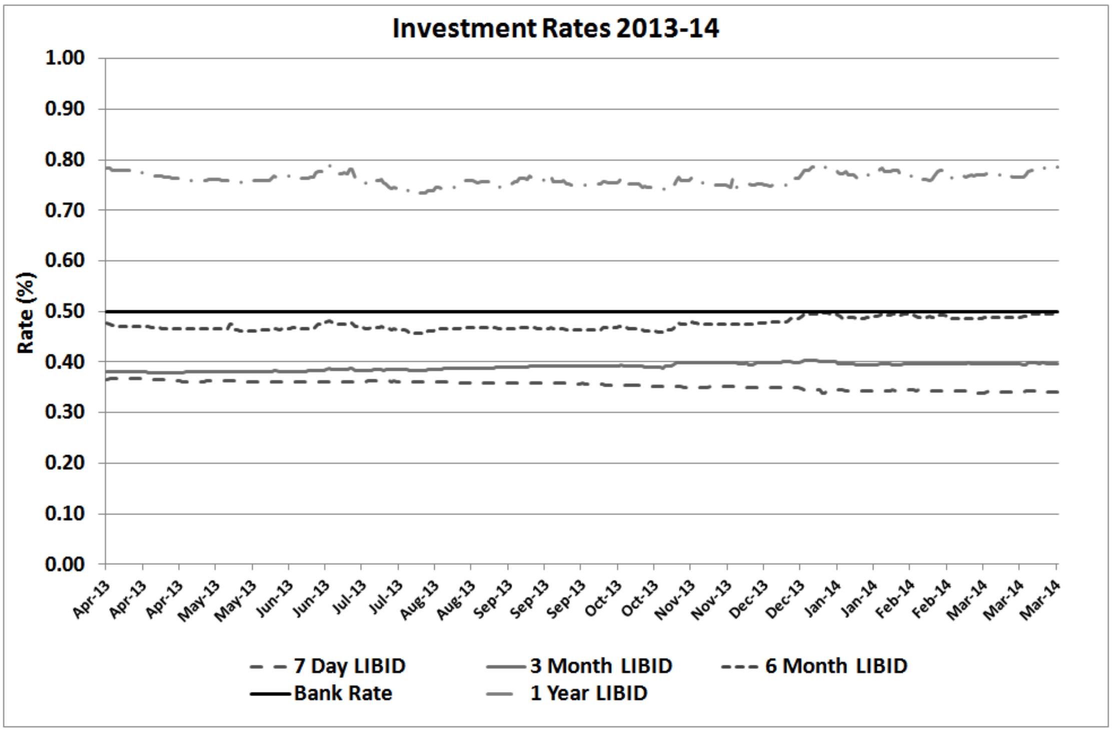
Borrowing – the following loans were taken during the year: -

Due to investment concerns, both counterparty risk and low investment returns, no long term borrowing was undertaken during the year.

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.

8. Investment Rates in 2013/14

Bank Rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for five years. Market expectations as to the timing of the start of monetary tightening ended up unchanged at early 2015. The Funding for Lending Scheme resulted in deposit rates remaining depressed during the whole of the year, although the part of the scheme supporting provision of credit for mortgages came to an end in the first quarter of 2014.



9. Investment Outturn for 2013/14

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 21/3/2113. 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.

Investments held by the Council - the Council maintained an average balance of £60m of internally managed funds. The internally managed funds earned an average rate of return of 0.812%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.354%.

Appendix 1: Prudential and Treasury Indicators

During 2013/14, 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:

Actual prudential and treasury indicators	2012/13 Actual £000	2013/14 Original £000	2013/14 Actual £000
Capital expenditure	35,140	35,045	34,462
Capital Financing Requirement	258,398	272,695	260,749
External debt	241,786	249,625	240,785
Investments	34,032	25,000	44,350
Net borrowing	207,754	224,625	196,435

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2013/14) plus the estimates of any additional capital financing requirement for the current (2014/15) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2013/14.

The authorised limit – this Council has kept within the authorised external borrowing limit as shown by the table below. Once this has been set, the Council does not have the power to borrow above this level.

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.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2013/14
Authorised limit	£326m
Maximum gross borrowing position	£242m
Operational boundary	£320m
Average gross borrowing position	£242m
Financing costs as a proportion of net revenue stream	10.69%

Ratio of financing costs to net revenue stream	31 March 2013 actual	2013/14 original limits	31 March 2014 actual
Non - HRA	11.70%	10.69%	10.69%

Incremental impact of capital investment decisions	31 March 2013 actual	2013/14 original limits	31 March 2014 actual
Increase in council tax (band D) per annum	£46.57	£6.28	£6.28

TABLE 1	31 March 2013 Principal		Rate/ Return	Average Life yrs	31 March 2014 Principal		Rate/ Return	Average Life yrs
Fixed rate funding:								
-PWLB	£108.1m				£108.1m			
-Market	**£12.5m**	£120.6m	6.8%	23	**£12.5m**	£120.6m	6.8%	22
Variable rate funding:								
-PWLB								
-Market	£39.2m	£39.2m	4.4%	56	£39.2m	£39.2m	4.4%	55
Temporary Loans		£0.8m	0.5%			£1.4m	0.3%	
Total debt		***£160.6m***	***6.1%***			***£161.2m***	***6.1%***	
CFR		***£177.0m***				***£180.0m***		
Over/ (under) borrowing		***£16.4m***				***£18.8m***		
Total investments		***£34.0m***	***1.4%***			***£44.4m***	***0.8%***	
Net debt		**£126.6m**				**£116.8m**		

The maturity structure of the debt portfolio was as follows:

	31 March 2013 actual	2013/14 original limits	31 March 2014 actual
Under 12 months	£0.743m	£48.122m	£9.661m
12 months and within 24 months	£8.353m	£48.122m	£10.605m
24 months and within 5 years	£33.841m	£48.122m	£23.237m
5 years and within 10 years	£17.541m	£64.163m	£17.541m
10 years and above	£100.137	£128.326m	£100.137m

All investments were for less than one year.

The exposure to fixed and variable rates was as follows:

	31 March 2013 actual	2013/14 original limits	31 March 2014 actual
Fixed rate (principal or interest)	95%	180%	103%
Variable rate (principal or interest)	32%	90%	35%