ARGYLL AND BUTE COUNCIL	**PERFORMANCE REVIEW AND SCRUTINY COMMITTEE**
HEAD OF STRATEGIC FINANCE	**22 AUGUST 2013**

TREASURY MANAGEMENT MONITORING REPORT – 30 JUNE 2013

1 SUMMARY

1.1 This report summarises the monitoring as at 30 June 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	272,893	292,977
Net Capital Expenditure	32,536	19,586	37,676	5,683
Less Loans Fund Principal Repayments	(18,041)	(18,041)	(17,592)	(12,123)
Estimated CFR 31 March	**272,893**	**272,695**	**292,977**	**286,537**
Less Funded by NPDO	(79,218)	(79,218)	(77,968)	(76,718)
Estimated Net CFR 31 March	**193,675**	**193,477**	**215,009**	**209,819**
Estimated External Borrowing at 31 March	170,407	170,407	175,407	180,407
Gap	**23,268**	**23,070**	**39,602**	**29,412**

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 30 June 2013 is £193.675m. 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 £60.7m is currently invested.

	Position at 31/3/2013 £000's	**Position at 30/6/2013 £000's**
Loans	160,615	160,585
Internal Balances	50,645	93,772
Less Investments & Deposits	(34,032)	(60,682)
Total	177,228	193,675

Borrowing Activity

3.4 The table below summarises the borrowing and repayment transactions in the period 1 September 2012 to 30 June 2013.

	Actual £000's
External Loans Repaid 1 April to 30 June 2013	30
Borrowing undertaken 1 April to 30 June 2013	0
Net Movement in External Borrowing	**(30)**

3.5 No local bonds were repaid in the period 1 April 2013 to 30 June 2013.

3.6 No new loans were taken out in the period 1 April 2013 to 30 June 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 costs temporary borrowing has been minimal.

	£000s	**% Rate**
Temp borrowing at 1 April 2013	743	0.49%
Temp borrowing at 30 June 2013	713	0.49%

Investment Activity

3.8 The average rate of return achieved on the Council's investments to 30 June 2013 was 0.824% compared to the average LIBID rate for the same period of 0.361% which demonstrates that the Council is achieving a reasonable rate of return on its cash investments. At the 30 June 2013 the Council had £60.7m of short term investment at an average rate of 0.841%. 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	8,000	0.40%	Short Term A-1, Long Term A
Bank of Scotland	13/12/2013	20,000	1.35%	
Royal Bank of Scotland	Instant Access	16,000	0.50%	Short Term A-1, Long Term A
Royal Bank of Scotland	95 Days Notice	15,000	0.80%	
Clydesdale Bank	Instant Access	1,682	0.50%	Short Term A-2, Long Term BBB+
Total		**60,682**		

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 June 2013 is shown in appendix 1.

Prudential Indicators

3.13 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:

- During the quarter ended 30th June: -
  - Indicators suggested that the economy accelerated;
  - Stronger household spending, both on and off the high street;
  - Inflation remained stubbornly above the MPC's 2% target;
  - The MPC remained in a state of limbo ahead of Mark Carney's arrival;
  - 10-year gilt yields rose above 2.5% and the FTSE 100 fell below 6,100;
  - The Federal Reserve discussed tapering the pace of asset purchases under Quantitative Easing 3 (QE3).

- After avoiding recession in the first quarter with a 0.3% quarterly expansion, it looks likely that the economy grew even more strongly in Q2. On the basis of past form, the CIPS/Markit business surveys for April and May point to 0.5% quarterly growth in the second quarter of 2013. Official output data echoed the message from the business surveys. The 3m/3m change in industrial production reached 0.9% in April, the strongest pace since July 2010. Similarly, the service sector expanded by 0.8% on the same basis. And while output in the volatile construction sector in April was 1% lower than a year ago, it was the smallest annual fall since the end of 2011, raising the prospect that the sector supported the recovery in Q2.

- There have been signs of renewed vigour in household spending in the second quarter. May's 2.1% monthly rise in retail sales overturned April's 1.1% fall. This tallied with information from the Bank of England agents, who reported a further pick-up in retail sales values in May. Non-high street spending looks to have been robust too, with new car registrations up by 20% in the year to May.

