CITY OF YORK COUNCIL

Appendix A

Cabinet

Report of the Cabinet Member for Corporate Services

Treasury Management Monitor 3 and Prudential Indicators 2011/12

Summary

1. This Council is required through regulations issued under the Local Government Act 2003 and the revised 2009 (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management (as revised) to provide members with an update on treasury management activities at least twice a year.

2. This report therefore ensures this council is implementing best practice in accordance with the Code. It updates on the Treasury Management activities for the period 1 April 2011 to 31 December 2011 and reviews:

   - Economic Background
   - Annual Investment Strategy
   - Investment portfolio
   - Borrowing portfolio
   - Compliance with Prudential Indicators

Background

3. The Council's Treasury Management function is responsible for the effective management of the Council's investments, cash flows, its 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.

Economic Background and Analysis

4. The Council's treasury management activities have operated within the following economic background:

a) Indicators suggest that the economy is at higher risk of a recession;

b) Weak demand on the high street has forced retailers to offer generous discounts; reflecting the pressures on households' finances;

c) The labour market has deteriorated, but at a slower pace than in previous months; employment surveys have continued to point to further job losses ahead;

d) Public borrowing has fallen in line with the fiscal plans, but forecasts for future deficits have been revised up;

e) Inflation begins to fall from its recent peak of 5.2% in September to 4.8% in November; the November Inflation Report forecast projected CPI inflation to be well below the 2% target in two years' time;

f) The Monetary Policy Committee (MPC) restarted quantitative easing (QE) and indicated its intention to sanction more;

g) Gilt yields reached new lows, in spite of a recovery in equity prices and growing fiscal fears;

h) Euro-zone policymakers failed to make progress towards a solution to the region's debt crisis.

5. There continues to be uncertainty in the current economic climate and Sector – the Council's treasury management advisers – have undertaken a review of their interest rate forecast as a result of this economic background and the following two major events:

a) the decision by the MPC to expand quantitative easing by a further £75bn is to be completed in February 2012. This clearly underlines how concerned the MPC is about the prospects for UK growth and that recession is now a much greater concern than inflation. This decision had the immediate result of depressing gilt yields at the long end of the interest rate gilt yield curve, effecting Sector's interest rate forecasts.

b) The marked deterioration of growth prospects in the US, EU and UK, (especially as concerns have further increased over Greece) and the potential fall out from their debt situation. This has led in turn to a further increase in safe haven flows into UK gilts since Sector's last interest rate forecast (16.8.11) which have depressed gilt yields and pushed PWLB rates to even lower levels.

6. From the economic uncertainty described above, the Sector central interest rate forecast is for the bank base rate to rise in 2 years time in September 2013. The current environment of exceptional levels of volatility which are highly correlated to political developments (or lack of them) in the Eurozone sovereign debt crisis, highlights how unpredictable PWLB rates and bond yields remain.

7. Figure 1 below shows the actual and projection of the bank base rate, which has remained at historically low levels since April 2009. Sector forecast bank base rate in January 2011 is compared to their revised forecast in January 2012. Other economists latest forecast are also shown for January 2012. The graph highlights the delay in the expectation of the increase in the Bank Base rate which is as a result of the decision to expand quantitative easing and deterioration of growth prospects.

