ARGYLL AND BUTE COUNCIL **COUNCIL**
HEAD OF STRATEGIC FINANCE **28 NOVEMBER 2013**

TREASURY MANAGEMENT MONITORING REPORT – 30 SEPTEMBER 2013

1 SUMMARY

1.1 This report summarises the monitoring as at 30 September 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	272,776	292,860
Net Capital Expenditure	32,419	19,586	37,676	5,683
Less Loans Fund Principal Repayments	(18,041)	(18,041)	(17,592)	(12,123)
Estimated CFR 31 March	**272,776**	**272,695**	**292,860**	**286,420**
Less Funded by NPDO	(79,218)	(79,218)	(77,968)	(76,718)
Estimated Net CFR 31 March	**193,558**	**193,477**	**214,892**	**209,702**
Estimated External Borrowing at 31 March	170,407	170,407	175,407	180,407
Gap	**23,151**	**23,070**	**39,485**	**29,295**

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 September 2013 is £193.558m. 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 £59.2m is currently invested.

	Position at 30/6/2013 £000's	**Position at 30/6/2013 £000's**
Loans	160,585	160,598
Internal Balances	93,772	92,127
Less Investments & Deposits	(60,682)	(59,167)
Total	193,675	193,558

Borrowing Activity

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

	Actual £000's
External Loans Repaid 1 July to 30 September 2013	0
Borrowing undertaken 1 July to 30 September 2013	12
Net Movement in External Borrowing	**12**

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

3.6 No new loans were taken out in the period 1 June 2013 to 30 September 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 June 2013	713	0.49%
Temp borrowing at 30 Sept 2013	727	0.49%

Investment Activity

3.8 The average rate of return achieved on the Council's investments to 30 September 2013 was 0.865% compared to the average LIBID rate for the same period of 0.358% which demonstrates that the Council is achieving a reasonable rate of return on its cash investments. At the 30 September 2013 the Council had £59.2m of short term investment at an average rate of 0.924%. 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	500	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	2,500	0.50%	Short Term A-1, Long Term A
Royal Bank of Scotland	95 Days Notice	15,000	0.80%	
Clydesdale Bank	Instant Access	3,662	0.50%	Short Term A-2, Long Term BBB+
Barclays	35 Day Notice	7,005	0.57%	Short Term A-1, Long Term A
Santander	Instant Access	10,500	0.80%	Short Term A-1, Long Term A
Total		**59,167**		

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 September 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

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Appendix 1

Economic background:

- The quarter ended 30 September saw:
  - Indicators suggested that the economic recovery accelerated;
  - Household spending growth remained robust;
  - Inflation fell back towards the 2% target;
  - The Bank of England introduced state-contingent forward guidance;
  - 10-year gilt yields rose to 3% at their peak and the FTSE 100 fell slightly to 6460;
  - The Federal Reserve decided to maintain the monthly rate of its asset purchases.
- After strong growth of 0.7% in Q2, it appears that UK GDP is likely to have grown at an even faster pace in Q3. On the basis of past form, the CIPS/Markit business surveys for July and August point to quarterly growth of potentially over 1.0% in the third quarter of 2013. Similarly, the official data have continued to improve. Admittedly, industrial production was flat in July. But even if it held steady in the rest of the quarter, it would still be 0.9% higher in Q3 than in Q2. In addition, the service sector expanded by 0.2% m/m and the construction sector grew by 2.2% m/m in July after growth of 1.8% q/q in Q2.
- Consumer spending also continued to rise and may beat the increase seen in Q2. While the 1.1% monthly rise in retail sales in July was almost entirely offset by a 0.9% fall in August, the unusually warm weather in August is likely to have had a part to play in this. The retail surveys also painted a positive picture for household spending growth, with the Bank of England's Agents' Scores, BRC and CBI retail sales indicators showing stronger growth in Q3. And while growth in non-high street spending may have slowed, it probably remained robust. For example, although annual growth in new car registrations eased from the 24% rate seen in Q2, it was still a strong 15% in August.
- The run of good news on the labour market continued, with the ILO unemployment rate falling to 7.7% in July from 7.8% in June. Employment rose by 80,000 in the three months to July, supported by an even bigger rise in full-time employment. This meant that the ratio of full-time to part-time workers continued to rise after it troughed last summer. The timelier claimant count measure of the unemployment rate also fell. Indeed, the cumulative fall in unemployment of 68,900 in July and August – the biggest two month fall since

May and June 1997 – brought the claimant count unemployment rate down from 4.4% at the end of Q2 to 4.2% in August. Despite this, the headline (3 month average of the annual) rate of pay growth fell from 2.2% in June to just 1.1% in July. Excluding bonuses, earnings growth ticked up slightly to 1.1% y/y, but this remained well below the rate of CPI inflation at 2.7% in August, meaning real wages continued to fall.

