CITY OF YORK COUNCIL	
Cabinet	**17 July 2012**
Report of the Cabinet Member for Corporate Services	

Treasury Management Annual Report & Review of Prudential Indicators 2011/12

Summary

1. This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2011/12. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

2. During 2011/12 the minimum reporting requirements were that the full Council receive the following reports:
   a) an annual treasury strategy in advance of the year (February 2011)
   b) a mid year (minimum) treasury update report (December 2011)
   c) an annual review following the end of the year describing the activity compared to the strategy (this report)

3. Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members. Prudential Indicators are attached at Annex A.

4. The Council has complied with the requirement under the Code to give scrutiny to all of the above treasury management reports by the Audit & Governance Committee and member training on

treasury management issues was undertaken during the year on 13 February 2012 in order to support Members' scrutiny role.

5. The treasury management annual activities detailed in the report ensure the Council's treasury management activities are affordable sustainable and prudent as approved by Council on 24 February 2011 and the Council's debt and investment position ensures adequate liquidity for revenue and capital activities, security for investments and manages risks within all treasury management areas.

6. The Council's treasury position for 2011/12 is in the table below, compared to 2010/11. It shows that the Council's Capital Financing Requirement, borrowing and investment position. In 2011/12, £121.5m of debt was taken in accordance with the new HRA self financing reform. Further detail is included later in the report.

	31-Mar-12 £m	Rate %	31-Mar-11 £m	Rate %
GF Total Debt	**121.3**	**4.2%**	**114.3**	**4.2%**
HRA Debt	18.8	4.2%	18.8	4.2%
HRA Self Financing	121.5	3.2%		
HRA Total Debt	**140.3**	**3.4%**	**18.8**	**4.2%**
Total debt	**261.6**	**3.8%**	**133.1**	**4.2%**
Capital Financing Requirement	**293.2**		**152.5**	
Over/ (under) borrowing	**(31.6)**		**(19.4)**	
Investments:	**26.2**	**1.45%**	**35.2**	**1.15%**

Table 1 – Position of the treasury management portfolio

Background

Economic Background

7. The performance of the council's treasury management function is an outcome of the long-term borrowing and short-term investment decisions affected by the economic conditions during the 2011/12 financial year.

8. The financial year continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2011-12 was that Bank Rate would start gently rising from quarter 4 2011. However, GDP growth in the UK was disappointing during the year under the weight of the UK austerity programme, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the EU.

9. The EU sovereign debt crisis grew in intensity during the year until February 2012, when a second bailout package was eventually agreed for Greece. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £75bn in October 2011 and another £50bn in February 2012. Bank Rate therefore ended the year unchanged at 0.5% while CPI inflation peaked in September 2011 at 5.2% but then fell to 3.4% in February 2012, with further falls expected to below 2% over the next two years.

10. Gilt yields which affect the rate at which the Council can borrow, fell for much of the year, until February 2012, as concerns continued to build over the EU debt crisis. This resulted in safe haven flows into UK gilts which, together with the two UK packages of quantitative easing during the year, combined to depress borrowing rates which continued at historically low levels.

11. Investment rates, the rate at which the Council can lend, remained low throughout 2011/12. This was due to widespread and multiple downgrades of many banks credit ratings and country sovereign ratings, continued Eurozone concerns, and the significant funding issues still faced by many financial institutions.

12. Figure 1 shows the base rate movements since 1 January 2011 with predictions from economists and the Council's treasury management advisors – Sector - to March 2015. The graph shows how predictions have changed. The circle line shows Sectors prediction of the base rate in January 2011compared to their latest prediction in triangles. All forecasts show the base rate to remain flat at 0.5% until December 2013.