- The pick-up in economic growth appears to have supported the labour market, with employment rising by 24,000 in the three months to April. Admittedly, this was a lot slower than the 113,000 quarterly gain in employment seen on average over the past twelve months. But the rise in employment was still strong enough to reduce the level of unemployment further. The ILO measure fell by 5,000 in the three months to April while the timelier claimant count measure reported an 8,600 fall in May. Meanwhile, pay growth rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the additional rate of income tax. Excluding bonuses, earnings rose by just 1.3% y/y, well below the rate of inflation at 2.7% in May.

- Meanwhile, the Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with the quoted interest rate on a 2-year fixed rate mortgage at a 90% loan-to-value ratio now 4.6%, around 130 basis-points lower in May than when the FLS was introduced in August 2012.

- Alongside the Government's Help to Buy scheme, which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. Mortgage approvals by high street banks, as measured by the BBA, rose from 33,000 to 36,100 in May. Excluding a stamp-duty holiday related spike in January 2012, this was the highest level for over three years. The rise in demand has helped to push up house prices, with both the Halifax and Nationwide measures reporting a 0.4% monthly gain in May. On an annual basis, measured prices were up by 3.7% and 1.1% respectively.
- Turning to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in Q2 looked to be broadly in line with last year's figures, highlighting the government's difficulty in reducing borrowing while economic growth is relatively lacklustre.
- Meanwhile, the 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan. Total expenditure was still forecast to be broadly flat in real terms in 2015/16 and the £50bn planned capital expenditure announced for that fiscal year was identical to the amount already outlined in March's Budget.
- On the monetary policy front, June's MPC meeting, the last chaired by the outgoing Governor Mervyn King, showed that the Committee remained in limbo ahead of the arrival of his replacement, Mark Carney. The Committee voted 6-3 to keep the level of asset purchases unchanged at £375bn, with the majority judging that the current stimulus and Funding for Lending Scheme would be sufficient to support growth in the context of price stability.
- Having fallen from 2.8% to 2.4% in April, CPI inflation rose to 2.7% in May. May's rise mostly reflected price changes due to the earlier timing of Easter, which depressed inflation in April. Even so, inflation is still likely to have risen further in June due to base effects, with last year's fuel price falls providing an unfavourable annual comparison. That said, underlying price pressures do seem to be easing, with wages and producer prices both growing at subdued rates. Indeed, if anything, the inflation outlook brightened over the second quarter, with the price of oil falling from $108pb to $103pb while sterling appreciated by around 1.5% on a trade-weighted basis.
- Having continued to rally over April and May, financial markets sold off in June following a Federal Reserve statement that suggested the central bank may 'taper' its asset purchases earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK, with 10 year gilt yields rising to 2.5%

from 1.8% at the start of the quarter. Equities were hit too, with the FTSE 100 falling from 6,411 at the start of the quarter to below 6,100 before ending the quarter a bit higher at 6,240.

- In the US, the statement from the Fed took the limelight. The Fed's comments sparked a sharp sell-off in the Treasury market, with 10-year Treasury yields hitting 2.54%. The Fed move was a response to the improving economic outlook in the US. Indeed, payroll figures showed that the US added 175,000 new jobs in May, helping to pull the unemployment rate down to 7.6%, from 8.2% a year ago. In the housing market, house prices rose by 12% in the year to April, which helped to bring more households out of negative equity.
- Meanwhile, tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a potential flare-up. For example, the Democratic Left party left the Greek governing coalition in June, causing 10 year Greek government bond yields to surge to 11.5% from around 8% a month ago. And while the economic survey data improved consistently over the first half of the year, the composite Eurozone PMI is still pointing to a further contraction in output in Q2. If this materialises, it would be the seventh quarter of Eurozone recession, the longest on record.

APPENDIX 2 : PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2013/14	2013/14	2014/15	2015/16
(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	35,045	35,045	41,826	24,716
TOTAL	35,045	35,045	41,826	24,716
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%