CITY OF YORK COUNCIL

Executive Member for Corporate Services and Advisory Panel — **25th July 2006**

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 2005/06 compared against the budget report taken to Council on 22nd February 2005. The report highlights the economic environment of the last year and in this context reviews treasury management performance covering:

    - short-term investments,
    - long-term borrowing,
    - venture fund,
    - treasury management outturn and
    - the Prudential Indicators.

2. The Treasury Management in the Public Services Code of Practice has recently been reviewed by the Chartered Institute of Public Finance and Accountancy (CIPFA) and recommends that Local Authorities update their Treasury Management Policy Statement and Practices. These have been updated and are attached in Annexes E and F.

Consultation

3. The majority of this report is for information and reporting on the performance of the treasury management function. The budget process sets the level of budget and performance expected from the Council's treasury management function as decided by Members.

Options/Analysis

4. This majority of this report is for information, however the Executive Member is requested to formally adopt the Treasury Management Policy and Practices as set out in Annexes E and F, as required by CIPFA in its Treasury Management in the Public Services Code of Practice. This is seen to be best practice and failure to adopt will 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, 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. In doing this the Council will meet its priority to "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.

   - Bank of England base rates began 2005/06 at 4.75% following a number of increases from the 20 year low of 3.5% recorded between August and November 2003. Since then there has been only one change, a 25 basis points reduction to 4.5%. Figure 1 shows the actual base rate movements since 2003/04 with, predictions from economic commentators for 2006/07.

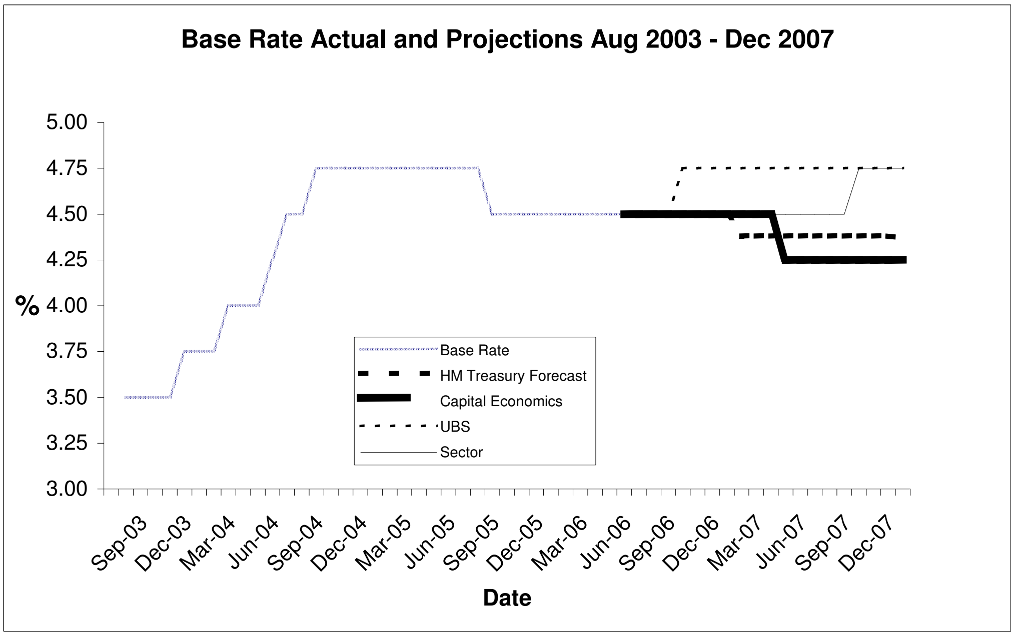

Figure 1 – Base Rates 2003-2007 as at May 2006

   - In general the market opinion was predicting no changes with rates expected to stay at 4.75% for the foreseeable future. The reduction in August 2005 surprised the market, with the MPC[1] decision to reduce rates taken after a 5-4 vote in favour of the reduction. Rates have continued to remain at 4.5% with a mix of market opinion on the direction of the next movement. Our treasury management advisors, Sector, are now predicting that rates remain on hold until September 2007, when a 0.25% increase is expected. There is now a consensus that rates are likely to remain on hold at 4.5% with a risk of a 0.25% increase at some stage over the next 18 months.