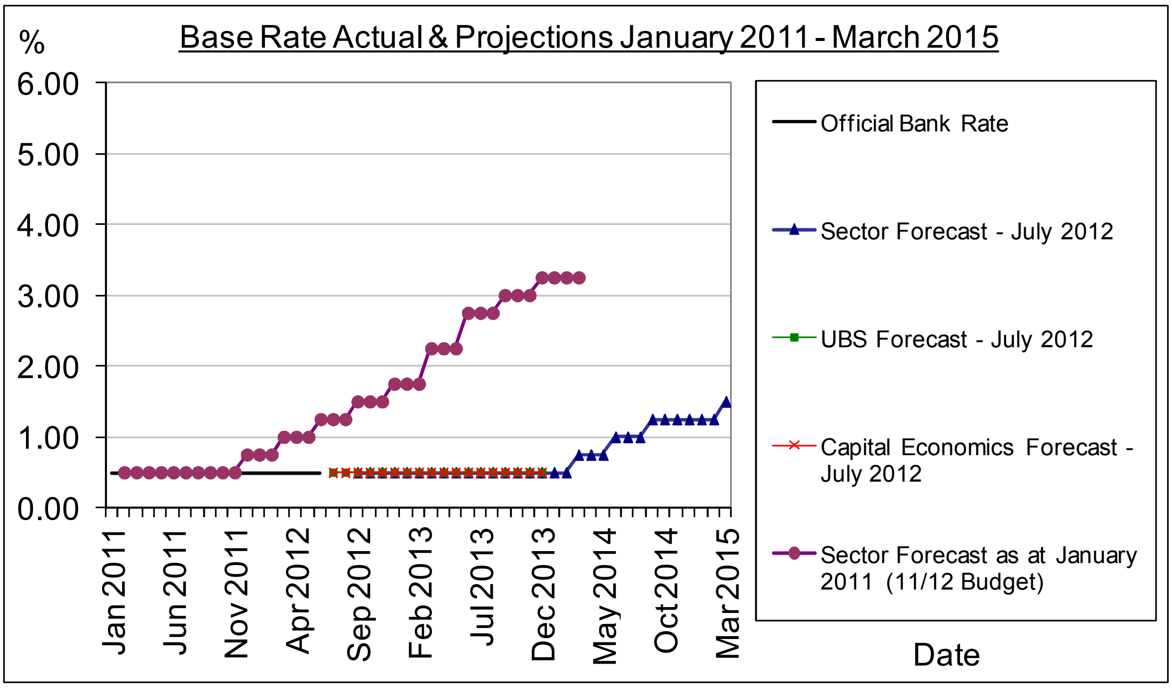

Figure 1 – Forecast Base Rates 2011- 2015

Treasury Management Strategy

13. The Council's borrowing strategy set for 2011/12 at full Council on 24 February 2011 followed advice from the council's treasury management advisors –Sector - to have a balanced approach and lock into some long term borrowing in 2011/12 where interest rates were expected to be lower than in the coming years, whilst also considering reducing the Councils surplus funds due to investment rates yielding relatively low returns compared to borrowing rates.

14. External borrowing would be taken throughout the financial year when interest rates seemed most favourable at a target interest rate of 5%. The target rate was revised at the midyear review report to Cabinet on 1 November 2012 to 4.3%. The maturity profile of the debt portfolio was taken into account, so the Council was not exposed to the concentration of debt being in any one year.

15. Also running down the investment portfolio and using the Council's surplus cash rather than taking further external borrowing was also deemed a favorable approach. Due to continued uncertainty in the aftermath of the 2008 financial crisis consideration was given to postponing borrowing to avoid the

cost of holding higher levels of investments and to reduce counterparty risk.

16. The actual movement in gilt yields meant borrowing rates fell sharply during the year and continued at historically very low levels.

17. Figure 2 shows the PWLB interest rates from 1 October 2010 to 31 March 2012 and includes the loans borrowed by the council. It illustrates that the Council took loans during the year as rates continued to fall. At the end of March, the triangle at the far right is the average loan rate for the 21 HRA self financing loans at 3.2%.

