Treasury Management Mid-Year Review Report 2013/14

Report by Gary Fairley, Head of Finance and Human Resources

1 Purpose of Report

The purpose of this report is to inform members of the Treasury Management activity undertaken during the first half of 2013/14, the forecast activity for the second half of 2013/14, and update the Prudential Indicators for 2013/14.

2 Background

Council, on 05 February 2013, approved the Treasury Management and Annual Investment Strategy Statement for the financial year 2013/14.

3. Treasury Activity during first half of 2013/14

A detailed report on the activity during 2013/14, to 30 September 2013, is enclosed as Appendix A. The main points arising from treasury activity during the first half of 2013/14 were:

- The average interest rate earned on external investments was 1.46%, more than double the benchmark rate of 0.51%. The comparator figure for the half-year in 2012/13 was 2.11% (and full year equivalent 2.09%), with the year-on-year drop reflective of the challenging economic and investment environment;
- Total long term borrowing in the half year was £10 million;
- No debt rescheduling has been undertaken during the period;
- Due to the challenging low investment return environment, the maturing £12.1m short-term investment with Lloyds Banking Group was used to finance the unsupported element of the Council's Capital Plans (internal borrowing), eliminating the cost of carry of 2-3% of holding this investment, by deferring borrowing costs of 3-4% per annum and foregoing investment returns of sub 1% per annum.

The Council's loan and investment portfolio as at 30 September 2013 is shown in the table below (position at 31 March 2013 also shown for comparison):-

Loan Type	31 March 13 Principal Outstanding £000's	31 March 13 Weighted Average Rate %	30 September 13 Principal Outstanding £000's	30 September 13 Weighted Average Rate %
PWLB Annuity	£ 842	8.90%	£ 829	8.89%
PWLB Maturity	£ 177,175	3.86%	£ 187,175	3.86%
LOBO	£ 20,000	4.51%	£ 20,000	4.51%
Temporary Market	£ 32,000	0.35%	£ 11,250	0.30%
EIB	£ 3	8.75%	£ -	n/a
Total Loans	**£ 230,020**	**3.45%**	**£ 219,255**	**3.75%**
Underlying Borrowing Requirement*	**£ 238,307**		**£ 246,127**	
Internal Borrowing	**£ 8,287**		**£ 26,872**	
Investment Type	**31 March 13 Principal Outstanding £000's**	**31 March 13 Weighted Average Rate %**	**30 September 13 Principal Outstanding £000's**	**30 September 13 Weighted Average Rate %**
Bank Call Accounts	£ 9,928	0.75%	£ 7,591	0.80%
Money Market Funds	£ -	n/a	£ -	n/a
Bank Notice Accounts	£ 17	1.10%	£ 8,337	1.10%
Bank Fixed Term Deposits	£ 28,900	2.13%	£ 16,800	1.50%
Total Investments	**£ 38,844**	**1.78%**	**£ 32,729**	**1.24%**

** The Underlying Borrowing Requirement is the Capital Financing Requirement excluding the PPP Liabilities*

4. Expected Treasury Activity during second half of 2013/14;

- The strategy for borrowing to fund Capital Expenditure in the second half of 2013/14 is expected to conform to the Treasury Management and Investment Strategy 2013/14 reported to Council on 05 February 2013;
- The £16.8m short-term investment with the RBS Banking Group, maturing in December 2013, is expected to be used to finance the unsupported element of the Council's Capital Plans (internal borrowing), again eliminating the cost of carry of 2-3% of holding this investment by deferring borrowing costs of 3-4% per annum and foregoing investment returns of sub 1% per annum;
- As a result, no further long-term borrowing is envisaged in the second half of 2013/14, unless there is a marked change in the investment return environment and/or market conditions support borrowing in advance of need.