[1] Monetary Policy Committee (of the Bank of England)

- Long term borrowing was affected by two main factors during 2005/06. The introduction, by the Public Works Loans Board (PWLB), of 50 year loan terms allowed Councils to take advantage of spreading the maturity profile of their debts, and the demand of insurance companies for long term gilt edged securities (Treasury debt) drove longer term rates to historic lows. Further detail is given in paragraph 11.

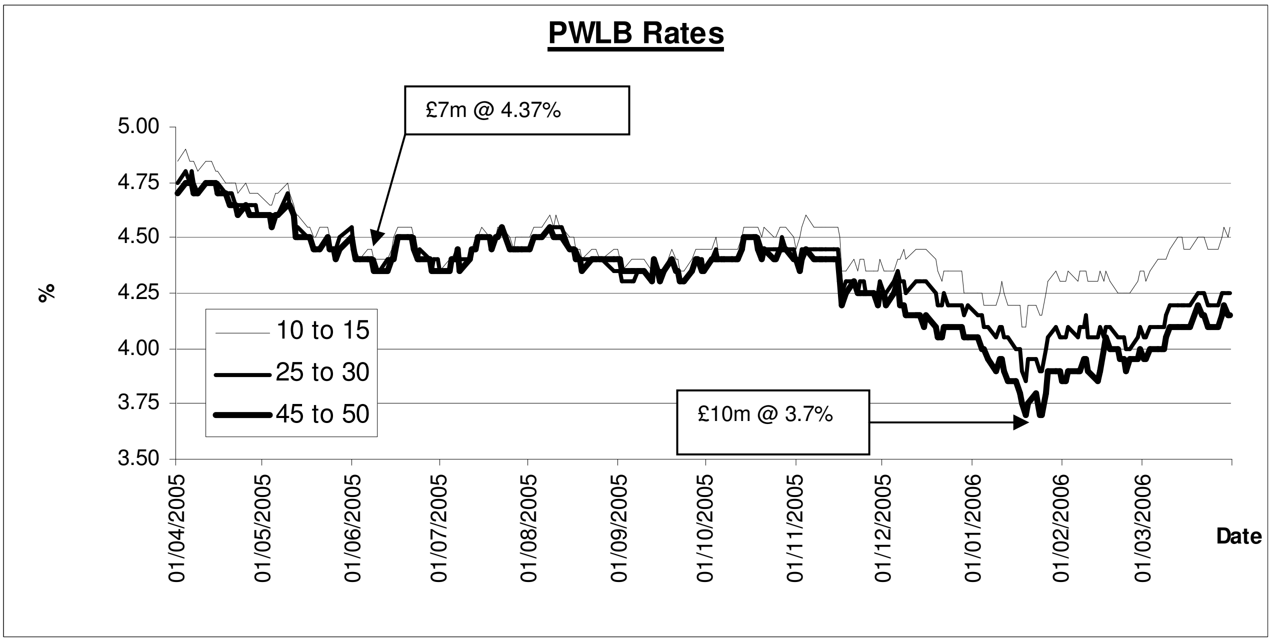

Figure 2 – PWLB rates 2005/06

- Money Market rates for short-term investments (overnight to 3 months) have generally been poor throughout the year. Longer term rates (3 months to 364 days) have been more volatile and have allowed the opportunity for favourable investments to be made.
- A number of institutions have been offering competitive interest rates on business call accounts, paying at least base rate on balances held with them. The poor short term money market rates has meant that the Council has been taking advantage of the business call accounts and actively operates 4 accounts:
  - The Abbey continues to be the best performing call account, offering 0.09% above base rate.
  - Bank of Scotland 7 day base plus notice account – pays 0.01 to 0.13% above the base rate on a rate that is set weekly,
  - Bank of Scotland Call Account – pays base rate.
  - Anglo Irish Bank – pays base rate.
- 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 dropped slightly from £29.2m in 2004/05 to £27.6m in 2005/06. The reasons for this are:

- The capital receipts target was not achieved reducing the level of investment cash.