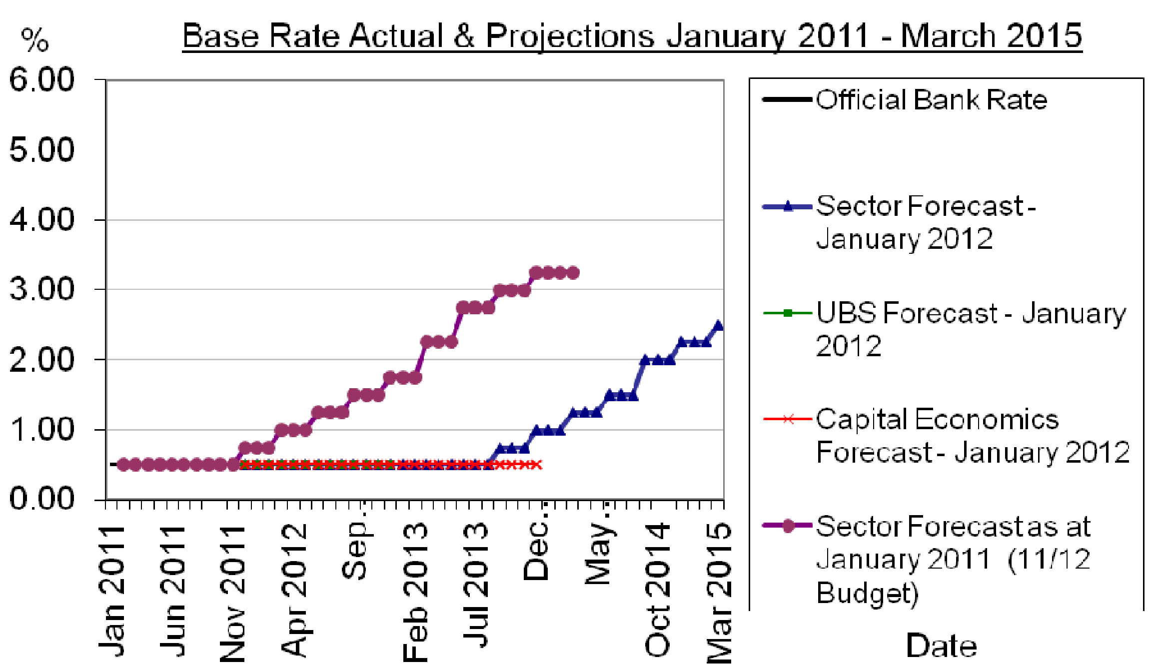

Figure 1: Base Rate 2011 to 2015 - latest forecast January 2012

Annual Investment Strategy

8. Treasury Management Strategy Statement for 2011/12 was approved by Council on 24 February 2011. The Council's

Annual Investment Strategy, which is incorporated in the Strategy, outlines the Council's investment priorities as follows:

- security of capital
- liquidity
- yield

The Council will aim to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity.

9. Investments are placed with highly credit rated financial institutions using the creditworthiness matrices described in the Treasury Management Strategy, which includes sovereign credit ratings from the rating agencies and the credit default swap (CDS) overlay information provided by Sector.

10. The current economic climate with the continuing Euro zone sovereign debt crisis and its potential impact on banks prompts a low risk and short term strategy. It is considered appropriate to keep investments short with a maximum duration of 3 months. This applies to all entities in which the Council is considering investing, except for the following institutions:
    (a) UK Government and related entities such as Local Authorities – suggested limit remains at 5 years.
    (b) UK semi-nationalised institutions e.g. Lloyds / RBS – suggested limit remains at 1 year. UK ownership provides considerable conform to investors.
    (c) Money market Funds – suggested limit remains at 1 year.

11. Investments held during the first nine months of 2011/12, in accordance with Sector's Creditworthiness matrices and changes to Fitch and Moody's credit ratings, remained within the Council's approved credit criteria limits contained in the Annual Investment Strategy.

Investment Portfolio

12. Investment rates available in the market have continued at historical low levels. The average level of funds available for investment purposes in the nine months of 2011/12 was £58.085m. The level of funds available is largely dependent on the timing of the Council's cash flow as a result of precept payments, receipt of grants, borrowing and progress on the

Capital Programme. These funds are therefore available on a temporary basis dependant on cash flow movement.

13. There are no funds currently invested for periods of a year or more due to the limited institutions available for investment in the current market environment; in accordance with the credit criteria policy.

14. Investment activity during the first nine months of 2011/12 earned a rate of return of 1.22%. This is 0.74% better than the average 7 day London Inter-Bank Deposit rate (LIBID) of 0.48% and 0.72% higher than the average base rate for the period of 0.50%.The interest earned to date in 2011/12 is in line with the treasury management budget.

15. The higher rate of return on investment activity compared to the average LIBID rate and base rate for the period is due to the treasury team continuing to monitor the market and taking advantage of opportunities when they become available, whilst ensuring the security of the council's funds. Investments in the portfolio are diversified and include deposits in short term call accounts, fixed term investments and money market funds.