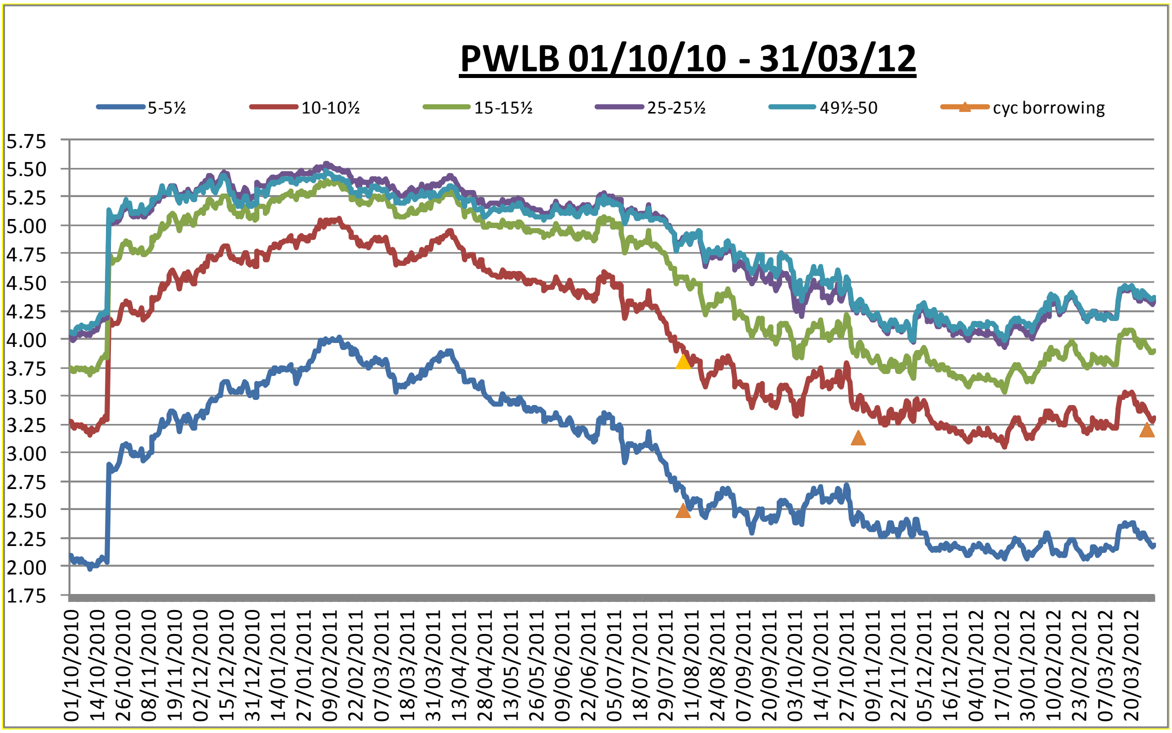

Figure 2 - PWLB rates and CYC borrowing levels

18. Figure 2, illustrates that over 2011/12, that PWLB rates have fallen significantly and have almost returned to the level that they were at prior to the government increasing all PWLB rates by 0.85 basis points on 20 October 2012.

Borrowing Outturn 2011/12

19. The Council undertakes capital expenditure on long-term assets as part of the Capital programme. The way that the capital

programme is financed affects the treasury management activity of the Council, and ultimately borrowing. The prudential indicators which control the borrowing activity of the Council are contained in Annex A.

20. The purpose of the Council's underlying need to borrow is to finance capital expenditure and this is termed the Capital Financing Requirement (CFR). In 2011/12 the Council's CFR significantly increased compared to previous years. This was due to the implementation of the housing finance reform at the end of the financial year, which abolished the housing subsidy system financed by central government. Consequently, all housing debt had to be reallocated nationally between housing authorities. The result of this reallocation is that this Council made a capital payment to the Department of Communities and Local Government of £121.550m. This resulted in an increase in the CFR.

21. The total CFR for the council at the end of 2011/12 was £293.2m and this was split between the General Fund at £152.9m and the HRA at £140.3m. In accordance with the borrowing strategy, some external borrowing was taken to finance this requirement but also surplus funds were used and the investment portfolio was reduced.

22. Total borrowing at the start of 2011/12 was £133.1m (General Fund £114.3m / HRA £18.8m) and at the end of 2011/12 excluding the HRA self financing settlement £140.1m (General Fund £121.3m / HRA £18.8m). Total borrowing at the end of 2011/12 including the HRA self financing settlement of £121.55m, was £261.6m. This is split between the General Fund £121.5m and the HRA £140.3m. In accordance with the HRA Self Financing regulations, there will be two borrowing portfolios from 2011/12 which will be monitored separately in future.

23. It should be noted that there was no impact on HRA revenue budget in 2011/12 to finance the £121.550m payment made as compensating adjustments were made in the HRA subsidy determination. The HRA subsidy determination continued to 31/3/2012, from 1/4/2012 the new self financing system commences.

24. Table 2 and Table 3 show the movement in borrowing during the year split between the General Fund and HRA. Details on the interest rates obtained on new borrowing, the average rate of the portfolio and the year of maturity are also shown.