The Council's expected loan and investment portfolio at 31 March 2014 is shown in the table below:-

Loan Type	31 March 14	
	Principal Outstanding	Weighted Average Rate
	£000's	%
PWLB Annuity	£ 818	8.89%
PWLB Maturity	£ 187,175	3.86%
LOBO	£ 20,000	4.51%
Temporary Market	£ 17,500	0.30%
EIB	£ -	n/a
Total Loans	**£ 225,493**	**3.66%**
Underlying Borrowing Requirement*	**£ 260,997**	
Internal Borrowing	**£ 35,504**	
Investment Type	**31 March 14**	
	Principal Outstanding	**Weighted Average Rate**
	£000's	**%**
Bank Call Accounts	£ 5,000	0.50%
Money Market Funds	£ -	n/a
Bank Notice Accounts	£ 4,977	1.10%
Bank Fixed Term Deposits	£ -	n/a
Total Investments	**£ 9,977**	**0.92%**

** The Underlying Borrowing Requirement is the Capital Financing Requirement excluding the PPP Liabilities*

5. Prudential Indicators 2013/14

The following prudential indicators have been refreshed from those reported to Council on 05 February 2013 in the original Treasury Management and Annual Investment Strategy Statement 2013/14, based on the actual outturn for 2012/13 and the Council's Capital Plans for 2013/14, 2014/15 and 2015/16:-

Prudential Indicators 2013/14		
	2013/14 Original Estimate £000's	2013/14 Revised Estimate £000's
Capital Expenditure	£ 40,401	£ 42,260
Required Borrowing	£ 30,006	£ 29,457
Capital Financing Requirement*	£ 327,544	£ 318,297
Underlying Borrowing Requirement**	£ 270,244	£ 260,997
External Debt - Borrowing	£ 263,573	£ 225,494
Authorised Limit - Borrowing***	£ 291,875	£ 313,583
Operational Boundary - Borrowing***	£ 277,281	£ 297,904

** Includes on balance sheet PPP schemes.*

*** Excludes on balance sheet PPP schemes.*

**** Authorised Limit for Borrowing equates to the maximum expected Underlying Borrowing Requirement over this financial year and the following 2* *financial years. Operational Boundary equates to 95% of the Authorised Limit and is the level of borrowing that day-to-day Treasury activity will be focused on to ensure that the Authorised Limit is not breached.*

The Capital Financing Requirement (CFR) denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing), with the balance of external and internal borrowing generally driven by market conditions. The CFR includes borrowing arising as a result of the Council's Capital Plans, plus the long-term liability arising from the Council's two PPP contracts.

The Underlying Borrowing Requirement strips out the long-term liability arising from the two PPP contracts from the CFR.

The Authorised Limit for Borrowing represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It is the expected maximum borrowing need with some headroom for unexpected movements.

Rather than restrict borrowing in the remainder of 2013/14 to:-

- the expected Underlying Borrowing Requirement for this year (£261.0m); or
- the Authorised Limit for Borrowing of £291.9m approved by Council on 05 February 2013 (the projected Underlying Borrowing Requirement as at 31 March 2016)

it is proposed that permission be granted to borrow up to the forecast 2015/16 Underlying Borrowing Requirement of £313.6m, if market conditions supported this action.

This would have the effect of securing lower costs for future years but care would be taken to ensure that the cost of carry from borrowing early is minimised and that the maturity structure of all debt is sufficiently robust to ensure that the Underlying Borrowing Requirement, and CFR, at 31 March 2016 remain achievable.

6 Report Implications

6.1 Resource

Expenditure on loan charges is reported in quarterly financial positions to Council, with Quarter 2 monitoring reflected in the Financial Monitoring report elsewhere on today's agend**a**.

6.2 Risk

As the Council follows the requirements of the CIPFA Code of Practice for Treasury Management, and the Prudential Code, there is a reduced level of risks involved in Treasury Management activities. Those risks that do exist are further controlled through written Treasury Management Practices which define the responsibilities of all staff involved and these have recently been reviewed and updated.