16. Figure 2 shows the interest rates available on the market between 7 days and 1 year and also the rate of return that the Council has achieved for the first nine months of 2011/12. It shows that favourable / competitive interest rates have been obtained for investments whilst ensuring the required liquidity and security of funds for the Council.

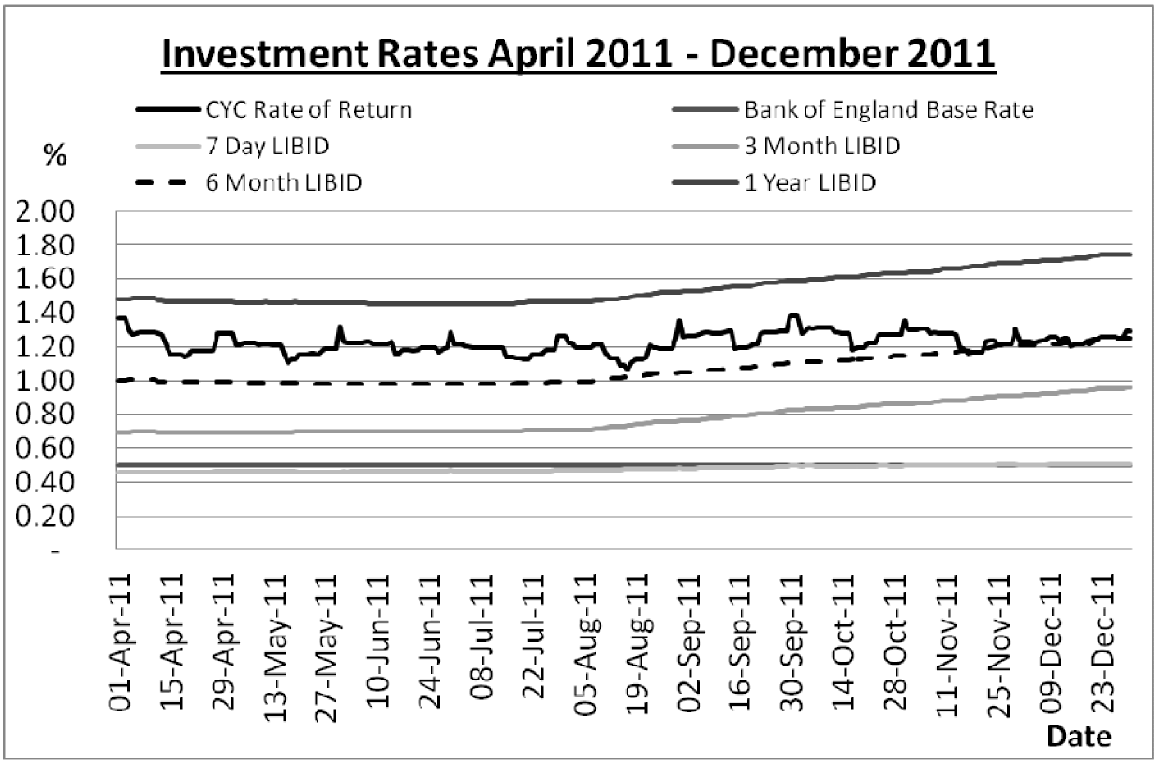

Figure 2 CYC Investments vs Money Market Rates

Borrowing Portfolio

17. The Council undertakes long term borrowing in accordance with the investment requirements of the capital programme and all borrowing is therefore secured against its asset base.

18. The level of borrowing taken by the Council is determined by the Capital Finance Requirement (the Councils underlying need to borrow for capital expenditure purposes). Borrowing needs to be affordable, sustainable and prudent and the treasury management budget supports the borrowing finance costs in the longer term.

19. Under regulation, the Council can borrow in advance of need in line with its future borrowing requirements in accordance with the Capital Financing Requirement. The Administrative Accommodation project increases the Council's need to borrow in 2011/12 and 201/13 and therefore the markets will continue to be closely monitored to ensure that advantage is taken of favourable rates in 2011/12 and the increased borrowing requirement is not as dependant on interest rates in any one year.