General Fund					
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		
		Loans net position 2011/12	**7,000,000**		
		Opening loan balance 2011/12	**114,271,110**		
		Closing loan balance 2011/12	**121,271,110**		

Table 2 - Movement in General Fund Borrowing 2011/12

HRA					
Loan Type	**Date Raised**	**Date Matured**	**Amount**	**Interest**	**Duration**
Raised	28/03/2012	31/03/2027	5,000,000	3.050%	15.01
Raised	28/03/2012	31/03/2032	3,750,000	3.320%	20.01
Raised	28/03/2012	31/03/2026	4,500,000	2.970%	14.01
Raised	28/03/2012	31/03/2031	6,000,000	3.328%	19.01
Raised	28/03/2012	31/03/2026	5,000,000	2.970%	14.01
Raised	28/03/2012	31/03/2024	1,900,000	2.760%	12.01
Raised	28/03/2012	31/03/2042	8,100,000	3.510%	30.01
Raised	28/03/2012	31/03/2025	4,000,000	2.870%	13.01
Raised	28/03/2012	31/03/2028	7,000,000	3.120%	16.01
Raised	28/03/2012	31/03/2029	7,900,000	3.180%	17.01
Raised	28/03/2012	31/03/2028	6,500,000	3.120%	16.01
Raised	28/03/2012	31/03/2030	5,600,000	3.230%	18.01
Raised	28/03/2012	31/03/2027	5,600,000	3.050%	15.01
Raised	28/03/2012	31/03/2025	4,400,000	2.870%	13.01
Raised	28/03/2012	31/03/2042	8,100,000	3.510%	30.01
Raised	28/03/2012	31/03/2030	6,000,000	3.230%	18.01
Raised	28/03/2012	31/03/2029	7,000,000	3.180%	17.01
Raised	28/03/2012	31/03/2031	6,100,000	3.280%	19.01
Raised	28/03/2012	31/03/2030	5,000,000	3.230%	18.01
Raised	28/03/2012	31/03/2042	8,100,000	3.510%	30.01
Raised	28/03/2012	31/03/2031	6,000,000	3.280%	19.01

	Loans net position 2011/12		**121,550,000**		
Opening loan balance 2011/12			**18,793,846**		
Closing loan balance 2011/12			**140,343,846**		

Table 3 - Movement in HRA Borrowing 2011/12

25. The General Fund new borrowing decisions were taken in light of the maturity structure of the Council’s current long term borrowing and the advantageous interest rates available. The new HRA self financing borrowing was taken in accordance with the HRA self financing model, to ensure the most optimum position could be obtained for the HRA in this historical low interest rate environment.

26. The Council did not restructure any of its borrowing portfolio during the year as no opportunities were favourable due to the disparity in PWLB rates since November 2007 and the governments increase in PWLB rates in the comprehensive spending review October 2010 by 0.85 basis points. The graph at figure 2 does highlight however, that interest rates have substantially fallen during 2011/12 and that rates are almost as low as they were prior to the governments overnight interest rate increase. Therefore, in 2012/13 there could be potential rescheduling opportunities.

27. The overall position of the borrowing activity resulted in a fall in the average interest rate by 0.4% from 4.2% to 3.8%. If the HRA self financing debt is excluded to give a fairer comparison between 2010/11 and 2011/12 then the average interest rate remained the same at 4.2%.

28. Figure 3 shows the average rate of CYC borrowing in 2010/11 continues to be lower than other unitary authorities and the national average. No figures as yet are available for 2011/12.

