CITY OF YORK COUNCIL

Meeting of Executive Member for Corporate Services and Advisory Panel

24 July 2007

Report of the Director of Resources

Treasury Management Annual Report & Review of Prudential Indicators

Summary of Report

1. This report updates the Executive Member on Treasury Management performance for 2006/07 compared against the budget taken to Council on 01 March 2006. The report highlights the economic environment over the 2006/07 financial year and in relation to this reviews treasury management performance covering:

   - Short-term investments,
   - Long-term borrowing,
   - Venture Fund,
   - Treasury Management Outturn and
   - The Prudential Indicators.

Background

2. The Treasury Management in the Public Services Code of Practice recommends that Local Authorities annually review and update where necessary their Treasury Management Policy Statement and Practices. These updated documents are attached in Annex E and F.

Consultation

3. The majority of this report is for information and reporting on the performance of the treasury management function. Members through the budget process set the level of budget and expected performance of the Councils treasury management function.

Options/Analysis

4. The majority of this report is for information however the Executive Member is requested to approve the adoption of the revised Treasury Management Policy and Practices set out in Annexes E and F, as required by CIPFA in its Treasury Management in the Public Services Code of Practice. Adopting the

Policy and Practices and approval by an Executive Member is recognised as best practice and failure to adopt can result in an adverse Comprehensive Performance Assessment (CPA) score.

Corporate Priorities

5. Effective treasury management is concerned with the management of the Council's cash flows, it's banking, money market and capital transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks. By effectively managing its treasury activities the Council will meet its Corporate Strategy Priority of "Improve efficiency and reduce waste to free-up more resources".

Economic Background

6. The Council's short term investment and long term borrowing decisions have been affected by the following economic conditions.

    a. The Bank of England base rate started 2006/07 at 4.5%, having been unchanged at this level since August 2005. The Bank of England Inflation Report of May 2006 marked a watershed in as much as the Monetary Policy Committee (MPC) switched from a loosening bias on interest rates to a tightening bias. Previous expectations of cuts in Bank Rate in 2006 were replaced by the reverse expectation i.e. at least one, if not two increases of 0.25% by the end of 2006. Bank Rate accordingly rose to 4.75% in August 2006 and then to 5.0% in November.

    b. This was then followed by another rate increase in January to 5.25% which was not anticipated by the financial markets and forecasters and immediately sparked inferences that the MPC had had access to some bad news on the inflation front, which was not available to the markets at that time, before it took that decision. These fears were indeed confirmed soon after by the news that CPI (Consumer Price Inflation) had risen sharply to 3.0% in December, a whisker away from the MPC having to write a letter of explanation to the Chancellor (if it had gone over 3.0%). Figure 1 shows the actual base rate movements since 2004/05 with predictions from economic commentators for 2007/08.