20. On the reverse side, the Council's level of borrowing can also be below the Capital Financing Requirement. This would mean that instead of increasing the Council's level of borrowing, surplus funds held for investment purposes would be utilised instead, decreasing the level of surplus funds being available for investment. In the current interest rate environment where investment rates are below borrowing rates consideration is given to the value of taking borrowing or whether it is better for the council to keep investment balances lower.

21. Sector – the Council's treasury management advisers - forecast that overall future PWLB rates will rise, although there is still expected to be volatility in the market over the coming months. At this Treasury Management Monitor 3 report the target level for loans for the remainder of 2011/12 is 4.3% - which is at the lower end of Sector's target range. Sector's 25 year PWLB target rate for new long term borrowing for the quarter started at 5.00% and ended at 4.20%.

22. As shown in Table 1 below, all Government Public Works Loan Board (PWLB) borrowing interest rates have generally been on a downward trend during the third quarter of 2011/12. The low points during the quarter were seen towards the end of December. The high points were seen in October.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.19%	1.96%	3.01%	3.96%	3.98%
Date	29/12/11	30/12/11	30/12/11	30/11/11	30/11/11
High	1.54%	2.56%	3.71%	4.52%	4.64%
Date	07/10/11	17/10/11	28/10/11	28/10/11	12/10/11
Average	1.39%	2.25%	3.33%	4.22%	4.28%

Table 1 – PWLB Borrowing Rates - quarter ended 31.12.2011

23. The Councils long-term borrowing started the year at a level of £133.1m. A £5m loan was repaid in May 2011 in line with its maturity date. New borrowing of £7m was taken in August 2011 and £5m in November 2011. Table 2 details the borrowing taken during 2011/12:

Loan Type	Date Raised	Date Matured	Amount	Interest Rate	Duration
Matured	28/05/2010	27/05/2011	5,000,000	0.700%	1.00
			5,000,000		
Raised	11/08/2011	10/08/2021	2,000,000	3.810%	10.00
Raised	11/08/2011	10/08/2016	5,000,000	2.500%	5.00
Raised	07/11/2011	07/11/2020	5,000,000	3.140%	9.00
			12,000,000		
Matured/Raised loans net position 2011/12			**7,000,000**		
	Opening loan balance 2011/12		**133,064,956**		
	Closing loan balance (current)		**140,064,956**		

Table 2 – Borrowing during 2011/12

24. The loans taken in 2011/12 are below the original target of 5% set in the Council approved 2011/12 strategy and also below the revised target rate of 4.3%. The £5m 10 year loan was at 3.81%, the £2m 5 year loan at 2.54% and the £5m 9 year loan at 3.14%.

25. It is anticipated that further borrowing will be undertaken during this financial year and rates continue to be monitored in this volatile opportunistic environment.

26. Figure 3 shows the fluctuation in PWLB rates since October 2010 when the Government's Comprehensive Spending Review increased rates to 1% above gilt yields. It indicates that all interest rates have generally been on a downward trend during the 2011/12, specifically low points were seen towards the end of December. The red triangles highlight when new borrowing in 2011/12 has taken place.

