ARGYLL AND BUTE COUNCIL HEAD OF STRATEGIC FINANCE	EXECUTIVE 4 NOVEMBER 2010

TREASURY MANAGEMENT MONITORING REPORT – 30 SEPTEMBER 2010

1 INTRODUCTION

1.1 This report summarises the monitoring as at 30 September 2010 of the Council's:

- Overall Borrowing Position
- Borrowing Activity
- Investment Activity
- Changes to PWLB interest rate margins
- Economic Forecast
- Prudential Indicators.

2 RECOMMENDATIONS

2.1 The treasury management monitoring report is noted.

2.2 The target interest rate for new borrowing is increased from 4.20% to 5.00%.

3 DETAIL

Overall Borrowing Position

3.1 The table below details the estimated capital financing requirement and compares this with the estimated level of external debt at the 31 March 2011. The CFR represents the underlying need for the Council to borrow to fund its fixed assets and accumulated capital expenditure.

	Forecast 2010/11 £000's	**Budget 2010/11 £000's**	**Forecast 2011/12 £000's**	**Forecast 2012/13 £000's**
CFR at 1 April	279,940	279,940	286,136	286,781
Net Capital Expenditure	23,353	26,958	24,626	15,844
Less Loans Fund Principal Repayment	(21,183)	(21,183)	(22,004)	(22,894)
Estimated CFR 31 March	**282,110**	**288,713**	**288,758**	**279,731**
Less Funded By NPDO	(85,856)	(85,856)	(85,151)	(84,446)
Estimated Net CFR 31 March	**196,254**	**202,857**	**203,607**	**195,285**
Estimated External Borrowing at 31 March	145,916	150,376	165,032	181,147
Gap	**50,338**	**52,481**	**38,575**	**14,138**

3.2 Borrowing is currently estimated to be below the CFR for the period to 2012/13. 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 2010 is £199.670m. 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 £52m is currently invested.

	Position at 31/6/2010 £000's	Position at 30/9/2010 £000's
Loans	151,937	168,867
Internal Balances	75,513	82,831
Less Investments & Deposits	(28,314)	(52,028)
Total	199,136	199,670

Borrowing Activity

3.4 The table below summarises the borrowing and repayment transactions in the period 1 July 2010 to 30 September 2010.

	Actual £000's
External Loans Repaid to 30 September 2010	(000)
Borrowing undertaken 1 July to 30 September 2010	17,000
Net Movement in External Borrowing	**17,000**

3.5 Repayment of £0.0 million has taken place during the period 1 July 2010 to 30 September 2010.. The full details of the loan repaid are shown in the table below.

No of Loans	Amount £'m	Average Rate	Average Life	Action
0	0.00	0%	0	
0	0.00	0%	0	

3.6 New borrowing of £17m has been taken during the period 1 July 2010 to 30 September 2010.. Details of the loans taken are shown in the table below.

No of Loans	Amount £'m	Average Rate	Average Life	Action
1	3.50	3.51%	9 years	New loan 27 July 2010
1	3.50	3.87%	12 years	New loan 27 July2010
1	10.00	3.95%	50 years	New loan 27 August 2010
3	17.00	3.776%	23.6 years	

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 2010	561	2.76
Temp borrowing at 30 September 2010	491	3.1

Investment Activity

3.8 The average rate of return achieved on the Council's investments to 30 September 2010 was 0.75% compared to the average LIBID rate for the same period of 0.43% which demonstrates that the Council is achieving a reasonable rate of return on its cash investments. At the 30 September 2010 the Council had £52.0m of short term investment at an average rate of 0.75%. The table below details the counterparties that the investments were placed with and the credit rating applicable for each of the counterparties.

Counterparty	Investment £	Rating
Bank of Scotland	10.1m	Short Term F1+, Long Term AA-
Clydesdale bank	41.9m	Short Term F1+, Long Term AA-
Total	**52.0m**	

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 . Deposits are for a maximum period of three months.

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.

Economic Forecast

3.11 The economic background for the period to 30 September 2010 and the economic forecast for the period to September 2012 are shown in appendix 1.

Prudential Indicators

3.12 The prudential indicators for 2010-2011 are attached in appendix 2.

Change to PWLB Interest Rates

3.13 As part of the spending review the Government has changed the interest rate margin that the PWLB add to the loans made to local authorities to 1% over the cost at which the PWLB can borrow. The impact of this change is to increase the rates at which the Council can borrow from the PWLB by approximately 0.80% across the periods for which new borrowing can be taken. This change became effective on the 20th of October 2010.

3.14 As a result of this change in PWLB margins the target interest rate for new long term borrowing will require to be increased from 4.20% to 5.00%.