6.3 Single Midlothian Plan and Business Transformation

Themes addresses in this report:-

☐ Community safety
☐ Adult health, care and housing
☐ Getting it right for every Midlothian child
☐ Improving opportunities in Midlothian
☐ Sustainable growth
☒ Business transformation and Best Value
☐ None of the above

6.4 Impact on Performance and Outcomes

The strategies adopted are an integral part of the corporate aim to achieve Best Value as they seek to minimise the cost of borrowing by exercising prudent debt management and investment. This in turn helps to ensure that the Council's capital expenditure is sustainable in revenue terms.

6.5 Adopting a Preventative Approach

The proposals in this report do not directly impact on the adoption of a preventative approach.

6.6 Involving Communities and Other Stakeholders

Although no external consultation has taken place, cognisance has been taken of professional advice obtained from Capita Asset Services, the Council's appointed Treasury Consultants.

6.7 Ensuring Equalities

There are no equality issues arising from this report.

6.8 Supporting Sustainable Development

There are no sustainability issues arising from this report.

6.9 IT Issues

There are no IT issues arising from this report.

7 Summary

Treasury Management activity during the half year has been effective in maximising investment income and minimising borrowing costs within the parameters set by the strategy for the year.

It is expected that Treasury Management activity will continue to follow the strategy in the second half of 2013/14.

The Prudential Indicators required by the Prudential Code have been revised to reflect the actual outturn position for 2012/13 and the updated Capital Plans for 2013/14, 2014/15 and 2015/16.

8 Recommendations

It is recommended that Council

a) Note that the Financial Services team has achieved a better than benchmark return on investments for the half year;
b) Note the report and the treasury activity undertaken in the first-half of the year, and the expected activity during the second-half of the year;
c) Approve the revisions to the Prudential Indicators in Section 5 of this report.

21 October 2013

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Appendix A

Treasury Management
Mid-year Review Report 2013/14

1 Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly treasury management is defined as:-

> *"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

2 Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management was adopted by the Council on 23 March 2010, with a revised 2011 edition noted by Council in the Treasury Management and Investment Strategy 2012/13 report on 28 February 2012.

The primary requirements of the revised Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy - for the year ahead; a **Mid-year Review Report (this report)** and an Annual Report (stewardship report) covering activities during the current/ previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Audit Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the 2013/14 financial year to 30 September 2013; (Section 3);
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy (Section 4);
- The Council's capital expenditure indicators (prudential indicators) (Section 5);
- A review of the Council's investment portfolio for 2013/14 (Section 6);
- A review of the Council's borrowing strategy for 2013/14 (Section 7);
- A review of any debt rescheduling undertaken during 2013/14 (Section 8).

3 Economic update

3.1 Economic performance to date

During 2013/14 economic indicators suggested that the economy is recovering, albeit from a low level. After avoiding recession in the first quarter of 2013, with a 0.3% quarterly expansion the economy grew 0.7% in Q2. There have been signs of renewed vigour in household spending in the summer, with a further pick-up in retail sales, mortgages, house prices and new car registrations.

The strengthening in economic growth appears to have supported the labour market, with employment rising at a modest pace and strong enough to reduce the level of unemployment further. Pay growth also rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the top rate of income tax. Excluding bonuses, earnings rose by just 1.0% y/y, well below the rate of inflation at 2.7% in August, causing continuing pressure on household's disposable income.

The Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding, particularly to small and medium size enterprises. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with mortgage interest rates falling further to new lows. Together with the Government's Help to Buy scheme, which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. Mortgage approvals by high street banks have risen as have house prices, although they are still well down from the boom years pre 2008.

Turning to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in Q2 started to come down, but only slowly, as Government expenditure cuts took effect and economic growth started to show through in a small increase in tax receipts. The 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan, and monetary policy was unchanged in advance of the new Bank of England Governor, Mark Carney, arriving. Bank Rate remained at 0.5% and quantitative easing also stayed at £375bn. In August, the MPC provided forward guidance that Bank Rate is unlikely to change until unemployment first falls to 7%, which was not expected until mid 2016. However, 7% is only a point at which the MPC will review Bank Rate, not necessarily take action to change it. The three month to July average rate was 7.7%.