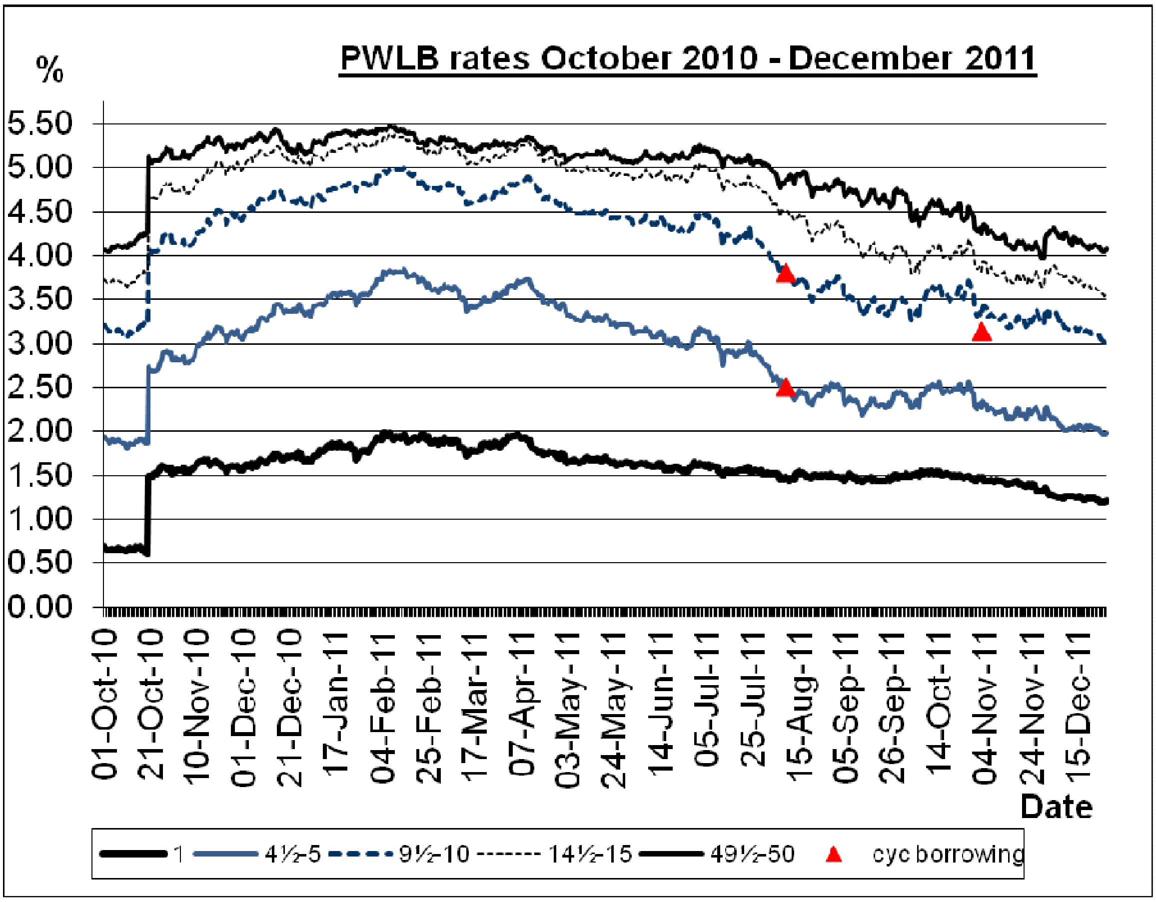

Figure 3 – PWLB rates vs CYC Borrowing Levels

27. Figure 4 illustrates the 2011/12 maturity profile of the Council's debt portfolio updated to reflect the borrowing this year to 31 December 2011. The maturity profile shows that there is no large concentration of loan maturity in any one year, thereby spreading the interest rate risk dependency.

