Appendix 1

Mid Year Monitoring Report 2013/14
Treasury Management and Prudential Indicators
1 April 2013 to 31 August 2013

1 Introduction

1.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government in Scotland Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Scottish Ministers to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made as yet during 201314;

- Statutory Instrument (SSI) 29 2004, requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities, and therefore to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services; and the treasury activity with regard to the CIPFA Code of Practice for Treasury Management in Local Authorities.

1.2 The regulatory framework of treasury management requires that the Council receive a mid year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously. This report meets that requirement and also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The treasury strategy and PIs were previously reported to Council on 27 March 2013. The current position is shown (where appropriate) and revisions to the 2013/14 estimate are provided where required.

1.3 This report sets out:

- Key changes to the Council's capital activity (the prudential indicators);

- The economic outlook;

- The actual and proposed treasury management activity (borrowing and investment); and

- The risk approach to treasury management (the treasury management indicators).

2 Key Prudential Indicators

2.1 This part of the report is structured to update:

- The Council's capital expenditure plans and how these plans are being financed;
- The impact of the changes in the capital expenditure plans on the PIs and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

2.2 **Capital Expenditure** – Table A shows the current position and revised estimates for capital expenditure for 2013/14 only. The original estimate has been revised from the General Services capital plan which was approved by Members on 6 February 2013 and has increased by £12.672m due to slippage of capital spend from 2012/13 carried forward into 2013/14 and additional grants and contributions from external bodies.

Table A:

£000	**2013/14 Original Estimate**	**Current Position**	**2013/14 Revised Estimate**
General Services	25,942	9,353	39,204
HRA	39,413	9,328	38,823
Capital Expenditure	**65,355**	**18,681**	**78,027**
Financed by:			
Capital receipts	3,669	641	5,253
Capital grants	16,798	6,224	18,044
Revenue	7,137	0	6,812
Net financing need for the year	**37,751**	**11,816**	**47,918**

2.3 **Impact of changes in Capital Expenditure Plans** – Table B shows the CFR, which is the underlying external need to borrow for a capital purpose while Table C shows the expected debt position over the period.

2.3.1 The reduction in the level of debt at 1 April between original estimate and revised estimate (as detailed in Table C) is due to the fact that no new capital borrowing was undertaken during 2012/13.

2.3.2 The CFR is calculated on a year end position based on the Council's balance sheet and therefore the current position is not shown. The CFR has not materially changed since originally set in March 2013 and the Executive Director of Corporate Services can report that the Council is on target to meet the 2013/14 revised estimates for both indicators.

Table B:

£000	**2013/14 Original Estimate**	**2013/14 Revised Estimate**
Capital Financing Requirement		
CFR – General Services	216,374	218,253
CFR – HRA	140,214	137,470
Total CFR	**356,588**	**355,723**
Movement in CFR (from Previous year)	19,997	30,352
Movement in CFR Represented by		
Net financing need for the year (from Table A, above)	37,751	47,918
Less loan repayments in year	(16,537)	(16,366)
New Borrowing : CFR	**21,214**	**31,552**
Less Long Term Liability repayment in years	(1,217)	(1,200)
Movement in CFR	**19,997**	**30,352**

Table C:

£000	**2013/14 Original Estimate**	**Current Position**	**2013/14 Revised Estimate**
External Debt			
Debt at 1 April 2013	236,751	218,226	218,226
Maturing Debt	(7,980)	(19,382)	(31,874)
New Borrowing : Maturing Debt	7,950	14,400	31,900
New Borrowing : CFR	21,214	0	31,552
Debt at 31 March (1)	**257,935**	**213,244**	**249,804**
Long Term Liabilities (LTL) at 1 April	91,912	91,442	91,442
Expected change in LTL	(1,217)	(500)	(1,200)
LTL at 31 March (2)	**90,695**	**90,942**	**90,242**
Actual Debt at 31 March (1) + (2)	**348,630**	**304,186**	**340,046**
CFR from Table B	**356,588**	**n/a**	**355,723**
Under/(Over) Borrowing	**7,958**	**n/a**	**15,677**

2.3.3 Table C highlights that the Council is forecast to be under borrowed by £15.677m at 31 March 2014 when compared to the CFR. This is due to the treasury management policy over the last few years which has been to use investment income to fund the replacement of naturally maturing debt and capital expenditure where possible. This policy resulted in lower debt position as at 1 April 2013 than anticipated. The reason behind this decision is explained further in section 4.2.

2.4 **Compliance with the limits in place for borrowing activity** – The first key control over the treasury activity is a PI to ensure that over the medium term, gross borrowing will only be for a capital purpose. Gross borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and next two financial years. This allows some flexibility for limited early borrowing for future years.

The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent. As discussed in section 2.3, above the current position is not shown since the CFR is calculated on a year end position. The revised indicator is detailed in Table D and the Executive Director of Corporate Services reports that no difficulties are envisaged for the current year in complying with this PI.