CPI inflation (MPC target of 2.0%), fell marginally from a peak of 2.9% in June to 2.7% in August. The Bank of England expects inflation to fall back to 2.0% in 2015.

Financial markets sold off sharply following comments from Ben Bernanke (the Fed chairman) in June that suggested the Fed. may 'taper' its asset purchases earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK. Equity prices fell initially too, as Fed. purchasing of bonds has served to underpin investor moves into equities out of low yielding bonds. However, as the market moves to realign its expectations, bond yields and equities are likely to rise further in expectation of a continuing economic recovery. Increases in payroll figures have shown further improvement, helping to pull the unemployment rate down from a high of 8.1% to 7.3%, and continuing house price rises have helped more households to escape from negative equity. In September, the Fed. surprised financial markets by not starting tapering as it felt the run of economic data in recent months had been too weak to warrant taking early action. Bond yields fell sharply as a result, though it still only remains a matter of time until tapering does start.

Tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a renewed flare-up. Economic survey data improved consistently over the first half of the year, pointing to a return to growth in Q2, so ending six quarters of Eurozone recession.

3.2 Outlook for the next six months of 2013/14

Economic forecasting remains difficult with so many external influences weighing on the UK. Volatility in bond yields is likely during 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds. Downside risks to UK gilt yields and PWLB rates include:

- A return to weak economic growth in the US, UK and China causing major disappointment to investor and market expectations;
- 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: the coalition government fell on 29 September;
- Problems in other Eurozone heavily indebted countries (e.g. Cyprus and Portugal) which could also generate safe haven flows into UK gilts;
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan;
- Weak growth or recession in the UK's main trading partners - the EU and US, depressing economic recovery in the UK;
- Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds.

Upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields;
- Increased investor confidence that sustainable robust world economic growth is firmly expected, together with a reduction or end of QE operations in the US, causing a further flow of funds out of bonds into equities;
- A reversal of Sterling's safe-haven status on a sustainable improvement in financial stresses in the Eurozone;
- In the longer term - a reversal of QE in the UK; this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held;

- Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt, consequent upon repeated failure to achieve fiscal correction targets and sustained recovery of economic growth, causing the ratio of total Government debt to GDP to rise to levels that provoke major concern.

The overall balance of risks to economic recovery in the UK is now weighted to the upside after five months of robust good news on the economy. However, only time will tell just how long this period of strong economic growth will last, and it remains exposed to vulnerabilities in a number of key areas. 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, there is some residual risk of further QE if there is a dip in strong growth or if the MPC were to decide to take action to combat the market's expectations of an early first increase in Bank Rate. If the MPC does takes action to do more QE in order to reverse the rapid increase in market rates, especially in gilt yields and interest rates up to 10 years, such action could cause gilt yields and PWLB rates over the next year or two to significantly undershoot the forecasts in the table below. The tension in the US over passing a Federal budget for the new financial year starting on 1 October and raising the debt ceiling in mid October could also see bond yields temporarily dip until agreement is reached between the opposing Republican and Democrat sides. Conversely, the eventual start of tapering by the Fed. will cause bond yields to rise.

3.3 Interest rate forecasts

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
5yr PWLB rate	2.50%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%
10yr PWLB rate	3.70%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
25yr PWLB rate	4.40%	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%
50yr PWLB rate	4.50%	4.40%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.30%