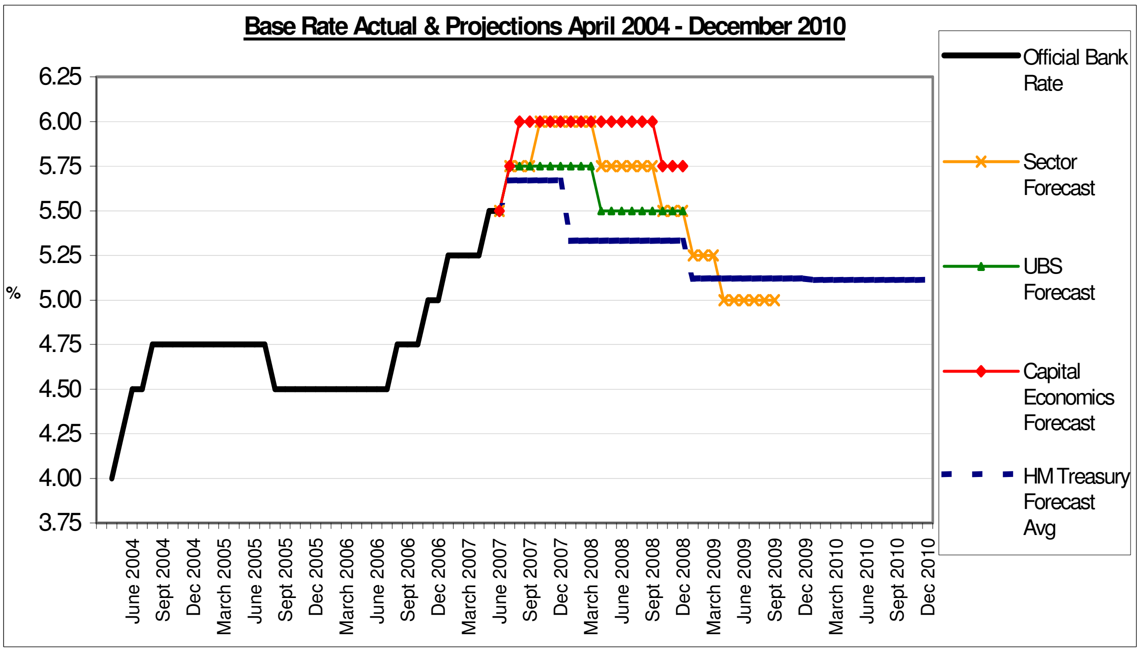

Figure 1 – Base Rates 2004- 2010 as at June 07

c. With regard to longer term borrowing the Public Works Loans Board (PWLB) 45-50 year rate started the year at 4.20% and fell to a low of 4.05% several times in late September to early November. The high point for 45-50 year was 4.50% in late March 2007 before finishing the year at 4.45%. The sustained rise in long term rates in Q4 2006 and Q1 2007 was underpinned by the rise in world inflationary expectations over the medium to long term.

d. Money Market rates have been volatile for the latter part of the year with two of the base rate increases being unforeseen by the money markets. Due to the volatility, longer term rates (3 months to 364 days) have been favourable at various points throughout the year but have been difficult to pick off due to the uncertainty regarding the short term direction of interest rates.

e. A number of institutions keen to accept Local Authority investments have been offering competitive interest rate on call accounts, paying Bank of England Base Rate as a minimum on all balances held with them. Such competitive rates have seen these accounts earn higher returns than money placed on the money markets for periods up to 1 and 2 months. This has seen the Council take advantage of such rates actively operating 4 accounts:

   i. Bank of Scotland 7 day notice base plus account is the best performing call account offering between 0.03% to 0.29% (averaging 0.12%) above base rate.

   ii. Anglo Irish Star call account paying on average 0.04% above base rate.

   iii. Abbey National call account paying base rate.

iv. Bank of Scotland call account paying base rate.

f. These accounts are the most competitive on the market with the Treasury Management team actively seeking the best deals available with authorised counterparties.

Short Term Investments

7. The Council's average balance available for investment has increased significantly from £27.6m in 2005/06 to £44.6m in 2006/07. The reasons for this are:

    - A high level of capital receipts received in 2006/07 was an increase of £10.4m on 2005/06 levels.
    - Early receipt of £2.8m of capital grants which where not applied in 2006/07.
    - General fund under spend of c £3m
    - Capital programme slippage of c£7m against start budget
    - An increase in Housing Revenue Account working balances
    - £0.5m Dedicated Schools Grant surplus
    - Surplus on collection fund of c£1m.

8. The day to day cash balances varied in relation to the Council's receipts and payments cycles. Cash balances reduce at the end of the month due to the monthly payroll and increase at the beginning and mid point of the month with the receipt of Council Tax and Non Domestic Rates. Annex A shows the movement in daily cash balances over the year. All surplus cash balances were invested with authorised counterparties in accordance with the Council's Treasury Policy Statement. Trading Activity during the year generated an excess of £2.184m of interest earned over interest payable, equivalent to a 4.90% rate of return. This is 0.06% better than the average 7 day London Inter-Bank Bid Rate (LIBID) of 4.84%, the standard benchmark for short term cash management.

9. Taking into account the direct costs of dealing, the in-house team achieved a net trading surplus of £2.165m. This is equivalent to a return of 4.86%, which is 1.04% above the average rate paid by the bank on credit balances held in the Council's accounts, as shown in Annex B. The bottom line value added by the Council's money market trading activities is estimated at £0.462m.

