ARGYLL AND BUTE COUNCIL	PERFORMANCE REVIEW AND SCRUTINY COMMITTEE
STRATEGIC FINANCE	28 AUGUST 2014

TREASURY MANAGEMENT MONITORING REPORT 30 JUNE 2014

1. EXECUTIVE SUMMARY

1.1 This report is for noting its sets out the Council's treasury management position for the period 1 April 2014 to 30 June 2014 and includes information on :

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

1.2 The Council has not undertaken or made any repayments of long term debt in the period. Due to a reduced Capital Financing Requirement (CFR) of £256m at 31 March 2014 the estimated CFR for 31 March 2015 has reduced from £275m to £272m from that predicted in the budget at February 2014.

1.3 In respect of investment activity the level of investments have increased by £14.9m from £44.4m at 1 April 2014 to £59.2m at 30 June 2014. The rate of return achieved was 0.668% which compares favourably with the target of 7 day LIBID which was 0.348%.

1.4 On June 27th the Council's treasury advisors changed their credit assessment methodology. This arose from changes being introduced by the credit rating agencies. Due to the prudent approach taken in placing funds with counterparties this change had no impact on the counterparties currently used by the Council for investment. The changes will remove the assessment of sovereign support with Fitch and Moody agencies focussing on short and long term ratings which is an approach already adopted by Standard and Poors and also Capita Asset Services. Capita Asset Services will maintain a colour coded system that sets out a proposed maximum duration of an investment with a counterparty. The Council's Investment Strategy and Treasury Management Practice Statements are structured on this basis so no change to these is required.

ARGYLL AND BUTE COUNCIL	POLICY REVIEW AND SCRUTINY COMMITTEE
STRATEGIC FINANCE	28 AUGUST 2014

TREASURY MANAGEMENT MONITORING REPORT 30 JUNE 2014

2. INTRODUCTION

2.1 This report summarises the monitoring as at 30 June 2014 of the Council's:

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

3. RECOMMENDATIONS

3.1 The treasury management monitoring report is noted.

4. DETAIL

Overall Borrowing Position

4.1 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 2014/15 £000's	Budget 2014/15 £000's	Forecast 2015/16 £000's	Forecast 2016/17 £000's
CFR at 1 April	256,463	258,871	272,831	288,833
Net Capital Expenditure	34,809	34,809	27,786	(5,903)
Less Loans Fund Principal Repayments	(18,441)	(18,441)	(11,784)	(10,784)
Estimated CFR 31 March	**272,831**	**275,239**	**288,833**	**272,146**
Less Funded by NPDO	(79,603)	(79,603)	(78,055)	(76,507)
Estimated Net CFR 31 March	**193,228**	**195,636**	**210,778**	**195,639**
Estimated External Borrowing at 31 March	161,315	161,315	169,315	177,315
Gap	**31,913**	**34,321**	**41,463**	**18,324**

4.2 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.

4.3 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 31/03/2014 £000's	**Position at 30/06/2014 £000's**
Loans	161,181	161,221
Internal Balances	60,027	91,236
Less Investments & Deposits	(44,350)	(59,229)
Total	**176,858**	**193,228**

Borrowing Activity

4.4 The table below summarises the borrowing and repayment transactions in the period 1 April 2014 to 30 June 2014.

	Actual £000's
External Loans Repaid 1st April 2014 to 30 June 2014	1
Borrowing undertaken 1st April 2014 to 3oth June 2014	41
Net Movement in External Borrowing	**40**

4.5 Two local bonds were repaid in the period 1 April 2014 to 30 June 2014. Both of these Bonds were repaid to trust funds prior to the trust funds being transferred as part of the charities amalgamation programme

4.6 No new local bonds were taken out in the period 1 April 2014 to 30 June 2014

4.7 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 £35k received form three companies with regard to Section 69 Planning agreements which have been placed here pending a specific bank account being opened.

	£000s	**% Rate**
Temp borrowing at 31st March 2014	1,310	0.30%
Temp borrowing at 30th June 2014	1,351	0.30%

Investment Activity

4.8 The average rate of return achieved on the Council's investments to 30th June 2014 was 0.668% 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 30 June 2014 the Council had £59m of short term investment at an average rate of 0.668%. 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	10,000	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%	
Bank of Scotland	07/01/2015	5,000	0.95%	
Bank of Scotland	23/01/2015	5,000	0.95%	
Royal Bank of Scotland	Instant Access	50	0.25%	Short Term A-2, Long Term A-
Clydesdale Bank	Instant Access	3,929	0.50%	Short Term A-2, Long Term BBB+
Handelsbanken	35 Day Notice	20,000	0.65%	Short Term A-1+, Long Term AA-
Santander	Instant Access	5,250	0.40%	Short Term A-1, Long Term A
Total		**59,229**		

4.9 Deposits with the Clydesdale Bank exceeded the limit of £5m on the following date

Date	Amount over Limit £'s	Explanation
03/04/2014	343,000	Unexpected income received after the deadline for moving money had passed.

