

TREASURY MANAGEMENT MONITORING REPORT – 30 SEPTEMBER 2011

1 INTRODUCTION

- 1.1 This report summarises the monitoring as at 30 September 2011 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.
- 2.2 In line with the Council Constitution part C paragraphs 2.2.2(5) to agree that the Head of Strategic Finance is permitted to retain a maximum deposit of £5m with the Clydesdale Bank.
- 2.3 The Executive recommend to the Council that the Investment Strategy be amended to allow up to £5m to held in the Instant Access Account with the Clydesdale Bank

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 2012. The CFR represents the underlying need for the Council to borrow to fund its fixed assets and accumulated capital expenditure.

	Forecast 2011/12 £000's	Budget 2011/12 £000's	Forecast 2012/13 £000's	Forecast 2013/14 £000's
CFR at 1 April	264,298	279,431	267,874	255,254
Net Capital Expenditure	25,580	23,264	10,274	7,363
Less Loans Fund Principal Repayments	(22,004)	(22,004)	(22,894)	(23,574)
<b>Estimated CFR 31 March</b>	<b>267,874</b>	<b>280,691</b>	<b>255,254</b>	<b>239,043</b>
Less Funded by NPDO	(81,921)	(81,921)	(80,719)	(79,517)
<b>Estimated Net CFR 31 March</b>	<b>185,953</b>	<b>198,770</b>	<b>174,535</b>	<b>159,526</b>
Estimated External Borrowing at 31 March	160,341	165,032	160,341	160,341
<b>Gap</b>	<b>25,612</b>	<b>33,738</b>	<b>14,194</b>	<b>(815)</b>

- 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 2011 is £185.953m. 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 £49m is currently invested.

	at 30/6/2011 £000's	at 30/9/2011 £000's
Loans	160,339	160,315
Internal Balances	75,933	74,667
Less Investments & Deposits	(50,656)	(49,029)
<b>Total</b>	<b>185,616</b>	<b>185,953</b>

### ***Borrowing Activity***

- 3.4 The table below summarises the borrowing and repayment transactions in the period 1 July 2011 to 30 September 2011.

	Actual £000's
External Loans Repaid 1 July to 30 September 2011	24
Borrowing undertaken 1 July to 30 September 2011	0
<b>Net Movement in External Borrowing</b>	<b>24</b>

- 3.5 No repayments have been made in the period 1 July 2011 to 30 September 2011.
- 3.6 No new borrowing has been taken during the period 1 July 2011 to 30 September 2011.
- 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 30 June 2011	464	0.14
Temp borrowing at 30 September 2011	440	0.15

### ***Investment Activity***

- 3.8 The average rate of return achieved on the Council's investments to 30 September 2011 was 0.62% compared to the average LIBID rate for the same period of

0.47% which demonstrates that the Council is achieving a reasonable rate of return on its cash investments. At the 30 September 2011 the Council had £49m of short term investment at an average rate of 0.663%. 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	20.0m	Short Term F1+, Long Term AA-
Clydesdale Bank	29.0m	Short Term F1+, Long Term A+
<b>Total</b>	<b>49.0m</b>	

- 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.

### ***Clydesdale Bank***

- 3.12 On 1 December 2011 Standard and Poors, one of the three rating agencies downgraded the Clydesdale Bank from A+ to BBB+. The consequence of this rating change was to remove the Clydesdale Bank from the list of approved counterparties.
- 3.13 At the start of the day on 2 December 2011 the Council had a total of £31.8m of cash with the Clydesdale Bank in the following accounts which was reduced to £14.6m at the end of the day:

Notice Period	Opening Balance £000s	Closing Balance £000s
Instant Access (Telebank)	1	1
Instant Access Treasury Account	21,775	4,581
15 Day Notice Account	5,000	5,000
30 Day Notice Account	5,000	5,000
<b>Total</b>	<b>31,776</b>	<b>14,582</b>

- 3.14 Following a meeting between the Head of Strategic Finance and the Finance Manager for Development and Infrastructure the following actions were taken:
- Notice was given to withdraw the funds from the two notice accounts £10m.
  - £17.5m was moved from the instant access account to an instant access account with the Royal Bank of Scotland.
  - The Spokesperson for Resources and the Chief Executive were informed about the downgrading and of the action taken.
- 3.15 The £10m on which notice has been given will be reinvested in institutions in accordance with the approved investment strategy and credit rating criteria and/or money market funds again in line with the approved investment strategy and credit rating criteria.
- 3.16 The Clydesdale Bank are the Council's retail bank and as such there is a need to hold some funds with them for treasury cash flow purposes and it is recommended that the Council's Investment Strategy be amended to allow up to a maximum of £5m be held within the Instant Access Account. The Executive is asked to approve this course of action in terms of the Council Constitution part C paragraph 2.2.2(5) and recommend to the Council that the Investment Strategy is amended accordingly.

#### ***Economic Forecast***

- 3.17 The economic background for the period to 30 September 2011 is shown in appendix 1.