Expectations for the first change in Bank Rate in the UK are now dependent on how to forecast when unemployment is likely to fall to 7%. Financial markets have taken a very contrary view to the MPC and have aggressively raised short term interest rates and gilt yields due to their view that the strength of economic recovery is now so rapid that unemployment will fall much faster than the Bank of England forecasts. They therefore expect the first increase in Bank Rate to be in quarter 4 of 2014. There is much latitude to disagree with this view as the economic downturn since 2008 was remarkable for the way in which unemployment did not rise to anywhere near the extent likely, unlike in previous recessions. This meant that labour was retained, productivity fell and now, as the MPC expects, there is major potential for unemployment to fall only slowly as existing labour levels are worked more intensively and productivity rises back up again. The size of the work force is also expected to increase relatively rapidly and there are many currently self employed or part time employed workers who are seeking full time employment. Capita Asset Services take the view that the unemployment rate is not likely to come down as quickly as the financial markets are currently expecting and that the MPC view is more realistic. The prospects for any increase in Bank Rate before 2016 are therefore seen as being limited. However, some forecasters are forecasting that even the Bank of England forecast is too optimistic as to when the 7% level will be reached and so do not expect the first increase in Bank Rate until spring 2017.

4 Treasury Management and Annual Investment Strategy Statement update

The Treasury Management & Annual Investment Strategy Statement (TMSS) for 2013/14 was approved by this Council on 5th February 2013

The following prudential indicators have been refreshed from those reported to Council in the original Treasury Management and Annual Investment Strategy Statement 2013/14 presented to Council on 05 February 2013, based on the actual outturn for 2012/13 and activity during the first 6 months of 2013/14:-

Prudential Indicators 2013/14		
	2013/14 Original Estimate £000's	2013/14 Revised Estimate £000's
Capital Expenditure	£ 40,401	£ 42,260
Required Borrowing	£ 30,006	£ 29,457
Capital Financing Requirement*	£ 327,544	£ 318,297
Underlying Borrowing Requirement**	£ 270,244	£ 260,997
External Debt - Borrowing	£ 263,573	£ 225,494
Authorised Limit - Borrowing***	£ 291,875	£ 313,583
Operational Boundary - Borrowing***	£ 277,281	£ 297,904

** Includes on balance sheet PPP schemes.*

*** Excludes on balance sheet PPP schemes.*

**** Authorised Limit for Borrowing equates to the maximum expected Underlying Borrowing Requirement over this financial year and the following 2 financial years. Operational Boundary equates to 95% of the Authorised Limit and is the level of borrowing that day-to-day Treasury activity will be focused on to ensure that the Authorised Limit is not breached.*

A breakdown of the Council's investment portfolio is shown in Section 6 of this report. New external borrowing undertaken is identified in Section 7 of this report.

5 The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

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

5.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the original Treasury Strategy was reported to Council on 05 February 2013.

Capital Expenditure			
Service	**2013/14 Original Estimate £000's**	**2013/14 Current Position £000's**	**2013/14 Revised Estimate £000's**
General Services			
Resources	£ 10,000	£ 2,198	£ 10,756
Education, Community & Economy	£ 16,704	£ 4,875	£ 11,661
Health & Social Care	£ 767	£ 1,052	£ 1,421
Business Transformation	£ 563	£ 569	£ 1,406
Total General Services	**£ 28,034**	**£ 8,694**	**£ 25,244**
Total HRA	**£ 12,367**	**£ 6,507**	**£ 17,016**
Combined Total	**£ 40,401**	**£ 15,201**	**£ 42,260**

Capital Expenditure on Education, Community & Economy has reduced by £5.0 million from the original estimate in the Treasury Management & Annual Investment Strategy Statement reported to Council on 05 February 2013, primarily as a result of the rephasing of expenditure on the Bilston & Gorebridge North Primary Schools.

Capital Expenditure on the HRA programme has increased by £4.6m as a result of the acceleration of the Phase II programme, and an increase in the SHQS provision for future major repairs and sanitary ware replacement.