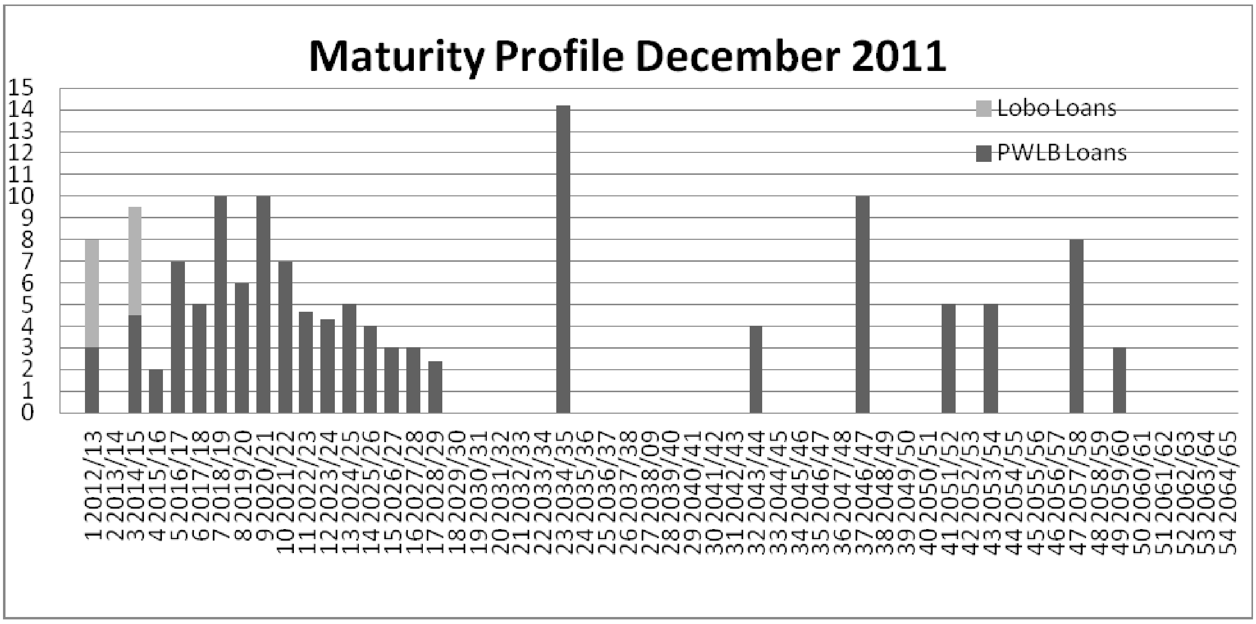

Figure 4 – Debt Maturity Profile 11/12

Compliance with Prudential Indicators

28. The Prudential Indicators for 2011/12, included in the Treasury Management Strategy Statement are based on the requirements of the Council's capital programme and approved at Council on 24 February 2011.

29. Revised Prudential Indicators for 2011/12 were approved by Council in December 2011 as recommended by Cabinet from the Treasury Management Monitor 2 Mid Year Review and Prudential Indicators 2011/12 Report. This revision occurred as a result of the HRA Self financing reform; further information is available in the Monitor 2 report.

30. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits" included in the Prudential Indicators. The monitoring of the Prudential Indicators is attached at Annex A, along with the revised limits for the HRA reform.

31. During the financial year2011/12 to date the Council has operated within the treasury limits and Prudential Indicators set out.

Consultation

32. The report shows the nine month position of the treasury management portfolio in 2011/12. The treasury management budget was set in light of the council's expenditure plans and the wider economic market conditions, based on advice from Sector - the Council's Treasury Management advisors.

Council Plan

33. The Council Plan has five priorities which all require a budget to achieve. The treasury management function aims to achieve the optimum return on investments commensurate with the proper levels of security, and endeavours to minimise the interest payable by the Council on its debt structure. It thereby contributes to all Council Plan priorities.

Human Resources Implications

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

Equalities

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

Legal Implications

36. Treasury Management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the Council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the *Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008* (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.

Crime and Disorder Implications

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

Information Technology Implications

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

Property Implications

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

Risk Management

40. The Treasury Management function is a high-risk area because of the level of large money transactions that take place. As a result of this there are procedures set out for day to day treasury management operations that aim to reduce the risk associated with high volume high value transactions. These are detailed in the Treasury Management Strategy Statement at the start of each financial year.

Recommendations

41. Members are required, in accordance with the Local Government Act 2003, to:
    - Note the Treasury Management activities in 2011/12
    - Note the movements in the Prudential Indicators at Annex A

Reason – to ensure the continued performance of the Council's Treasury Management function.

Contact Details

Author:	**Chief Officer Responsible for the report:**
Louise Branford-White Technical Finance Manager Corporate Finance Tel No. 551187	Ian Floyd - Director of Customer Business & Support Services
Ross Brown Principal Accountant Corporate Finance Tel No. 551207	Keith Best Assistant Director of CBSS (Finance)
	Report Approved ☐ Date 14/02/12

Wards Affected: All

Specialist Implication Officers: None

For further information please contact the author of the report

Background Papers

Cash-flow Model 11/12, Investment Register 11/12, PWLB Debt Register, Capital Financing Requirement 11/12, Venture Fund 11/12, Treasury Management budget 11/12, Statistics 11/112.

Annexes

Annex A – Prudential Indicators 2011/12