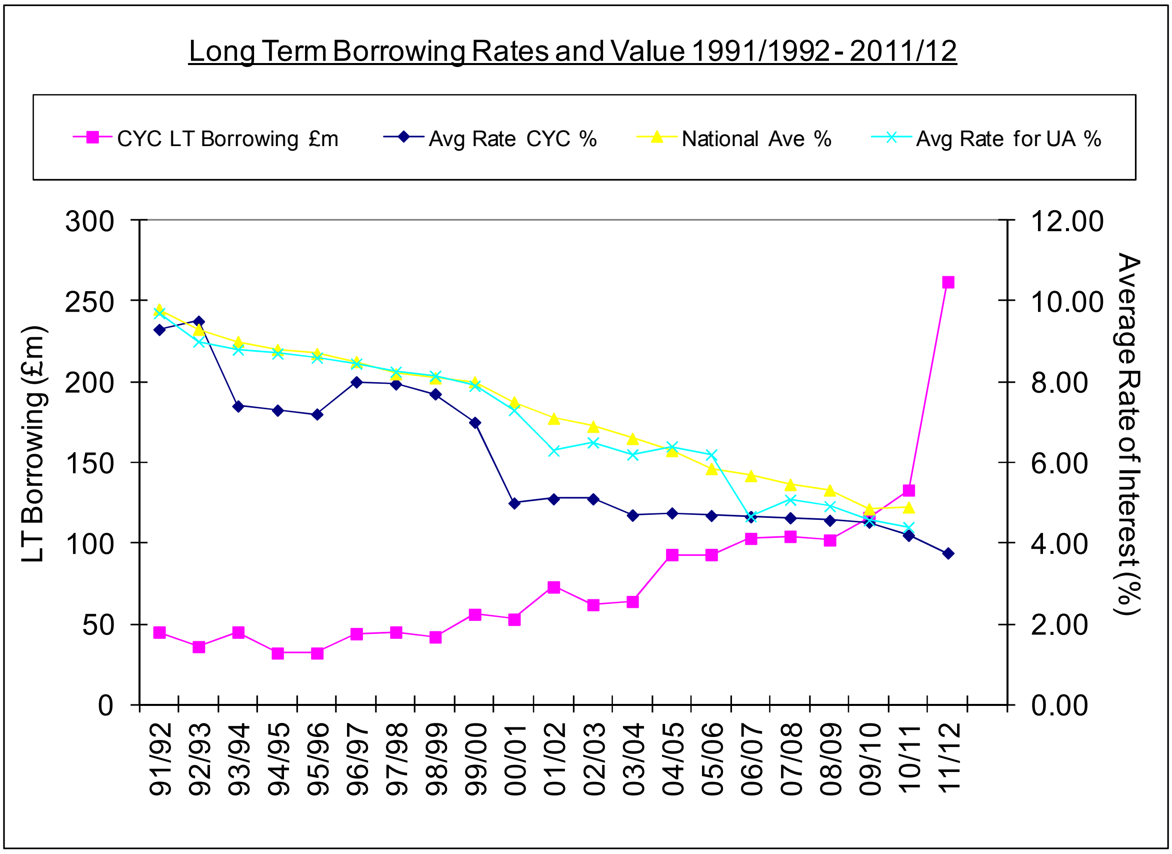

Figure 3 - CYC borrowing vs National Average vs Unitary Authority

Investment Outturn 2011/12

29. The tight monetary conditions following the 2008 financial crisis continued through 2011/12 with little material movement in the shorter term deposit rates. Bank Rate remained at its historic low of 0.5% throughout the year while market expectations of the imminence of monetary tightening and potential increase in interest rates, were gradually pushed further and further back during the year to the second half of 2013 at the earliest. Overlaying the relatively poor investment returns were the continued counterparty concerns generated by the Eurozone sovereign debt crisis.

30. The Council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the Council on 24 February 2011. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies (Fitch, Standard & Poors, Moody's) supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

31. The continued credit rating concerns of counterparty's resulted in very few counterparties being available in which the Council could invest its surplus funds. Those counterparties which were available were also utilised by other investors as better credit rated institutions hold lower risk. Therefore interest rates remained low at all level.

32. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

33. The Council maintained an average investment balance of £63.8m compared to £43.1m in 2010/11. The surplus funds earned an average rate of return in 2011/12 of 1.45% compared to 1.15% in 2010/11. This is due to cash flow movements giving rise to an increased average investment balance during 2011/12. The comparable performance indicator is the average 7-day LIBID rate, which was 0.48% in 2011/12 and the three month LIBID rate of 0.82%. All investments occurred in line with the investment strategy that the security of capital is of prime importance.

34. Figure 4 illustrates the investment interest rates available for 2011/12 including the rate of return on investments achieved. The Council's rate of return is continually higher than all yields except 1 year. The Council could not invest further in 1 year deposits due to the security of the Councils surplus fund being of prime importance.