4.10 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.

4.11 During June 2014 our treasury advisors Capita Asset Services altered their credit assessment methodology to reflect changes that the three ratings agencies (Fitch, Moody's and Standard and Poor's) are proposing to make to their ratings to reflect the removal of sovereign support in the future.

4.12 Both Fitch and Moody's are proposing to remove their standalone ratings and these have been removed from the credit assessment methodology. The new methodology will focus solely on the Short and Long Term ratings of an institution. In addition, Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that Capita have always taken. Furthermore, Capita will continue to utilise CDS prices as an overlay to ratings in our new methodology.

4.13 Capita Asset Services will maintain the same "colour coding" duration suggestions. These will be based on the new range of rating categories. The new methodology will come into effect starting with the list to be sent out on Friday 27th June.

4.14 The change to the ratings provided by Capita Asset Services will have no impact on the Investment Strategy or the Treasury Management Practices of the Council as these are already structured on the basis of the colour coded approach being maintained by Capital Asset Service..

4.15 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.

4.16 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

4.17 The economic background for the period to 30 June 2014 is shown in appendix 1.

Prudential Indicators

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

5. CONCLUSION

5.1 The Council has taken no new long term borrowing or made any repayments during the three months to 30 June 2014. The investment returns were 0.668% which is above the target of 0.348%. During the period the credit methodology used by Capita Asset Services but this had no impact on the Council's counterparties.

6. IMPLICATIONS

6.1	Policy –	None.
6.2	Financial -	None
6.3	Legal -	None.
6.4	HR -	None.
6.5	Equalities -	None.
6.6	Risk -	None.

6.7 Customer Service - None.

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Appendix 1 – Economic background
Appendix 2 – Prudential Indicators

Appendix 1

Economic background:

- During the quarter ended 30th June 2014:
  - Indicators suggested that the economic recovery accelerated;
  - Household spending rose again;
  - Inflation fell to its lowest level since September 2009;
  - The ILO measure of unemployment fell further to 6.6%;
  - The MPC suggested that the economy might warrant higher interest rates before the end of the year;
  - Low tax receipts put the fiscal tightening slightly off track; and
  - The European Central Bank (ECB) made announcements designed to boost bank lending and counter the risk of deflation.
- After a healthy quarterly expansion in UK GDP of 0.8% in Q1, some of the early indicators point to growth accelerating in the second quarter. On the basis of past form, the CIPS/Markit business activity surveys point to quarterly GDP growth of around 1.5% in Q2. Admittedly, the composite PMI has tended to overstate the pace of the recovery over the past year. However, survey data was also encouraging on the strength of the recovery in Q2. All of the headline figures in April's industrial production release were encouraging. Indeed, even if production only manages to hold steady in the remaining two months of the quarter, it would still be 0.7% higher in Q2 overall than in Q1. That said, the £2.5bn trade deficit in April, compared to £1.7bn last year, highlights that the recovery is still struggling to rebalance towards exports.
- Meanwhile, household spending looks to have supported further GDP growth in Q2. While retail sales volumes fell by 0.5% on the previous month in May, following strong growth in April, the underlying trend remains strong as a combination of rapid jobs growth and falling prices continues to fuel a recovery in consumer spending. In addition, the more forward-looking survey balances of expected sales also point to solid growth in consumer spending in the near-term. Furthermore, non-high street spending remained robust too. Annual growth in new car registrations averaged around 5% in April and May and the Bank of England's Agents' Survey recorded the measure of consumer services turnover at its joint highest level in May since 1998. So it still seems likely that overall household spending strengthened in the second quarter.
- The labour market has continued its strong recovery. Employment rose by a huge 345,000 in the three months to April, by far the biggest increase

since records began in 1971. Despite an increase in the workforce, employment growth was enough to bring the headline (three-month average) unemployment rate down to 6.6% in April. In addition, the timelier claimant count measure of unemployment fell by 27,400 in May, potentially pointing to further falls in the broader ILO measure of unemployment. Nonetheless, pay growth has remained subdued, with headline annual growth (three month average) in average earnings (including bonuses) falling to 0.7% in April, well below inflation of 1.8%. Since real earnings have yet to rise, some consumers may be overstretching their finances in order to spend more.

- Meanwhile, after sending dovish messages through the May Inflation Report, the MPC's communications have now gone full circle, from trying to prevent interest rate expectations from rising too quickly via the introduction of forward guidance last summer, to trying to *raise* them now. A number of Committee members, including Governor Mark Carney, have warned of not-too-distant policy tightening.

- Indeed, the main factor that could dissuade the MPC from starting on an earlier path for increasing Bank Rate is inflation. CPI inflation fell to 1.5% in May, the lowest rate since late 2009. Recent developments, including sterling's further appreciation, falls in producer price inflation and very weak wages growth, suggest that CPI inflation could fall to as low as 1% later this year.