- This was offset by borrowing in advance of 2006/07 in order to take advantage of favourable long term borrowing rates.

8. The daily cash balances varied in relation to the council's receipts and payments cycles. Cash balances reduce at the end of each month due to the payroll run and increase at the beginning of the month with the receipt of Council Tax and Non Domestic Rates. Annex C shows the movement in daily cash balances over the year. Surplus cash was invested in accordance with the Council's Treasury Policy Statement with major financial institutions. Trading activity during the year generated an excess of £1.293m of interest earned over interest payable, equivalent to a 4.69% rate of return. This is 0.15% better than the average 7 day London Inter-Bank Bid Rate (LIBID) of 4.54%, 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 £1.274m. This is equivalent to a return of 4.62%, which is 1.04% above the average rate (one per cent below bank base rate) paid by the bank on credit balances held in the Council's accounts, as shown in Annex A. In simple terms, the value added by the Council's money market trading activities is estimated at £0.287m.

10. During the year, the council has made 132 investments, compared with 110 in 2004/05. This increase is due to the short term money rates often beating the rates offered by the business reserve accounts and more proactive management of the Council's investments. The overall investment pattern has changed slightly with 53% of investments now being made into the business reserve accounts compared with 75% in 2004/05, this reflects a more lively money market compared to last financial year, when business reserve accounts rates were often better than money market rates. This is illustrated by figure 3:

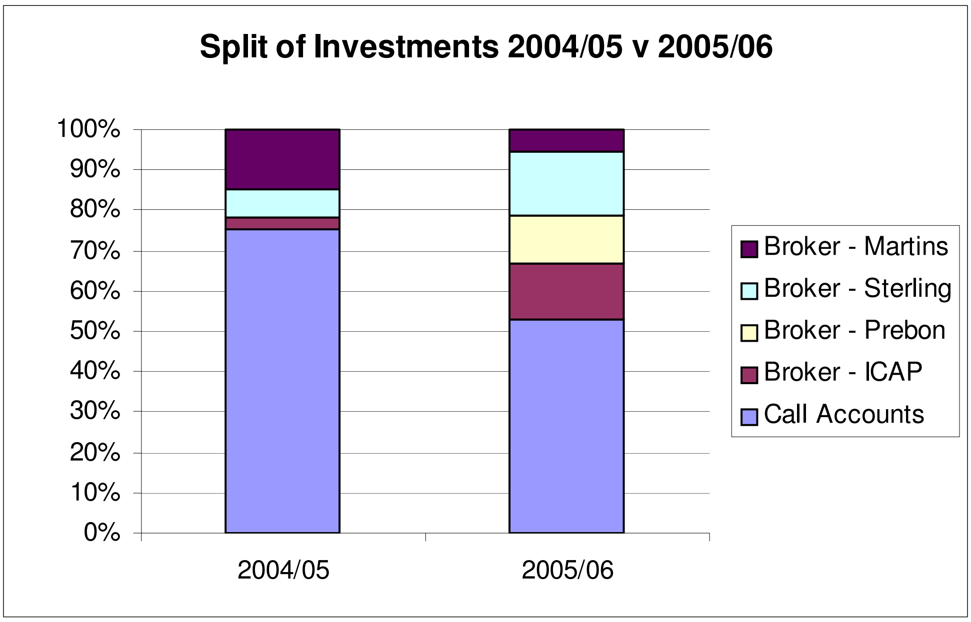

Figure 3 – Investment Split in 2005/06 and 2004/05

11. Additional information is provided in Annex B about the scale of money market activities for 2005/06 and the relative uses made of different types of lending institution and the various Council brokers.

12. The Council has made 62 investments with money market institutions during 2005/06. Of these 40 have been for a week or less and only 5 have been for over 3 months. Table 1 gives details of investments greater than 3 months.