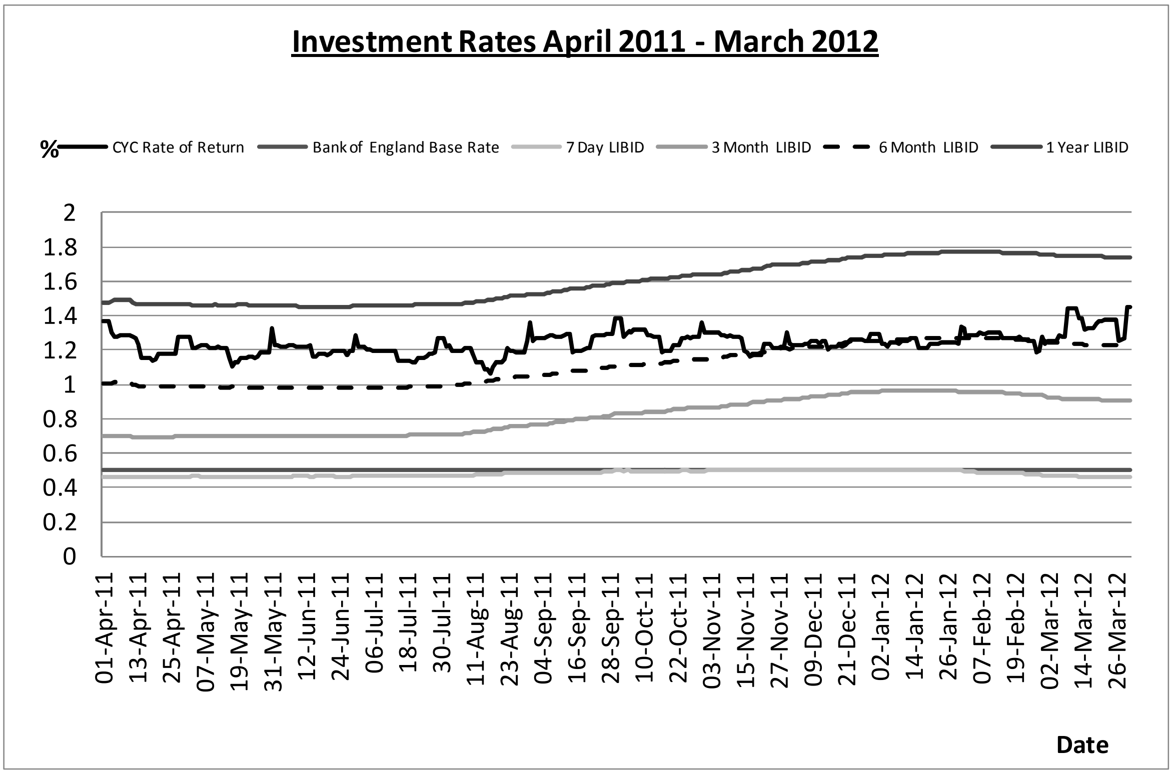

Figure 4 – Investment Rates vs. Rate of Return on CYC Investments

Consultation

35. This report is for information purposes and reports 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

36. In accordance with the Local Government Act 2003, it is a requirement under the CIPFA Prudential code and the CIPFA Treasury Management in Local Authorities that the Cabinet receives an annual treasury management review report of the previous year –2011/12- by 30 September 2012. It is also a requirement that the Council delegates the role of scrutiny of treasury management strategy and policies to a specified named body which in this Council is the Audit & Governance Committee. This annual treasury management report is scheduled at Audit & Governance Committee on 25th July 2012.

Corporate Priorities

37. Treasury Management is aimed at ensuring the Council maximises its return on investments and minimises the cost of its debts. This will allow more resources to be freed up to invest in the Council's priorities, values and imperatives, as set out in the Council's plan. Effective treasury management is concerned with the management of the council's cash flows, it's banking, money market and capital transactions, the management of debt, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks.

Implications

38.

(a) **Financial** These are detailed in the body of the report

(b) **Human Resources (HR)** There are no HR implications as a result of this report

(c) **Equalities** There are no equalities implications as a result of this report

(d) **Legal** 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 the CIPFA Treasury Management Code of Practice

(e) **Crime and Disorder** There are no crime and disorder implications as a result of this report

(f) **Information Technology (IT)** There are no IT implications as a result of this report

(g) **Property** There are no property implications as a result of this report

Risk Management

39. 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. The scrutiny of this and other

monitoring reports is carried out by Audit & Governance Committee as part of the council's system of internal control.

Recommendations

40. The Cabinet, in accordance with the Local Government Act 2003 is advised to:
    - **(a)** **Note** the 2011/12 performance of the Treasury Management activity,
    - **(b)** **Note** the change in the funding of the HRA from the subsidy system to the HRA Self Financing system
    - **(c)** **Note** the movements in the Prudential Indicators in Annex A

Reason – to ensure the continued performance of the Council's Treasury Management function and the affects of the HRA reform on treasury management activities can be monitored.

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<tr><td colspan="5">Specialist Implications Officer(s</td></tr>
<tr><td colspan="3">Wards Affected: All wards</td><td>All</td><td>Y</td></tr>
<tr><td colspan="5">For further information please contact the author of the report</td></tr>
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Background Papers:
Cash-flow Model 2011/12 Investment Register 2011/12, PWLB Debt Register, Capital Financing Requirement 2011/12 outturn, Prudential Indicators 2011/12, CIPFA Statistics 2010/11

Annexes - Annex A: Prudential Indicators 2011/12