10. During the year, the Council has made 144 investments totalling £306m, compared with 133 totalling £254m in 2005/06. This increase is due to proactive management of the Council's accounts with treasury management officers achieving returns above the levels of the standard call accounts with

the Council's investments. The overall investment pattern has changed slightly with 79% of investments being made into the call accounts compared to 53% in 2005/06. This reflects the higher returns that call accounts have been offering with 7 day notice call account returns beating money market investments for periods up to 1 month. This is illustrated in figure 2:

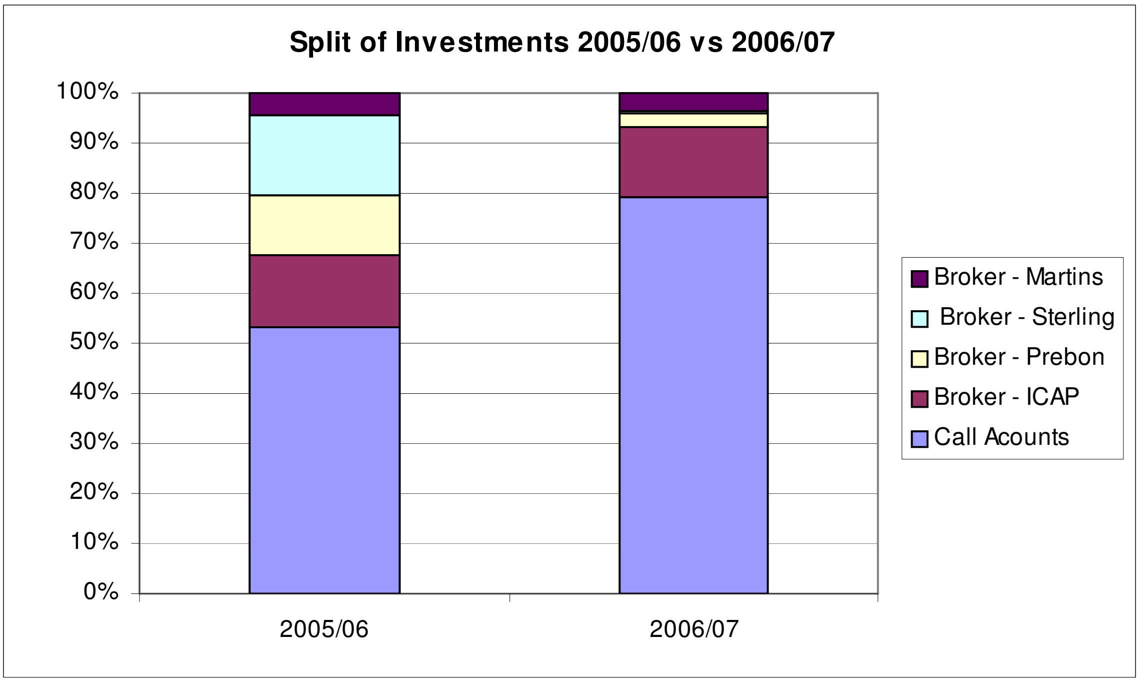

Figure 2 – Split of Investments by broker used

11. Additional information is provided in Annex C about the scale of money market activities for 2006/07 and the relative uses made of different types of lending institutions and the various Council brokers.

12. The Council has made 30 investments via the money market brokers during 2006/07. Of these 8 have been for a week or less with 12 being for a period of 3 months or over. Table 1 gives details of investments for periods greater than 3 months.

Financial Institution	Base Rate at time	Rate of Interest	Value	Start Date	Duration (days)
Bank of Ireland	4.5%	4.69%	£3.0m	04/04/06	364
Irish Intercontinental Bank	4.5%	4.86%	£3.0m	15/05/06	273
Nationwide Buildings Soc	4.5%	4.87%	£2.0m	28/06/06	275
Nationwide Buildings Soc	4.5%	4.90%	£2.0m	03/07/06	364
Bank of Ireland	4.5%	4.97%	£3.0m	20/07/06	364
Irish Intercontinental Bank *	4.75%	4.70%	£3.0m	08/09/06	364
Clydesdale Bank PLC	4.75%	5.285%	£1.5m	18/09/06	364
Clydesdale Bank PLC	5.00%	5.50%	£2.0m	22/12/06	364
Irish Intercontinental Bank	5.50%	5.70%	£2.5m	02/03/07	364
Clydesdale Bank PLC	5.25%	5.665%	£2.5m	09/03/07	364