Table D:

£000	**2013/14 Original Estimate**	**2013/14 Revised Estimate**
CFR at 31 March 2013		
2012/13 Actual	336,591	325,371
Estimated movement in CFR		
2013/14	19,997	30,352
2014/15	37,197	37,851
2015/16	52,178	51,375
Anticipated CFR at 31 March 2016	**446,963**	**444,949**
Gross Debt at 31 March 2013	**328,663**	**309,668**

2.4.1 The Operational Boundary is detailed in Table E below and is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Table E:

£000	**2013/14 Original Estimate**	**Current Position**	**2013/14 Revised Estimate**
External Debt	383,493	334,605	374,051

2.4.2 A further PI controls the overall level of borrowing. This is the Authorised Limit which is detailed in Table F and represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Table F:

£000	**2013/14 Original Estimate**	**Current Position**	**2013/14 Revised Estimate**
External Debt	418,356	365,023	408,056

3 Economic Outlook

3.1 **UK Economy** - In Mervyn King's last Inflation Report as Governor of the Bank of England, there was a distinct shift towards optimism in terms of a marginal upgrading of growth forecasts. In addition, there was a lowering of the inflation forecast to now hit the 2% target within two years. However, this is still a long way away from strong recovery though the chances of more quantitative easing (QE) has receded due to business surveys indicating that the economy is on the up.

3.1.2 Mark Carney started on 1st July as the new Governor of the Bank of England. His appointment could lead to some changes to the way the MPC operates and makes decisions and announcements. Forward guidance e.g. that Bank Rate will not go up until some target rate, e.g. unemployment, falls to a specified level has potentially closed the door to any increase in Bank Rate until sometime in 2016.

3.2 **Global Economy** – A summary of the global economic outlook is noted below.

3.2.1 **Eurozone** - Most Eurozone countries are now battling against recession, although Germany is experiencing a resurgence of business confidence and surveys are pointing towards a resumption of growth. Growth prospects for many Eurozone countries are poor due to the need to adopt austerity programmes to bring government deficits under control. The ECB cut its central rate from 0.75% to 0.5% in this quarter but this is unlikely to lead to much in the way of improvement in the prospects for GDP growth.

3.2.2 **US** - There has been a marked improvement in consumer, investor and business confidence this year along with a decline in unemployment to 7.6%, however this is still a long way from the target rate of 6.5%.

3.2.3 **China** - GDP growth has been disappointing in 2013. There are still concerns around an unbalanced economy which is heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector.

3.3 **Forward View** - Economic forecasting remains difficult with so many external influences weighing on the UK. Key areas of uncertainty include:

- The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis;
- The Italian political situation is frail and unstable;
- Problems in other Eurozone heavily indebted countries could also generate safe haven flows into UK gilts;
- Monetary policy action failing to stimulate growth in western economies, especially the Eurozone and Japan;
- The potential for weak growth or recession in the UK's main trading partners - the EU and US;
- The impact of the UK Government's austerity plan in dampening confidence and growth; and
- Geopolitical risks e.g. Syria, Iran, North Korea.

3.3.1 The overall balance of risks to economic recovery in the UK is now evenly weighted. Sector believes that the longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Near-term, the prospect of further QE has diminished but measures other than QE may be more favoured by Governor Carney if additional support is viewed as being required.

3.3.2 Given the generally weak outlook for economic growth, Sector sees the prospects for any increase in Bank Rate before 2015 as limited. Indeed, the first increase could be even further delayed if the tentative signs of growth failed to be maintained.

3.4 Interest Rate Movements and Expectations which take into account the economic outlook as described above are detailed in Table G below.

Table G:

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%
5yr PWLB rate	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.40%
10yr PWLB rate	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%	3.50%
25yr PWLB rate	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%	4.60%
50yr PWLB rate	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%	4.70%

Source: Sector Interest Rate View July 2013

4 Treasury Management Activity

4.1 This part of the report is structured to update:

- The Council's expected borrowing need and details of under/(over) borrowing;
- Debt rescheduling and new borrowing;
- Debt charges; and
- Investments.

4.2 **The Expected Borrowing Need** – This was set out in Table C and demonstrates that the Council is currently under-borrowed to reduce risks in investments held and the cost of carry on investments (investments yield up to 1%, long term borrowing rates for periods greater than 25 years are approximately 4.5%). This introduces an element of interest rate risk, as longer term borrowing rates may rise; however, this position is being carefully monitored.

4.3 **Debt rescheduling and new borrowing** – During the first half of 2013/14 the Council prematurely repaid a PWLB variable rate loan at a rate of 1.60% and replaced it with a loan from another Local Authority at 0.40%. The Council has also repaid naturally maturing debt of £14.500m in July 2013 which was funded by 2 new temporary loans of £10.000m and a new long term market loan of £5.000m.