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Appendix 1

Economic Background:

The quarter ended 30th September 2010 saw the following:

- Activity indicators suggest that the recovery has faded sharply since the second quarter (1st April to 30th June);
- The pace of recovery in retail spending is slowing, but the recovery in spending off the high street gather pace;
- Further doubt cast on the sustainability of the recovery in the labour market;
- The recovery in the housing market falter;
- Disappointment that the public finances are not on a clearly improving trend;
- The UK's trade deficit widen further, despite the continued weakness of sterling;
- CPI inflation fall at a slower pace than in the second quarter;
- The doves on the Monetary Policy Committee gain the upper hand;
- Equity and bond markets respond in different ways to the news that the recovery is faltering;
- The recoveries in the US and euro-zone lose further pace.

Activity indicators have suggested that the recovery has lost considerable pace since real GDP (Gross Domestic Product) expanded by 1.2% q/q in the second quarter of 2010. The weighted average of the output balances of the CIPS/Markit surveys fell from an average of 55.5 in Q1 to 52.6 in Q2. As the surveys tend to lead the official GDP data, the surveys are consistent with quarterly growth in GDP slowing to around only 0.2% by the end of the year (well below the long term average of about 0.5%)

The recovery off the high street may have picked up at a faster pace in Q2 but the recovery in retail spending through shops seems to have deteriorated over the quarter as retail sales volumes fell by 0.5% on the previous month in August. An average fall of -18 in Q1 to -20 in Q2 in consumer confidence (reported by GfK) may have also played a role in the fall in retail spending.

Further doubt has been cast on the sustainability of the recovery in the labour market. The ILO measure of unemployment was around 8,000 lower in the 3 months to July although employment actually rose by 286,000 over the same period.

The recovery in the housing market has also begun to falter. Only 47,400 mortgages for new house purchase were approved in August on the Bank of England's official measure; this is nearly 20% lower than at the end of 2010. Furthermore, the Nationwide house price index fell by 0.5% and 0.8% in July and August respectively before rising by 0.1% in September.

August's public finances figures severely dented hopes that the fiscal position is on a clearly improving trend. The public borrowing figure (on the PSNB ex. measure) of £15.9bn in August was nearly £2bn larger than at the same time a year ago. However, this figure still left a cumulative borrowing total in the first five months of the fiscal year of £58.1bn, around £4bn below last year's equivalent figure of £61.9bn. The UK's trade deficit widened further in the third quarter, despite the continued weakness of sterling. The trade in goods deficit rose from £7.5bn to £8.7bn in July which was the largest deficit on record.

CPI (consumer price inflation) inflation fell from 3.2% to 3.1% in July, and remained unchanged in August. Inflation therefore fell in this quarter but at a slower pace than in the previous quarter. While oil price inflation has begun to ease, an easing in clothes deflation and a pick-up in food and drink inflation were responsible for preventing CPI inflation from falling further in August. The Bank of England's quarterly Inflation Report in August once again projected inflation to fall to below the 2% target and remain there at the two year policy horizon. The MPC (Monetary Policy Committee) voted to maintain the outstanding stock of asset purchases under quantitative easing (QE) at £200bn at each meeting in the quarter. The minutes to September's MPC meeting revealed that for most members "the probability that further action would become necessary to stimulate the economy and keep inflation on track to hit the target in the medium term had increased." Also, the majority of members on the MPC voted in each meeting to keep official interest rates on hold, apart from Andrew Sentence who voted for a 25bp rise.

APPENDIX 2 : PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2010/11	2010/11	2011/12	2012/13
(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	32,417	32,417	34,202	20,716
TOTAL	32,417	32,417	34,202	20,716
Ratio of financing costs to net revenue stream				
Non - HRA	11.68%	11.68%	11.90%	12.14%
Net borrowing requirment				
brought forward 1 April *	279,940	279,940	286,012	291,683
carried forward 31 March *	286,012	286,012	291,683	280,378
in year borrowing requirement	6,072	6,072	5,671	(11,305)
In year Capital Financing Requirement				
Non - HRA	6,072	6,072	5,671	(11,305)
TOTAL	6,072	6,072	5,671	(11,305)
Capital Financing Requirement as at 31 March				
Non - HRA	286,012	286,012	291,683	280,378
TOTAL	286,012	286,012	291,683	280,378
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	31.57	31.57	46.27	24.15

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000
Authorised limit for external debt -			
borrowing	239,000	231,000	217,000
other long term liabilities	91,500	91,500	91,500
TOTAL	330,500	322,500	308,500
Operational boundary for external debt -			
borrowing	234,000	226,000	212,000
other long term liabilities	88,500	88,500	88,500
TOTAL	322,500	314,500	300,500
Upper limit for fixed interest rate exposure			
Principal re fixed rate borrowing	100%	100%	100%
Upper limit for variable rate exposure			
Principal re variable rate borrowing	30%	30%	30%
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 2008/09	upper limit	lower limit
under 12 months	30%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	75%	0%
10 years and above	90%	10%