Irish Intercontinental Bank	5.25%	5.745%	£2.5m	21/03/07	364
Nationwide Buildings Soc	5.25%	5.805%	£4.0m	30/03/07	364

Table 1 - Council fixed term investments over 3 months in duration

* Forward deal arranged in 05/06 financial year becoming live in 06/07. The decision to enter into this forward investment was taken due to economic forecasters predicting rates to be in the region of 4.0 – 4.5% at the date of the investment becoming live. It represented a small proportion of the investment portfolio being at a fixed rate of interest to hedge against a reduction in the base rate.

13. Due to the relatively low number of deals this year, it has been decided not to complete a full annual review of the brokers. Informal feedback received from the dealing team indicate all brokers continue to provide a satisfactory service to the Council. It is intended to retain all four brokerage organisations.

Long term Borrowing

14. The majority of Council borrowing is funded by the government through the Revenue Support Grant (RSG), which provides the Council with revenue funding to allow it to meet the interest and repayment costs of borrowing. The introduction of the Prudential Code in April 2004 gives the Council more flexibility in respect of how much and when it borrows. Under the Prudential Code, Councils are free to borrow up to a level that is deemed prudent, affordable and sustainable and within their prudential indicator limits.

15. The Council's borrowing strategy is to borrow from the PWLB when the rates are low and hold back on borrowing when rates are high following advice from the Councils treasury management advisors (Sector Treasury Services). The Council set a trigger point for taking long term borrowing of 4.25% during 2006/07. Long term borrowing rates started the year around the 4.25% mark fluctuating throughout the year between 4.05% and 4.45%.

16. The Councils long term borrowing started the year at £93.4m with two new loans being taken out in September and November. The two additional loans totalling £10m were taken at the two yearly low points of 4.05% in September and November. Figure 3 shows the PWLB rates (the grey area showing rates between 25 and 50 years) for 2006/07.