Financial Institution	Base Rate at time	Rate Achieved	Value	Start Date	Maturity
Nationwide BS	4.50%	4.55%	£2m	21/10/05	364 days
Irish Intercontinental Bank	4.50%	4.63%	£1.5m	3/11/05	364 days
Irish Intercontinental Bank	4.50%	4.56%	£1.8m	17/11/05	120 days
Irish Intercontinental Bank	4.50%	4.53%	£1.3m	23/01/06	364 days
Irish Intercontinental Bank	4.50%	4.60%	£1.5m	26/01/06	364 days

Table 1 – Investments for 3 months or greater

13. In addition to these deals one forward deal has been entered in to. A forward deal is when the Council enters in to an agreement to invest a specified sum of money on a specified future date for a specified length of time. The decision to make this forward deal has been made by considering key economic data and projections and through the use of the recently developed 3 year cashflow model which assists with taking such investment decisions by ensuring that the Council maximises the return on its money market investments. Table 2 illustrates the investment.

Financial Institution	Base Rate Projection	Rate	Value	Start Date	Maturity
Irish Intercontinental Bank	4.0 –4.5%	4.70%	£3m	08/09/06	364 days

Table 2 – Forward Market Investments

14. Due to a relatively low number of deals this year, it has been decided not to complete a full annual review of the brokers. Informal feedback from the dealing team indicate that all brokers continue to provide a good service to the council supplying rates on a consistent basis, but since rates have been poor throughout the market this has inevitably led us to invest in the business reserve accounts. It is intended to retain the services of all four brokers. The split of investments between brokers remains fairly even.

Long Term Borrowing

15. 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 the 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 as much as they like provided that it is prudent, affordable and sustainable and within their prudential indicators.

16. The council's borrowing strategy is to borrow when the Public Works Loans Board (PWLB) rates are low and hold back on borrowing when rates are high following advice from its treasury advisors. The council set a trigger point for taking long term borrowing of 4.50% during 2005/06. Long term borrowing rates started the year at around 4.75%, but quickly dropped in the 1st quarter to between 4.25 – 4.50% during quarters 2 and 3 before falling to an historic low of 3.7% in January. Rates have since risen and ended the financial year at 4.25%.

17. The Councils long term borrowings started the year at £80.4m, with two tranches of £2m been repaid in August and February. Two additional loans totaling £7m were taken in June achieving rates of 4.35% and 4.4% respectively, with a final loan of £10m taken in February, at the historically low rate of 3.7%. Total long term borrowing at the end of the year was £93.4m. Table 3 summarises the movement in total council borrowings during the year.

	Date	£	Prevailing Base Rate	Weighted %	Year of Maturity
Total Debts as at 1/4/05		**80,364,956**	**4.75%**	**4.828%**	
Plus New Loans	9 June 2005	4,000,000	4.75%	4.350%	2007/08
	9 June 2005	3,000,000	4.75%	4.400%	2012/13
	23 Jan 2006	10,000,000	4.5%	3.700%	2046/47
Less Loans repaid	28 Aug 2005	(2,000,000)	4.5%	4.375%	2005/06
	28 Feb 2006	(2,000,000)	4.5%	4.375%	2005/06
Total Debts as at 31/3/06		**93,364,956**	**4.5%**	**4.692%**	

Table 3 – Movement in Long Term Borrowing 2005/06

18. The first loan for £4m is to replace 2 loans which mature during 2005/06 at an average rate of 4.375%. The second loan for £3m is for the remaining amount the council requires to fund the 2005/06 capital programme. The council required £10.2m worth of borrowing for the capital programme as detailed in the Budget report on 22nd February 2005. Borrowing of £7m was made in December 2004 for the 2005/06 capital programme so the £3m represents the remainder. This borrowing was taken below the borrowing trigger point rate of 4.50%, as advised by Sector, our treasury management advisors. The additional £10m taken out in January 2006 was to respond to the historically low interest rate of 3.7% and has been taken in advance of the 2006/07 capital programme and the Council's Administrative Accommodation needs.

19. 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 £4m and £3m loans were taken over relatively short periods to smooth the maturity profile, with the £10m loan taken over 41 years which allowed the most competitive rate to be gained and to reflect the long term

nature of the capital assets that it would be financing, namely the new Civic building. Table 4 illustrates the 2005/06 and 2006/07 maturity profiles of the Council's borrowing.