- Meanwhile, May's public borrowing figures contained tentative signs that the coalition is struggling to bring down the deficit in line with fiscal plans this year. The underlying measure of borrowing (PSNB ex. excluding APF and Royal Mail pension fund transfers) was £13.3bn in May, exceeding the consensus forecast of £12.2bn. The increase was largely driven by a drop in tax receipts, rather than strong increases in spending. Spending in April and May is around 9% higher than it was in the same period last year. However, it is still too early in the fiscal year to draw conclusions from these figures.

- One risk which continues to linger is an overheating housing market. Fears that a nationwide bubble is building will not have been assuaged by the Financial Policy Committee's (FPC) relatively timid action announced alongside June's Financial Stability Report. Indeed, the 15% limit on the proportion of the volume of new mortgages that can be advanced at a multiple of 4.5 times income or more is unlikely to prevent a further rise in high loan-to-income ratio lending, given that the limit is a fair way above the actual current proportion of 10%. Furthermore, the tweaks to the existing stress tests used to assess mortgage applicants seem unlikely to make a material difference either. Admittedly, the housing market has already shown some signs of slowing of its own accord. Indeed, approvals for new mortgages fell to an eleven-month low in May, and the new buyer enquiries balance of the RICS Housing Market Survey has continued to moderate. However, with supply remaining tight, further strong increases in house prices in the near-term look likely. Although the FPC could announce further measures at a later date, the timidity of its actions so far may have slightly increased the chances that the MPC could raise Bank Rate in the not too distant future.

- Internationally, the robust 217,000 increase in US non-farm payrolls in May is another encouraging sign that the economy is getting back on the right track after the weather-related weakness during the winter. The 0.6% m/m rise in US industrial production in May also suggests that activity is bouncing back. Meanwhile, the US Federal Reserve continued tapering its asset purchases by a further $10bn in June's policy meeting and highlighted that the benign outlook for inflation means monetary policy will remain loose for some time. The Fed lowered its forecasts for GDP growth and unemployment, but the FOMC's policy statement made no reference to the recent build up of price pressures.

- Activity indicators for the Eurozone suggest that the recovery only gained a little momentum in Q2. Moreover, the spectre of deflation continues to hang over the region. HICP inflation fell from 0.7% to 0.5% in May, the joint weakest rate since 2009 and far beneath the ECB's 2% price stability ceiling. Furthermore, unit labour costs have risen by just 0.1% in the past year. As developments in wages tend to affect wider measures of inflation after a short lag, the latest data suggests that consumer price inflation could fall even further. Accordingly, the ECB made a number of announcements in June designed to boost bank lending and counter deflationary risks, including rate cuts and potential asset purchases. However, the policies involved are not as bold as they might seem. The interest rate cuts were very small and the decision not to sterilise bond purchases made under the Securities Markets Programme amounts to just 1.7% of GDP.

- In the UK, equities continued to underperform, despite improving expectations for the strength and sustainability of the UK's recovery. Indeed, they have continued to underperform US equities, even though the consensus expects the UK to grow faster than the US in 2014. Meanwhile, gilt yields edged up – particularly at the short-end of the curve – following the MPC's communications in June, which were more hawkish than May's Inflation Report. In contrast, forward rates at the long end of the curve fell further, although it is not clear whether this is a result of pessimism about the UK's growth prospects in the long run, or a decline in the term premium which reflects uncertainty about the future path of interest rates.

APPENDIX 2 : PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2014/15	2014/15	2015/16	2016/17
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT				
	Original Estimate	**Forecast Outturn**	**Forecast Outturn**	**Forecast Outturn**
Capital Expenditure	**£'000**	**£'000**	**£'000**	**£'000**
Non - HRA	50,185	50,185	44,218	12,197
TOTAL	50,185	50,185	44,218	12,197
Ratio of financing costs to net revenue stream				
Non - HRA	10.98%	10.98%	8.24%	7.96%
Net borrowing requirment				
brought forward 1 April *	258,871	258,871	275,239	291,241
carried forward 31 March *	275,239	275,239	291,241	274,554
in year borrowing requirement	16,368	16,368	16,002	(16,687)
In year Capital Financing Requirement				
Non - HRA	16,368	16,368	16,002	(16,687)
TOTAL	16,368	16,368	16,002	(16,687)
Capital Financing Requirement as at 31 March				
Non - HRA	275,239	275,239	291,241	274,554
TOTAL	275,239	275,239	291,241	274,554
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	69.61	69.61	60.80	(12.92)

PRUDENTIAL INDICATOR	2014/15	2015/16	2016/17
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
Authorised limit for external debt -			
borrowing	203,000	220,000	205,000
other long term liabilities	81,000	80,000	78,000
TOTAL	284,000	300,000	283,000
Operational boundary for external debt -			
borrowing	198,000	215,000	200,000
other long term liabilities	78,000	77,000	75,000
TOTAL	276,000	292,000	275,000
Upper limit for fixed interest rate exposure			
Principal re fixed rate borrowing	195%	190%	190%
Upper limit for variable rate exposure			
Principal re variable rate borrowing	60%	60%	60%
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 2014/15	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%