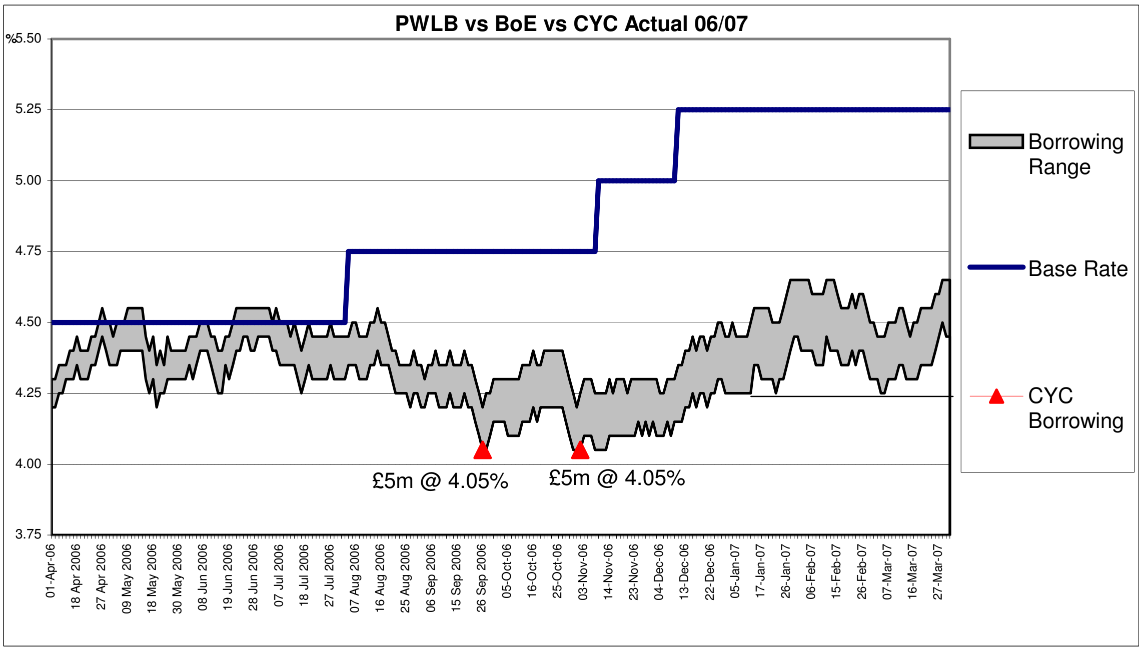

Figure 3 – PWLB rates vs. Bank of England vs. CYC borrowing levels

17. No loans were repaid during 2006/07 and the borrowing at the end of the year was £103.4m. Table 2 summarises the movement in total Council borrowings during the year.

	Date	£	Prevailing Base Rate	Weighted %	Year of Maturity
Total Debts as at 1/4/06		**93,364,956**	**4.50%**	**4.692%**	
Plus New Loans	26 Sept 2006	5,000,000	4.75%	4.05%	2051/52
	02 Nov 2006	5,000,000	4.75%	4.05%	2053/54
Less Loans Repaid		0			
Total Debts as at 31/03/07		**103,364,956**	**5.25%**	**4.630%**	

Table 2 – Movement In Long Term Borrowing 2006/07

18. All of the new borrowing decisions were taken in light of the maturity structure of the Council's current long term borrowing. Prudential indicator 9 sets the permitted maturity structure of borrowing. The two loans of £5m each were taken over 44 and 46 year periods allowing the most competitive rate to be gained and to reflect the long term of the assets that it would be financing, namely the new Civic building. Figure 4 illustrates the 2006/07 and 2007/08 maturity profiles of the Council's outstanding loans.

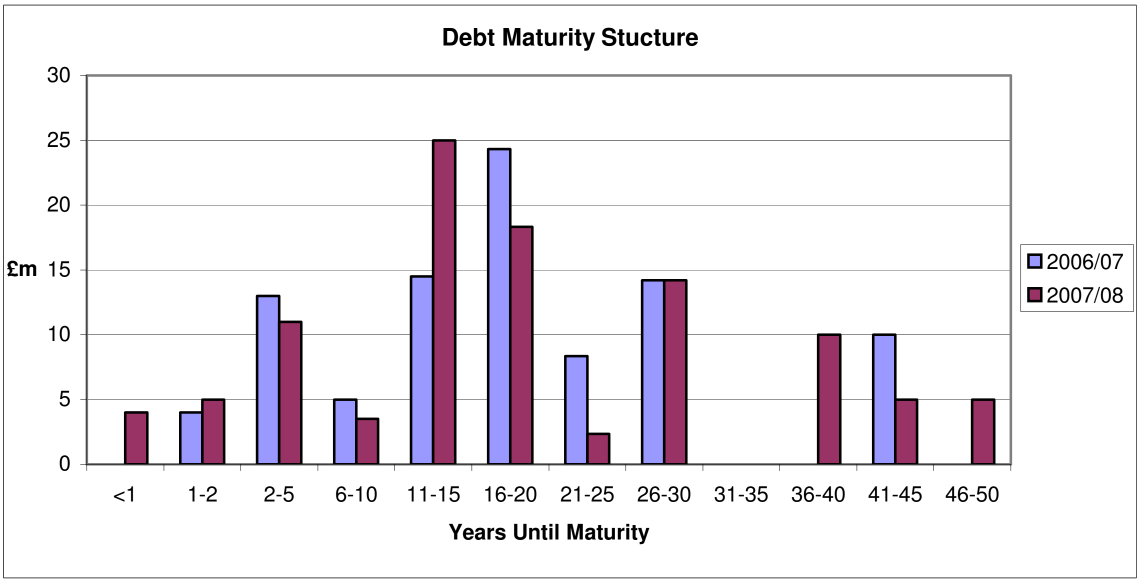

Figure 4 – Debt Maturity Profile 06/07 vs 07/08

19. As a result of the borrowing undertaken in-year, the average rate of interest on the Council's long term borrowing has fallen from 4.69% in 2006/07 to 4.63%. This is 1.56% lower than the latest available average long term borrowing rate (source Sector 2005/06) for unitary authorities of 6.19%. The long term borrowing rates are expected to be around the 4.50% level for the latter part of the 2007/08 financial year having seen rates as high as 4.85% in the early stages of 2007/08. Figure 5 shows the Council's long term borrowing compared to the national average and other unitary authorities.