5.2 Changes to the Financing of the Capital Programme

The table below details how the Capital Expenditure in Section 5.1 is to be financed:-

Financing of Capital Expenditure			
	2013/14 Original £000's	2013/14 Current £000's	2013/14 Revised £000's
Total Spend	**£ 40,401**	**£ 15,201**	**£ 42,260**
Financed By:-			
Capital Receipts	£ 1,635	£ 679	£ 1,477
Capital Grants	£ 6,877	£ 3,339	£ 7,574
Capital Reserves	£ -	£ -	£ -
Developer/Other Contributions	£ 1,883	£ 1,541	£ 3,752
Total Financing	**£ 10,395**	**£ 5,559**	**£ 12,803**
Borrowing Required to finance Capital Plans	**£ 30,006**	**£ 9,642**	**£ 29,457**

The borrowing element of the table above increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although both (i) the required borrowing, and (ii) the CFR, will be reduced in part by the in-year revenue charges for the repayment of debt (the Principal Debt Repayments).

This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period.

Prudential Indicators for CFR and External Debt			
	2013/14 Original Estimate £000's	2013/14 Current Position £000's	2013/14 Revised Estimate £000's
Prudential Indicator - Capital Financing Requirement (CFR)			
CFR - General Services	£ 124,112	£ 106,730	£ 114,246
CFR - HRA	£ 146,132	£ 139,397	£ 146,751
CFR - PPP Liability	£ 57,300	£ 58,303	£ 57,300
Total CFR at Year End	**£ 327,544**	**£ 304,430**	**£ 318,297**
Net Movement in CFR	**£ 22,017**	**£ 6,817**	**£ 20,684**
Prudential Indicator - External Debt			
Borrowing	£ 263,573	£ 219,255	£ 225,494
Other Long-Term Liabilities (PPP Liability)	£ 57,300	£ 58,303	£ 57,300
Total Debt at Year End	**£ 320,873**	**£ 277,558**	**£ 282,794**

The original estimate of the CFR for 2013/14, of £327.5m, has reduced by £9.2 million to £318.3m as a result of a reduction in the borrowing requirement arising from the Council's capital plans in 2012/13 and 2013/14, compared with the original forecasts.

The prudential indicator for External Debt is expected to be £38.1m less than originally forecast as a result of the utilisation of £28.9m of maturing short-term investments to fund the unsupported element of the Council's capital plans (see Sections 6 and 7) and the reduction in the borrowing requirement for the Council's capital plans in 2012/13 and 2013/14 as noted above.

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross 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 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.

The Head of Finance & Human Resources reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which 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 in Scotland Act 2003.

Authorised Limit for External Debt		
	2013/14 Original Estimate £000's	**2013/14 Revised Estimate £000's**
Authorised Limit		
Borrowing*	£ 291,875	£ 313,583
Other Long-term Liabilities**	£ 57,300	£ 57,300
Total	**£ 349,175**	**£ 370,883**

** Authorised Limit for Borrowing equates to the maximum expected Underlying Borrowing Requirement over this financial year and the following 2 financial years.*

*** Includes on balance sheet PFI schemes.*

The Authorised Limit for Borrowing in the table above has increased by £21.7m as a result of an increase in borrowing required to support the Council's Capital Plans of £31.1m over the period 2013/14 to 2015/16 and a decrease in borrowing required to support the Council's Capital Plans of £9.4m in 2012/13.

Council is asked to approve that, rather than restrict borrowing in the remainder of 2013/14 to the expected Underlying Borrowing Requirement for this year (£261.0m) or the previously approved Authorised Limit for Borrowing of £291.9m (the projected Underlying Borrowing Requirement as at 31 March 2016 as noted in the Treasury Management and Annual Investment Strategy Statement 2013/14 approved by Council on 05 February 2013), that permission be granted to borrow up to the 2015/16 Underlying Borrowing Requirement forecast of £313.6m, if market conditions supported this action.

This would have the effect of securing lower costs for future years but care would be taken to ensure that the cost of carry from borrowing early is minimised and that the maturity structure of all debt is sufficiently robust to ensure that the Underlying Borrowing Requirement, and CFR, at 31 March 2016 remains achievable.

6 Investment Portfolio 2013/14

Actual Investments in the half year to date

As at 30 September 2013, the Council held £32.7m of investments (£38.8m as at 31 March 2013) and the investment portfolio yield for the first six months of the year is 1.46% against a benchmark 3 month un-compounded LIBOR rate of 0.51%. Investment returns for the half-year to 30th September 2013 amount to £0.290m.