#### ***Prudential Indicators***

- 3.18 The prudential indicators for 2011-2012 are attached in appendix 2.

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7 December 2011

## Economic background:

### Global economy

The Euro zone sovereign debt crisis continued with Spain, and particularly Italy, being the focus of renewed market concerns that they may soon join with Greece, Ireland and Portugal in needing assistance. This uncertainty and the lack of a co-ordinated or credible Euro zone response, left commentators concerned over the potential impact of sovereign default and resulting effect on the Euro zone banking sector. The approval by various countries of the £440bn bail out fund in September has brought temporary relief to financial markets but this does not provide a credible remedy to the scale of the Greek debt problem or the sheer magnitude of the potential needs of other countries for support.

This, coupled with political difficulties in the US over their plans to address the budget deficit, the size and control over the US sovereign debt, and the subsequent loss of the AAA credit rating from Standard and Poors, has led to a much more difficult and uncertain outlook for the world economy.

Growth prospects in the US, UK and the Euro zone have been lower than expected, with future prospects similarly cut. Whilst not a central view, concerns of a double dip recession in some Western countries have increased. World stock markets fell in the second quarter of 2011/12 as a consequence.

### UK economy

Following zero growth in the final half of 2010/11 the UK economy grew by a weaker than expected 0.2% in the first quarter of 2011/12, providing a knock on effect to future growth prospects. Growth prospects will be governed by UK consumer sentiment, which is currently subdued due to falling disposable income. Higher VAT, overhanging debt, high inflation and concerns over employment are likely to weigh heavily on consumers into the future.

Inflation remains stubbornly high, although the expectation of future falls, the external nature of the price increases (energy, oil, food etc.), and the negative impact a rate rise would have on the UK economy, is likely to stop the Monetary Policy Committee from raising the Bank Rate for some considerable time to come. An indicator of the worsening position arose from the Monetary Policy Committee minutes recently signalling a greater willingness to expand the quantitative easing programme

International investors continue to view UK government gilts as being a safe haven from the EU sovereign debt crisis. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and sent PwLB borrowing rates to low levels.

## Outlook for the next six months of 2011/12

There remain huge uncertainties in economic forecasts due to the following major difficulties:

- the speed of economic recovery in the UK, US and EU;
- the likely political gridlock in the US preventing significant government fiscal action to boost growth ahead of the Presidential elections in November 2012
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy
- the degree to which government austerity programmes will dampen economic growth;
- the potential for more quantitative easing, and the timing of this in both the UK and US
- the speed of recovery of banks' profitability and balance sheet imbalances

The overall balance of risks is weighted to the downside:

- We expect low and modest growth in the UK to continue, with a low Bank Rate to continue for at least 12 months, coupled with a possible extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB borrowing rates is for them to rise, primarily due to the need for a high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. However the current safe haven status of the UK may continue for some time, postponing any increases until 2012.

**APPENDIX 2 : PRUDENTIAL INDICATORS**

PRUDENTIAL INDICATOR	2011/12	2011/12	2012/13	2013/14
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	£ p	£ p	£ p	
	Original Estimate	Forecast Outturn	Forecast Outturn	Forecast Outturn
	£'000	£'000	£'000	£'000
<b>Capital Expenditure</b>				
Non - HRA	23,264	23,264	10,274	7,363
TOTAL	23,264	23,264	10,274	7,363
<b>Ratio of financing costs to net revenue stream</b>				
Non - HRA	11.68%	11.68%	11.90%	12.14%
<b>Net borrowing requirement</b>				
brought forward 1 April *	279,431	279,431	282,122	271,086
carried forward 31 March *	282,122	282,122	271,086	257,124
in year borrowing requirement	2,691	2,691	(11,036)	(13,962)
<b>In year Capital Financing Requirement</b>				
Non - HRA	2,691	2,691	(11,036)	(13,962)
TOTAL	2,691	2,691	(11,036)	(13,962)
<b>Capital Financing Requirement as at 31 March</b>				
Non - HRA	282,122	282,122	271,086	257,124
TOTAL	282,122	282,122	271,086	257,124
<b>Incremental impact of capital investment decisions</b>	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	32.40	32.40	7.99	(12.02)

PRUDENTIAL INDICATOR	2010/11	2011/12	2012/13
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000
<b>Authorised limit for external debt - borrowing</b>			
other long term liabilities	240,000	239,000	231,000
TOTAL	331,500	330,500	322,500
<b>Operational boundary for external debt - borrowing</b>			
other long term liabilities	235,000	234,000	226,000
TOTAL	323,500	322,500	314,500
<b>Upper limit for fixed interest rate exposure</b>			
Principal re fixed rate borrowing	100%	100%	100%
<b>Upper limit for variable rate exposure</b>			
Principal re variable rate borrowing	30%	30%	30%
<b>Upper limit for total principal sums invested for over 364 days (per maturity date)</b>	£10m	£10m	£10m

Maturity structure of new fixed rate borrowing during 2011/12	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%