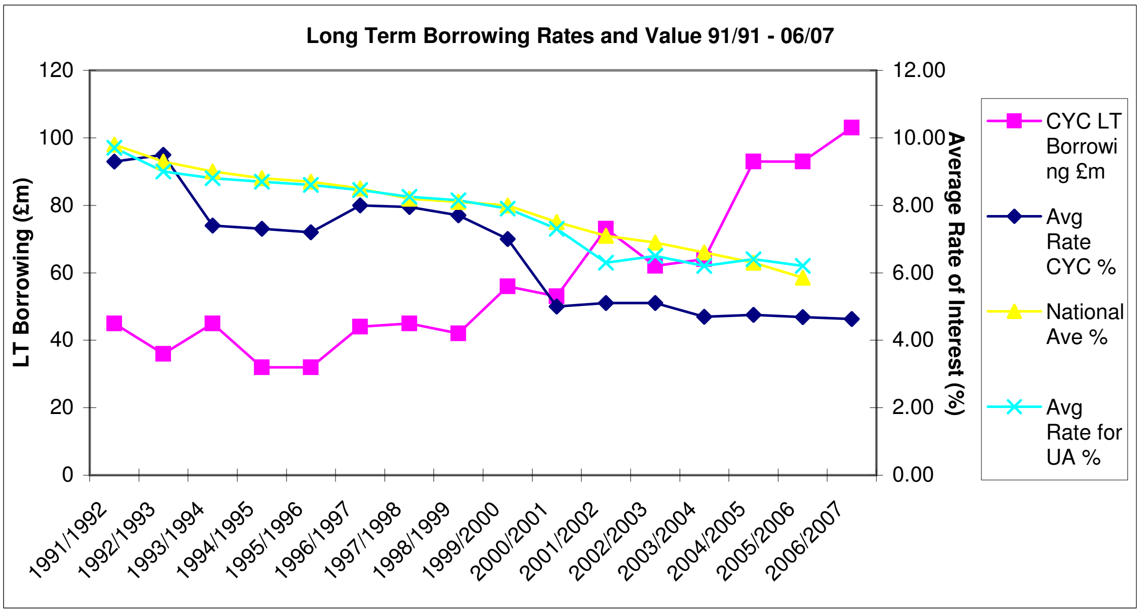

Figure 5 – CYC borrowing vs National Average vs Unitary Authority

Debt Restructure

20. No debt restructures occurred during 2006/07. The council is still benefiting from restructures made in previous years which have considerably lowered the average debt interest rate in comparison with other unitary authorities.

Venture Fund

21. The Venture Fund is used to provide short to medium term investment for internal projects which provide a robust new revenue stream or recognisable budget reductions and contribute to operational benefits or policy objectives. The movements on the Venture Fund in the year are shown in table 3.

	£'000
Balance at 1 April 2006	**852**
New Loan Advances	(801)
Loan Repayments Received	1,155
Net Interest Received	0
Repayment 05/06 transfer to fund capital programme	405
Balance at 31 March 2007	**1,611**

Table 3 – Venture Fund Movement 2006/07

22. New loan advances were made in 2006/07 for Oakland's Partnership Scheme, Assets in Good Repair and LPSA2 scheme in the main with repayments being received from a total of 13 schemes.

23. The repayment of the 2005/06 transfer for funding the capital programme relates to the shortfall in capital receipts in 2005/06 which left the Council with having to borrow to fund the programme. This option would have incurred a statutory minimum revenue provision charge of 4% of any borrowing taken. The option was therefore taken to borrow from internal earmarked reserves thus avoiding minimum revenue provision (MRP) charges. The £405k repayment represents the part reversal of this transaction in 2006/07 due to the higher level of capital receipts realised in 2006/07.

Financial Implications – Budget Outturn

24. Treasury Management activity is contained within the Corporate Budget, which was approved prior to outturn at £6,740k for 2006/07. The outturn is £6,280k, this results in an under spend of £460k which has been reported as part of the overall outturn report in June. The principal elements that contribute towards this surplus are shown briefly in table 4 below.