Investment Type	31 March 13			30 September 13		
	Principal Outstanding		Weighted Average Rate	Principal Outstanding		Weighted Average Rate
	£000's		%	£000's		%
Bank Call Accounts	£	9,928	0.75%	£	7,591	0.80%
Money Market Funds	£	-	n/a	£	-	n/a
Bank Notice Accounts	£	17	1.10%	£	8,337	1.10%
Bank Fixed Term Deposits	£	28,900	2.13%	£	16,800	1.50%
Total Investments	**£**	**38,844**	**1.78%**	**£**	**32,729**	**1.24%**

The Head of Finance & Human Resources confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2013/14.

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

As set out in Section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low, with instant access deposits in line with the 0.5% Bank Rate and fixed term deposits with a 1 year term yielding c. 1% or below throughout the first half of the year.

Indeed, the introduction of the Funding for Lending scheme has reduced market investment rates even further. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

With this in mind, the maturing £12.1m deposit with Lloyds Banking Group in the half-year, originally invested in July 2012 for a fixed term of 1 year and earning an interest return of 3%, was not reinvested at maturity (rates for reinvestment for 1 year in July 2013 averaged 0.95%), and instead has been utilised to fund part of the unsupported element of the Council's 2013/14 capital plans.

This has increased the Council's internal borrowing position i.e. the capital borrowing need has not been fully funded with loan debt as some of the cash supporting the Council's reserves and balances has been used as a temporary measure. This strategy is prudent given the low investment returns and relatively high counterparty risk.

Projected Investment Activity for the second half of the year

The expected investment portfolio as at 31 March 2014 is shown in the table below:-

Investment Type	31 March 14		
	Principal Outstanding		Weighted Average Rate
	£000's		%
Bank Call Accounts	£	5,000	0.50%
Money Market Funds	£	-	n/a
Bank Notice Accounts	£	4,977	1.10%
Bank Fixed Term Deposits	£	-	n/a
Total Investments	**£**	**9,977**	**0.92%**

The Council's budgeted investment return for the full year 2013/14 is £0.425m (representing a 1.27% return on an expected average investment level of £33.4m).

As noted above, investment returns are likely to remain low throughout the remainder of 2013/14. With that in mind, utilisation of the £16.8m short-term investment with the RBS Banking Group to support the Council's in-year capital plan expenditure (internal borrowing) will eliminate the 2-3% cost of carry of holding this investment by deferring borrowing costs of 3-4% per annum and foregoing investment returns of sub 1% per annum.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function. This uses the Capita Asset Services credit scoring methodology which is a sophisticated methodology incorporating credit ratings from the three main credit rating agencies, credit watches and credit outlooks, CDS spreads and Country sovereign ratings to provide a list of only the most creditworthy counterparties, and for these counterparties, a maximum suggested duration for any one investment.

7 Borrowing

Actual borrowing in the half-year to date

As at 30 September 2013, the Council held £219.3m of external borrowing (£230.0m as at 31 March 2013), as shown in the table below:-

Loan Type	31 March 13			30 September 13		
	Principal Outstanding		Weighted Average Rate	Principal Outstanding		Weighted Average Rate
	£000's		%	£000's		%
PWLB Annuity	£	842	8.90%	£	829	8.89%
PWLB Maturity	£	177,175	3.86%	£	187,175	3.86%
LOBO	£	20,000	4.51%	£	20,000	4.51%
Temporary Market	£	32,000	0.35%	£	11,250	0.30%
EIB	£	3	8.75%	£	-	n/a
Total Loans	**£**	**230,020**	**3.45%**	**£**	**219,255**	**3.75%**
Underlying Borrowing Requirement*	**£**	**238,307**		**£**	**246,127**	
Internal Borrowing	**£**	**8,287**		**£**	**26,872**	