	2005/06		2006/07	
Years to Maturity	**£**	**Maturity Profile**	**£**	**Maturity Profile**
<1	4,000,000	5%	0	0%
1-2	0	0%	4,000,000	4%
2-5	9,000,000	11%	13,000,000	14%
6-10	4,000,000	5%	5,000,000	5%
11-15	16,500,000	21%	14,500,000	16%
16-20	22,314,956	28%	24,314,956	26%
21-25	10,350,000	13%	8,350,000	9%
26-30	14,200,000	18%	14,200,000	15%
31-35	0	0%	0	0%
36-40	0	0%	0	0%
41-45	0	0%	10,000,000	11%
Total	80,364,956	100%	93,364,956	100%

Table 4 – Debt Maturity Profile 2005/06 vs 2006/07

20. As a result of the borrowings made in-year, the average rate of interest on the Council's long term borrowing has fallen from 4.83% in 2005/06 to 4.69%. This is 1.08% lower than the latest available[2] average long term borrowing rate for unitary authorities of 5.75%. The long term borrowing rate is expected to reduce further in 2006/07 with longer term rates expected to be below trend for the majority of the year.

Debt Restructure

21. No debt restructures occurred during 2005/06. The council is still benefiting from restructures made in previous years which have considerably lowered our average debt interest rate in comparison with other unitary authorities.

22. The anticipated restructure of the £10m club loan did not take place during 2005/06. This is a loan from the Royal Exchange Trust Company which was taken out by York in conjunction with 2 other local authorities. In order to restructure this loan the agreement of all partners is necessary. All parties met in March to discuss the possibility of restructuring, but it was apparent that one of the local authority partners is reluctant because of the negative impact that it would have on their Housing Revenue Account (HRA). The Council are continuing to have discussions with this partner to see if this can be resolved.

Venture Fund

23. 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 5.

[2] 2004/05 Treasury Management Statistics from ODPM

	£'000
Balance at 1 April 2004	**1,467**
New Loan Advances	(174)
Loan Repayments Received	1,016
Net Interest Received	13
Transfer to fund capital programme	(1,470)
Balance at 31 March 2005	**852**

Table 5 – Venture Fund

24. New loan advances were made in 2005/06 for the benefits take up campaign and towards set up the procurement team. Repayments were received in relation to 16 schemes.

25. The slippage of a number of high value capital receipts resulted in a shortfall in the available funding available to finance the capital programme. The Council had an option to borrow to fund the shortfall, however, taking this option would increase the level of borrowing and as a result increase the amount of funding that has to be set aside for the repayment of debt (the minimum revenue provision – MRP) during 2006/07. It would cost the Council £45k in additional MRP costs if the venture fund were not to be used in this way. There are more than £10m of capital receipts due to be received by the end of June from which the venture fund can be replenished.

Financial Implications – Budget Outturn

26. Treasury Management activity is contained within the Corporate Budget, which is currently approved at £2,526k for 2005/06. The outturn is £2,628k, which results in a small overspend of £102k. The principal elements that contribute to this deficit are shown in Table 6 and are compared to the previous monitor.

	Previous Forecast £(000)	Provisional Outturn £(000)
Decrease in average balances The delay in the capital receipts has resulted in an impact on the Council's cash flow, which has had a knock on effect on the treasury management budget. As a result of the underachievement of capital receipts against the anticipated plan the Council is using its existing cash balances to fund the capital programme, resulting in a significant drop in the average core general fund cash balances available for investment.	+597	+502
Investment interest Interest rates were reduced in August 2005 to 4.5%, which was slightly later than budgeted for. This, with the interest from Harewood Whin being received and a number of market beating investments has resulted in a better than forecast interest return.	-109	-189
Venture Fund Interest There have been a number of changes to the repayment profiles on the venture fund, including a number of deferrals which has result in interest earned being more than budgeted for.	-44	-51