- Meanwhile, the cost of new credit has continued to fall, perhaps in response to the extension of the Bank of England's Funding for Lending Scheme (FLS) earlier this year. The quoted interest rate on a 5-year fixed mortgage at a 75% loan-to-value ratio was 3.34% in August, 7 basis points lower than in June and 77 basis points lower than when the FLS was introduced in July 2012.
- Demand in the housing market continued to grow at a fast pace, supported by the FLS and the Government's Help to Buy scheme, which provide equity loans to credit-constrained borrowers. The RICS housing market survey reported that new buyer enquiries hit their highest level on record in August. Mortgage approvals for new house purchase rose to their highest level since February 2008 in August. Consequently, house prices continued to rise, with the Halifax and Nationwide measures recording 6.2% and 3.5% y/y rises in August, respectively. ONS data, though, shows that in real terms only London experienced year-on-year price rises in July. All other regions saw modest falls.
- The economic recovery may finally be feeding through to the public finances. Although the government registered a surprise deficit in July (a month that normally delivers a surplus), in August net borrowing was 'just' £13.2bn, compared to £14.4bn in August 2012.
- The new Governor of the Bank of England, Mark Carney, took office in July. Alongside the August Quarterly Inflation Report, the Bank introduced its new policy of forward guidance in which the Monetary Policy Committee (MPC) pledged not to raise official interest rates, or reduce the size of the asset purchase facility, until the ILO unemployment rate falls to 7%. At this point, the MPC would discuss whether or not to alter official policy. This guidance was subject to three 'knockouts' which, if breached, would invalidate the guidance. These are that the MPC forecasts inflation at or above 2.5% in 18-24 months' time, inflation expectations are no longer sufficiently well anchored or financial stability is threatened by the stance of monetary policy. On the MPC's current forecasts, the unemployment rate is most likely to reach 7% in late 2016.
- However, financial markets continued to price in increases in Bank Rate by mid-2015, with overnight index swap rates and gilt yields rising after the

announcement of forward guidance. Members of the MPC subsequently appeared at the Treasury Select Committee and three gave further speeches to clarify the guidance, but there was little market impact. However, the Bank of England's surveys suggest the message may have got through to the public as the balance of people expecting interest rates to rise over the next 12 months fell from 29% in May to 24% in August.

- Meanwhile, CPI inflation fell from a 2013 peak of 2.9% in June to 2.7% in August. The fall was primarily the result of a drop in the contribution from petrol prices and a reduction in core inflation from 2.3% in June to 2% in August. CPI inflation looks likely to have edged down again in September, perhaps to about 2.5%, reflecting a further fading of both energy prices and core inflation.

- The big news in financial markets was that the Federal Reserve unexpectedly decided not to taper its asset purchases in September. In announcing its decision to maintain monthly purchases at $85bn, the Fed explained that it wanted to *"await more evidence that [the economic recovery] will be sustained before adjusting the pace of its purchases."* This came despite previous hints of tapering from the Fed and the fall in the unemployment rate in both July and August. It currently stands at 7.3%.

- Across the quarter as a whole, advanced economy bond markets sold off, suggesting the rise in UK gilt yields was not solely down to markets' scepticism about domestic forward guidance. Gilt yields tracked US Treasury yields up, with ten-year gilts rising by around 60 basis points to reach 3% in early September for the first time since mid-2011. After the Fed's decision not to taper, gilt yields fell back, although not enough to offset the previous rise. Ten-year gilts finished the quarter at 2.7%. Equity markets stayed relatively flat over the quarter. While the FTSE 100 rose from 6470 to 6620 over the first few weeks of June, the index closed the quarter at 6462.

- Meanwhile, Eurozone business surveys suggested that the economy continued to expand in Q3, albeit at a moderate pace. There was also a general election in Germany in which the incumbent Chancellor, Angela Merkel, performed better than expected by winning 41.5% of the vote. She is now likely to form a coalition, but it remains to be seen what form this will take.

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%