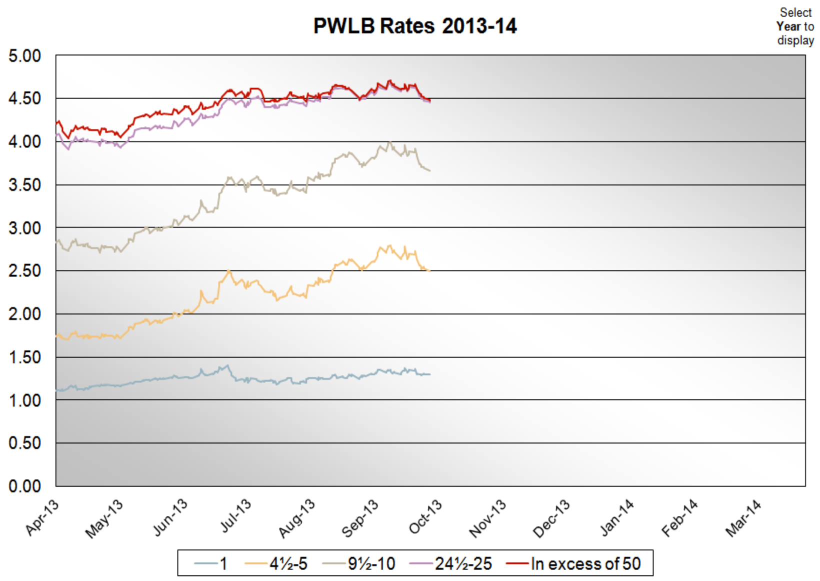
** The Underlying Borrowing Requirement is the CFR excluding the PPP Liabilities*

Due to the overall financial position and the underlying need to borrow for capital purposes, new long-term external borrowing of £10m was undertaken from PWLB in April 2013 with a term of 21.5 years at an interest rate of 3.71% (net of certainty rate discount).

Short-term borrowing from the money markets totalling £29.75m was sourced at terms ranging between 1 month to 1 year and at rates of 0.26% to 0.35%; replacing a total of £50.5m of maturing short-term market loans and thereby allowing the Council to reduce its exposure to short-term market money by £20.75m.

The table in section 7 above shows the Council currently has borrowings of £219.3m, with an Underlying Borrowing Requirement of £246.1m. The Council has therefore utilised £26.9m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

The graph and table below show the movement in PWLB rates for the first six months of the year to 30th September 2013:-



Projected borrowing for the second half of the year

The expected external borrowing portfolio at 31 March 2014 is as shown in the table below:-

Loan Type	31 March 14	
	Principal Outstanding	Weighted Average Rate
	£000's	%
PWLB Annuity	£ 818	8.89%
PWLB Maturity	£ 187,175	3.86%
LOBO	£ 20,000	4.51%
Temporary Market	£ 17,500	0.30%
EIB	£ -	n/a
Total Loans	**£ 225,493**	**3.66%**
Underlying Borrowing Requirement*	**£ 260,997**	
Internal Borrowing	**£ 35,504**	

** The Underlying Borrowing Requirement is the CFR excluding the PPP Liabilities*

The Council's capital financing requirement (CFR) for 2013/14 is £318.3m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

The 2013/14 CFR of £318.3m includes the PPP Liability of £57.3m, thereby giving an Underlying Borrowing Requirement of £261.0m.

From Table 5.2, the Council's has a borrowing requirement of £19.8m in the second half of 2013/14. It is anticipated that further external long-term borrowing will not be undertaken during this financial year, with the Council instead utilising both:-

(i) the remaining balance of the matured investment of £12.1m with Lloyds Banking Group in July 2013, and
(ii) the maturing investment of £16.8m with Ulster Bank in December 2013;

to finance this borrowing requirement (internal borrowing).

Borrowing in Advance of Need

The Council has not borrowed in advance of need during the first half of 2013/14 and will only borrow in advance in the second half if market conditions dictate that it is prudent to do so.

8 Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates and therefore no debt rescheduling was undertaken during the first six months of 2013/14.