4.4 **Debt Charges** – The revised estimate for debt charges for both the General Fund and the HRA is shown in Table H.

Table H:

£000	2012/13 Original Estimate	Current Position	2013/14 Revised Estimate
Borrowing	27,784	11,531	27,675
Other Long Term Liabilities	7,943	3,283	7,880
Total	35,727	14,814	35,555

4.5 **Investments** – The objectives of the Council's investment strategy are the safeguarding of the re-payment of the principal and interest of its investments on time with the investment return being a secondary objective. Following on from the economic background above, the current investment climate has one over-riding risk consideration which is the risk of default. As a result of these underlying concerns, officers continue to implement an operational investment strategy which tightens the controls already in place in the approved investment strategy.

4.5.1 The Council held £4.298m of investments at 31/08/2013, and the constituent parts of the investment position are detailed in Table I:

Table I:

£000	Country	< 1 Year	1 – 2 Years	2 – 3 Years
Banks	UK	4,298	Nil	Nil
Total		4,298	Nil	Nil

4.5.2 Table J details the revised budget position for investment income. The original estimate has been reduced by £0.120m due to the utilisation of investment income in lieu of new long term borrowing (as noted in 4.3).

Table J:

£000	2013/14 Original Estimate	Current Position	2013/14 Revised Estimate
Investment Income	180	20	60

4.5.3 A regulatory development to address risk is the consideration and approval of security, liquidity and yield benchmarks. Yield benchmarks are currently widely used to assess investment performance, however the application of security and liquidity benchmarks are more subjective in nature.

- **Security** - The Council's maximum security risk benchmark for the current portfolio in relation to investment periods of up to one year (when compared to historic default tables) was set at 0.08% and the Executive Director of Corporate Services can report that there have been no defaults of principal sums invested in the year to date.

- **Liquidity** – The Executive Director of Corporate Services can report that liquidity arrangements were adequate during the year to date and that the liquidity facilities and benchmarks set by the Council as noted below were maintained:

- Bank overdraft - £1.000m; and
- Liquid short term deposits of at least £5.000m available on an overnight basis.

- **Yield** – The Executive Director of Corporate Services can report that investment return to date average 0.59%. Table K illustrates how this average return compares with the local measures of yield investment benchmarks approved in March 2013.

Table K:

Benchmark	Benchmark Return	Average Return
Internal returns above the 7 day LIBID rate	0.36%	0.59%
Internal returns above the 1 month LIBID rate	0.37%	0.59%
Internal returns above the Council's Instant Access Account	0.50%	0.59%

4.5.4 The current investment counterparty criteria selection approved by Members in March 2013 meets the requirement of the treasury management function and no changes to the criteria are recommended at this time.

5 Key Treasury Management Indicators

5.1 This part of the report is structured to update:

- Actual and estimates of the ratio of financing costs to net revenue stream;
- Upper limits on interest rate exposure:
- The maturity structure of borrowing; and
- Total principal sums invested.

5.2 **Actual and estimates of the ratio of financing costs to net revenue stream** – This indicator (as shown below in Table L) identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream

Table L:

	2013/14 Original Estimate	2013/14 Revised Estimate
General Fund	6.84%	6.95%
HRA	38.22%	36.24%

5.3 **Upper Limits On Fixed and Variable Rate Exposure** – These indicators identify a maximum limit for fixed and variable interest rates based upon the debt position and were set at 100% and 50% respectively for 2013/14. The Executive Director of Corporate Services can report that no limits were breached in the year to date.

5.4 **Maturity Structures Of Borrowing** – These maximum limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) which are due to naturally mature in any given period as detailed in Table M.

Table M:

Maturity Structure of Fixed Interest Rate Borrowing	2013/14 Original Estimate	Current Position	2013/14 Revised Estimate
Under 12 months	50%	45.31%	50%
12 months to 2 years	50%	10.38%	50%
2 years to 5 years	50%	14.03%	50%
5 years to 10 years	50%	7.80%	50%
10 years to 20 years	50%	3.11%	50%
20 years to 30 years	50%	1.39%	50%
30 years to 40 years	50%	12.38%	50%
40 years to 50 years	100%	5.58%	100%
50 years to 60 years	100%	0%	100%
60 years to 70 years	100%	0%	100%

5.5 **Total Principal Funds Invested** – These limits are set to reduce the need to temporarily borrow to cover any unexpected expenditure, and show limits to be placed on investments with final maturities beyond each year-end. The Council does not currently invest sums for periods greater than 364 days, however as any potential investment in hub West Scotland would be for a period greater than 364 days a new indication is required and the limit is detailed in Table N.

Table N:

£000 Principal sums invested > 364 days	2013/14 Original Estimate	Current Position	2013/14 Revised Estimate
Over 12 months	0	0	1,000