Appendix 1

Mid Year Monitoring Report 2011/12
Treasury Management and Prudential Indicators - 1 April 2011 to 30 September 2011

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 2011/12);
- 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 during 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 30 March 2011. The current position is shown (where appropriate) and revisions to the 2011/12 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).
- 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. The revised estimate for capital expenditure during 2011/12 has increased by £6.043m from the original estimate due to additional grants and contributions from both the revenue account and external bodies.

Table A:

£000	2011/12 Original Estimate	Current Position	2011/12 Revised Estimate
Capital Expenditure	**34,483**	**9,620**	**40,526**
Capital receipts	4,193	538	3,797
Capital grants	8,060	2,602	11,979
Govt supported borrowing	5,070	2,113	5,070
Revenue	0	290	1,703
Net financing need for the year	**17,837**	**1,847**	**17,977**

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 2010/11.

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 Executive Director of Corporate Services can report however that the Council is on target to meet the 2011/12 revised estimates for both indicators.

Table B:

£000	2011/12 Original Estimate	2011/12 Revised Estimate
CFR – Non Housing	223,513	218,815
CFR – Housing	104,355	107,895
Total CFR	**327,868**	**326,710**
Movement in CFR	5,604	(1,158)

Table C:

£000	2011/12 Original Estimate	Current Position	2011/12 Revised Estimate
Debt at 1 April	319,830	313,286	313,286
Maturing Debt	(36)	(17)	(36)
New Borrowing : Maturing Debt	0	0	0
New Borrowing : CFR	6,002	1,437	6,808
Debt at 31 March	**325,796**	**314,706**	**318,957**
Operational Boundary	**358,376**	**346,177**	**350,852**
Investments at 31 March	12,930	26,206	10,548

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, net borrowing (borrowings less investments) will only be for a capital purpose. Net external 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 2011/12 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	2011/12 Original Estimate	2011/12 Revised Estimate
Gross Debt	325,796	318,957
Investments	12,786	10,548
Net Debt	313,010	308,409
CFR	327,868	326,710

2.4.1 A further PI controls the overall level of borrowing. This is the Authorised Limit which is detailed in Table E 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 E:

(£000)	2011/12 Original Estimate	Current Position	2011/12 Revised Estimate
Authorised Limit for External Debt	390,955	377,648	382,748

3 Economic Outlook

3.1 **Global Economy** - The Euro zone sovereign debt crisis, 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.

3.1.2 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

3.2 **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.

3.2.1 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

3.2.2 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.

3.3 **Outlook for the next six months of 2011/12** - There remains 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.

3.3.1 Taking into account the overall balance of risks the UK economy is expected to continue to show low and modest growth. It is expected that a low bank rate will continue for at least 12 months, coupled with a possible extension of quantitative easing which will keep investment returns depressed.

3.3.2 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 save haven status of the UK may continue for some time, postponing any increases until 2012.

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

Table F:

Date	Bank Rate	Money Rates		PWLB Rates		
		3 Month	1 Year	5 Year	25 Year	50 Year
Now	0.50%	0.82%	1.58%	2.45%	4.56%	4.72%
Dec 2011	0.50%	0.70%	1.50%	2.70%	5.00%	5.00%
Mar 2012	0.50%	0.70%	1.50%	2.90%	5.10%	5.10%
Jun 2012	0.50%	0.70%	1.60%	3.00%	5.10%	5.10%
Sep 2012	0.50%	0.70%	1.80%	3.10%	5.10%	5.10%
Dec 2012	0.75%	0.90%	2.00%	3.20%	5.20%	5.20%
Mar 2013	1.00%	1.10%	2.25%	3.40%	5.20%	5.20%
Jun 2013	1.25%	1.30%	2.50%	3.60%	5.30%	5.30%
Sep 2013	1.50%	1.60%	2.75%	3.80%	5.40%	5.40%
Dec 2013	1.75%	1.90%	3.00%	4.00%	5.40%	5.40%
Mar 2014	2.25%	2.40%	3.40%	4.10%	5.50%	5.50%

Source: Sector Interest Rate View Oct 2011

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; and
- Debt charges.
- Investments

4.2 **The Expected Borrowing Need** – This is set out in Table G and demonstrates that the Council is currently under-borrowed to address investment counterparty risk 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.

Table G:

£000	2011/12 Original Estimate	2011/12 Revised Estimate
CFR	327,868	326,710
Less Other Long Term Liabilities	93,743	90,716
Net Adjusted CFR	234,125	235,994
Actual/Estimated Borrowing at 31 March	232,052	226,571
Under/(Over) Borrowing	2,073	9,423

4.3 **Debt rescheduling and new borrowing** – During the first half of 2011/12 no debt rescheduling exercises have been undertaken.

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	2011/12 Original Estimate	Current Position	2011/12 Revised Estimate
Borrowing	29,702	13,065	28,570
Other Long Term Liabilities	7,919	4,135	8,270
Total	37,621	17,200	36,840

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, that of counterparty risk. 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 £26.222m of investments at 30/09/2010, 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	18,222	Nil	Nil
Local Authorities	UK	8,000	Nil	Nil
Total		26,222	Nil	Nil

4.5.2 Table J details the revised budget position for investment income:

Table J:

£000	2011/12 Original Estimate	Current Position	2011/12 Revised Estimate
Investment Income	160	87	186

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
  - 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 0.74%. Table K illustrates how this average return compares with the local measures of yield investment benchmarks approved in March 2011.

Table K:

Benchmark	Benchmark Return	Average Return
Internal returns above the 7 day LIBID rate	0.50%	0.74%
Internal returns above the 1 month LIBID rate	0.57%	0.74%
Internal returns above the Council's Instant Access Account	0.50%	0.74%

4.5.4 The current investment counterparty criteria selection approved by Members in March 2011 is meeting the requirement of the treasury management function and is no changes 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. The reduction in the estimated HRA financing costs percentage for 2010/11 is due to a reduction in estimated loan charges.

Table L:

	2011/12 Original Estimate	2011/12 Revised Estimate
Non HRA	6.84%	6.66%
HRA	43.61%	38.68%

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 30% respectively for 2011/12. 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 O.

Table M:

Maturity Structure of Fixed Interest Rate Borrowing	2011/12 Original Estimate	Current Position	2011/12 Revised Estimate
Under 12 months	15%	0%	15%
12 months to 2 years	15%	12%	15%
2 years to 5 years	30%	15%	30%
5 years to 10 years	50%	14%	50%
10 years to 20 years	50%	5%	50%
20 years to 30 years	50%	1%	50%
30 years to 40 years	50%	13%	50%
40 years to 50 years	100%	10%	100%
50 years to 60 years	100%	16%	100%
60 years to 70 years	100%	14%	100%

5.5 **Total Principal Funds Invested** – These limits are set to reduce the need for early sale of an investment, and show limits to be placed on investments with final maturities beyond each year-end. The Council does not invest sums for periods greater than 364 days and therefore this indicator is not applicable.