Minimum Revenue Provision (MRP) decrease There has been a reduction in MRP because the opening balance for 2005/06 on the Capital Financing Requirement is lower than expected. This is because under the Prudential System it is no longer necessary for the HRA to make a set-aside payment, and so this payment was not made in 2004/05.	-83	-47
Business Rates Refund Interest The Council has received backdated interest on a number of the large rating revaluations that took place in 2004/05. This income was unbudgeted for and therefore lowers the overall overspend.	-	-187
Club Loan Debt Restructure Negotiations to restructure the Council's £10m have been hampered by one of the partner authorities reluctance to reschedule. However, around the table negotiations are set to resume in December and it is hoped for a successful outcome in the new year. It is unlikely that the £80k saving forecast will be achieved in this financial year though.	+80	+80
Miscellaneous Small variances were also incurred.	+9	-6
TOTAL	+450	+102

Table 6 –Treasury Management Outturn 2005/06

Review of the Prudential Indicators

27. In accordance with the Prudential Code, the Prudential Indicators set by Full Council on 22nd February 2005 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 2005/06 Capital Programme was an estimate of £44.4m and the outturn recorded was £36.2m. Although this represents a £5.9m underspend against the original planned budget it is the Council's largest ever capital spend which was activity slowed towards to the end of the financial year in response to the delay in achieving key capital receipts that fund the programme.

- Net Revenue Stream (Indicator 2) – This indicator estimates how much borrowing for the capital programme will cost when compared with the total revenue budget/outturn. The General Fund indicator is 3% compared to 2.52%, with the increase mainly due to the level of capital receipts being lower than anticipated, thereby increasing net debt. The HRA version is much lower being 2.58% as opposed to 4.45%. The reduction in the HRA indicator is mainly because HRA cash balances are higher than anticipated, caused by a reduced revenue contribution to the capital programme and the decision not to make a set aside to repay HRA debt.

- Capital Financing Requirement (CFR) (Indicator 5) – The council's CFR (underlying need to borrow) has increased by £10.6m as a result of the 2005/06 capital programme to £83.5m at 31 March 2006. Anticipated level of the CFR as predicted in February 2005 is however, different because of 2004/05 year end changes to the opening balance of the CFR.

- Authorised Limit / Operational Boundary (Indicator 6) – The council took out additional debts of £17m, and repaid £4m, increasing its overall long term borrowing by £13m. The total level of debt currently stands ay £93.4m. Consequently the council's long term borrowing did not exceed either the Authorised Limit of £112.5m or the Operational Boundary of £95.6m. These limits have been reviewed as part of the 2006/07 budget process with the Authorised Limit for 2006/07 now standing at £165.7m and the Operational Boundary at £144.2m. The large increase is to accommodate the building of the new Civic Building and to give the Council sufficient flexibility to take advantage of historically low borrowing rates

- Comments on the remaining indicators are given in Annex D.

Human Resources Implications

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

Equalities Implications

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

Legal Implications

30. 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

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

Information Technology Implications

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

Property Implications

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

Risk Management

34. The treasury management function is a high risk area because of the volume and level of large money transactions. As a result of this there are strict procedures set out as part of the Treasury Management Practices statement, attached in Annex F

Recommendations

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

- Note the performance of the Treasury Management activity 2005/06, movements on the Venture Fund and the Treasury Management Outturn;

- Note review of the movements in the Prudential Indicators;

- Approve the revised treasury management policy and practices statement as per annexes E and F.

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

Contact Details

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Tel No. 551187	**Report Approved** ✓ **Date** *26/06/06*

Wards Affected: None

Specialist Implication Officers:

None

For further information please contact the author of the report

Background Papers:
Cash-flow Model, Investment Register, PWLB Debt Register, Budget monitoring 0506, Capital Financing requirement 0506 outturn, Venture Fund 0506, Prudential Indicators 0506.

Annexes
Annex A - Surplus on Money Market Trading Activity 2005/06
Annex B - Money Market Trading Statistics 2005/06
Annex C – 2005/06 Cash Balances
Annex D – 2005/06 Prudential Indicators
Annex E – Treasury Management Policy Statement
Annex F – Treasury Management Practices