	Outturn £,000
Increase in average balances	+89
Increase in Interest rates	+70
Delay in Borrowing	+131
IT Leasing and Prudential Borrowing	+143
Minor Budget Variations	+27
TOTAL	**+460**

Table 4 – Treasury Management Outturn 2006/07

Review of the Prudential Indicators

25. In accordance with the Prudential Code, the Prudential Indicators set by full Council on 1 March 2006 must be reviewed. Full detail on the indicators are given in Annex D, but some of the key points are:

- Size of the Capital Programme (Indicator 1) – The indicator set for the size of the 2006/07 Capital Programme was an estimate of £50.1m and the outturn was £48.5m. Despite representing an under spend of £1.6m against original budget it was the Council's largest ever capital spend. The under spend was comprised in the main of schemes being re-profiled into 2007/08 financial year.

- Net revenue Stream (indicator 2) – This indicator represents how much borrowing for the capital programme will cost as a percentage of the net revenue stream. The General Fund indicator is 5.27% compared to 6.09%, with the reduction being mainly attributable to the high level of cash balances in 2006/07 which reduce the Councils net debt position at the year end. The Housing Revenue Account (HRA) version of the indictor is 3.02% compared to 3.39%, the difference is again due to higher than anticipated cash balances serving to reduce the HRA net debt position.

- Capital Financing Requirement (CFR) (Indicator 5) – The Council's CFR (underlying need to borrow) at outturn was £84.4m a decrease of £11.6m against an estimated figure of £96m. The reduction is due in the main to an increased level of capital receipts and the application of cash backed financing rather than borrowing.

- Authorised Limit / Operational Boundary (Indicator 6) – The Council took on additional debt of £10m through two loans of £5m leaving the Council's total level of debt at a level of £103.4m. With the Council's Operational Boundary set at £144.2m and the Authorised limit set at £165.7m it can be seen that neither limit has been exceeded.

- Details of all the Prudential Indicators can be found in Annex D.

Human Resources Implications

26. There are no HR implications as a result of this report.

Equalities

27. There are no equalities implications as a result of this report.

Legal Implications

28. Treasury Management activities have to conform to the Local Government Act 2003, which specifies that the Council is required to adopt the CIPFA Prudential Code and work to its Treasury Management Policy and Treasury Management Practices. As a result the Council can only invest and borrow from approved institutions as set out in sections 1 and 12 of the Act.

Crime and Disorder Implications

29. There are no crime and disorder implications as a result of this report.

Information Technology Implications

30. There are no IT implications as a result of this report

Property Implications

31. There are no property implications as a result of this report

Risk Management

32. The treasury function is a high risk area because of the level of large money transactions that take place. As a result of this there are strict procedures set out as part of the Treasury Management Practices statement attached in Annex F.

Recommendations

33. Members are requested to advise the Executive Member to:

- Note the 2006/07 performance of the Treasury Management activity, movements on the Venture Fund and the Treasury Management Outturn.

- Note the movements in the Prudential Indicators

- Approve the revised Treasury Management Policy and Practices statement as set out in Annexes E and F.

Reason: In order to comply with the CIPFA Treasury Management in Public Services Code of Practice.

Contact Details

Author: Ross Brown Corporate Accountant	**Chief Officer Responsible for the report:** Peter Steed Head of Finance			
Tel No: 551207	Tel 551127			
Tom Wilkinson Corporate Finance Manager	Report Approved	✓	Date	06/07/07
Tel No: 551187				

Wards Affected: All ✓

Specialist Implication Officers:

None

For further information please contact the author of the report

Background Papers

Cash-flow Model 06/07, Investment Register 06/07, PWLB Debt Register, Capital Financing Requirement 06/07 outturn, Venture Fund 06/07, Prudential Indicators 06/07, Statistics 06/07.

Annexes

Annex A – Cash Balances Graph
Annex B – Surplus on Money Market Trading
Annex C – Money Markets Trading Statistics
Annex D – Prudential Indicators 06/07
Annex E – Treasury Management Policy Statement
Annex F – Treasury Management Practices Paper