CITY OF YORK COUNCIL

Executive **8 September 2009**

Report of the Director of Resources

Treasury Management Monitor 1 Report

Summary of Report

1. This report updates the Executive on the Treasury Management performance for the period 1 April 09 to 31 July 2009 compared against the budget presented to Council on 21 February 2009.

2. The report highlights the economic environment for the first four months of the 2009/10 financial year and in relation to this reviews treasury management performance covering:

   - Short-term investments,
   - Long-term borrowing,
   - Venture Fund,
   - Treasury Management Budget.

Background

3. The Council's treasury management function is responsible for the effective management of the Council's 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.

4. The Council approved the Treasury Management Strategy, budget and Prudential Indicators on 21 February 2009. The report monitors the Treasury Management activity for the first 4 months of 2009/10 and shows the change in the Treasury Management budget to 31 July 2009 and the forecast outturn position for the year.

Consultation

5. This report is for information and reporting on the performance of the treasury management function. The budget was set in light of the prevailing expenditure plans and economic conditions, based on advice from the Council's Treasury Management advisors.

Corporate Priorities

6. The Council has a priority to ensure value for money and efficiency of its services. Treasury Management 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.

Economic Background and Analysis

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

   a. The first quarter of the financial year of 2009 saw:
      i. The 'green shoots' of recovery emerge; Consumer confidence continue to pick up; Industrial production rose, the first time since Nov 2007; Nationwide house price index rose leading to the first quarterly rise since Q4 2007;
      ii. The rate of contraction in the economy ease considerably compared to the last quarter of 2008/09 when GDP contracted by 2.4%, the largest fall for over 50 years.
      iii. Monetary policy loosen further via the extension of the Bank of England's quantitative easing programme, but lending growth is still slow;
      iv. Unemployment rise and earnings growth fall;
      v. Inflation fall further, but oil prices rise;
      vi. Bond yields and equity prices rise in response to the improved economic outlook;
      vii. Sterling appreciate, but only to a level well below its 2007 peak; at the beginning of Aug 2009 sterling is $1.6399 and 0.86 against the Euro.
      viii. Activity strengthen to a similar extent in the US, but a much weaker extent in Europe.

   b. April's Budget announced an injection of £5.2bn in 2009/10, but a tightening of £5.2bn in 2011/12. The Chancellor forecast that public sector net borrowing would increase to 12.5% of GDP in 2009/10 and that net debt as a percentage of GDP will leap from 41.2% in 2008/09 to 62.9% in 2009/10, before peaking at 94.2% in 2015/16. This may have a significant impact on the UK economy.

   c. After rapidly cutting official interest rates to a record low of 0.5%, the MPC increased the amount of asset purchases under the Bank's quantitative easing (QE) programme from £75bn to £125bn in May. The MPC still retained the option to extend these purchases by a further £25bn. However on 6 Aug 2008, the Bank of England announced an increase to quantitative easing of a further £25bn to £175bn. This decision seems to be driven by the downside risk to inflation as a result of uncertain domestic and global demand. In May, the headline rate of CPI inflation fell to 2.2% and RPI inflation fell to -

1.1%. While QE does at least seem to have been successful in improving liquidity in financial markets, its impact on the real economy remains limited.

d. Figure 1 shows the actual and projection of the base rate, which shows that the bank rate will remain at an historical low level until midway through 2010. The Sector forecast (the Council's Teasury management Advisors) is more positive than the other economic forecast and growth could continue to be slow throughout 2011. This will result in a less aggressive rise in the base rate than shown below.

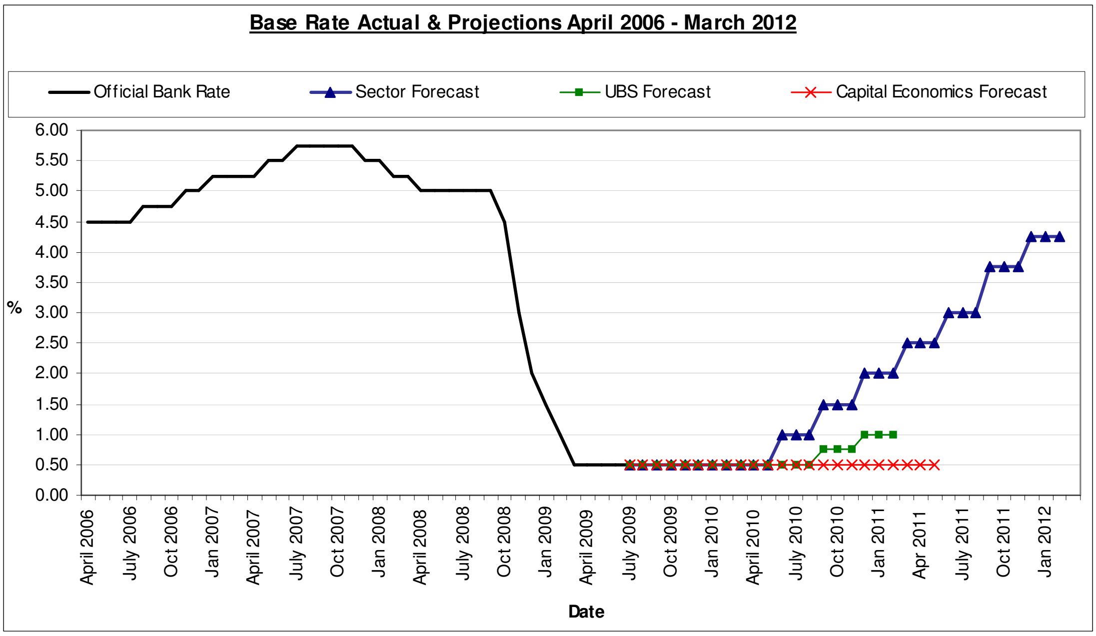

Figure 1 - Base Rate 2006 –2012 as at July 2009

e. Table 1 provides the Council's Treasury Advisers, Sector, forecast of the base rate and Public Works Loan Board (PWLB) rates as at 13 July 2009:

	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Bank rate	0.50%	0.50%	0.50%	1.00%	1.50%	2.00%	2.50%	3.00%	3.75%	4.25%	4.50%	4.75%
5yr PWLB rate	2.70%	2.75%	2.85%	3.10%	3.30%	3.45%	3.75%	4.00%	4.40%	4.70%	4.85%	5.00%
10yr PWLB rate	3.65%	3.70%	3.70%	3.80%	3.95%	4.15%	4.40%	4.65%	4.85%	5.00%	5.05%	5.20%
25yr PWLB rate	4.40%	4.40%	4.50%	4.50%	4.55%	4.70%	4.80%	4.95%	4.95%	5.10%	5.20%	5.30%
50yr PWLB rate	4.55%	4.55%	4.60%	4.65%	4.75%	4.85%	4.95%	5.05%	5.10%	5.25%	5.25%	5.35%

Table 1 – Sector's forecast interest rates at 13 July 2009

f. With regard to long term borrowing, the Public Works Loan Board (PWLB) 45-50 year rate started the year at 4.57%. Rates have risen steadily up to a high of 4.85% at the beginning of June 09 with rates dropping back to the lowest level in 09/10 of 4.39% by mid August 09. The medium term PWLB 9-10 year rate started the year at 3.36%, saw its lowest point at 3.3% in early April and by mid August the rate had risen to 3.96%.

g. Investment rates have fallen since the beginning of the financial year when the 1-year rate was at 2.15% to a level of 1.43% by the end of the July 09. Rates in the 1-year range continually fell in the first 4 months of the year.

h. A number of large UK banks keen to accept Local Authority investments continue to offer competitive rates on call accounts paying 0.25% to 0.3% above the Bank of England base rate as a minimum. In the first four months of 09/10 call accounts were paying rates equivalent or higher than could be achieved through 1 to 2 months fixed term money market investments. The Council takes advantage of such accounts and currently actively operates 3 call accounts:
    i. Bank of Scotland instant access call account has been fixed at 0.25% above base during the period.
    ii. Alliance and Leicester call account has been between 0.30% and 0.38% (averaging 0.31%) above base rate.
    iii. Yorkshire Bank call account fixed at 0.30% above base rate.

   During 2008/09, 6 call accounts were operated but currently in the first 4 months of 2009/10 they do not add value to the investment portfolio.

Investment Policy

8. The Treasury Management Strategy Statement for 2009/10 was approved by Council on 21 February 2009. The Council's Annual Investment Strategy, which is incorporated in the Strategy, outlines the Council's investment priorities as follows:
    - Security of Capital
    - Liquidity

9. The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with highly credit rated financial institutions using the Sector suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information provided by Sector, the Council's Treasury Management advisors.

10. Investments held at 31 July 2009 in accordance with Sector's Creditworthiness matrices, and changes to Fitch and Moody's credit ratings since Quarter 4 of 2008/09 remained within the Council's approved credit criteria limits contained in the Annual Investment Strategy and were not breached during the first 4 months of 2009/10.

Short Term Investments

11. Investment rates available in the market are at an historical low point. The average level of funds available for investment purposes in the first

four months of 2009/10 was £51.507m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of the Council's cash flow as a result of precept payments, receipt of grants and progress on the Capital Programme. The average balance is lower than in previous years due to the timing of grants received in advance of need being shorter. The authority holds some core cash balances for investment purposes, i.e. funds available for a year or more.

12. Treasury Management investment activity during the first four months earned interest £459k, equivalent to a 2.39% rate of return. This is 1.91% better than the average 7 day London Inter-Bank Deposit rate (LIBID) of 0.48% and 1.89% higher than the average base rate for the period of 0.50%. The high rate of return on investment activity compared to the average LIBID rate and base rate for the period is due to the treasury team monitoring the market and taking advantage of longer term rates out to a year when they become available. The level of activity compared to treasury management indicators is positive, however the market interest rates in the first 4 months of the year have been lower than anticipated.

13. Taking into account the direct cost of dealing, the in-house team is forecast to achieve a net trading surplus in 2009/10 of £877k. This will be equivalent to a return of 1.70%, which is 1.20% above the estimated average rate to be paid by the bank on credit balances held in the Council's main bank account. The bottom line added by the Council's money market trading activities taking off the direct cost of dealing is estimated at £619k for 2009/10.

14. The Council has made 8 investments via the money market brokers during the first 4 months of 2009/10. Of these 4 have been for a month or less, in accordance with the Treasury management Strategy keeping investments short. 4 have been invested for a period of greater than one month. Investments are made in accordance with the security of the Council funds, the cash flow position (Liquidity) and consideration to most favourable investment rates available.

15. Figure 2 shows the investments for periods over 1 month in duration in comparison to the range of rates (between 1 month and 1 year) being offered on the money markets at the time investments were made. It shows the investment rates obtained are in line with the interest rates which are available when security of funds are of prime importance.

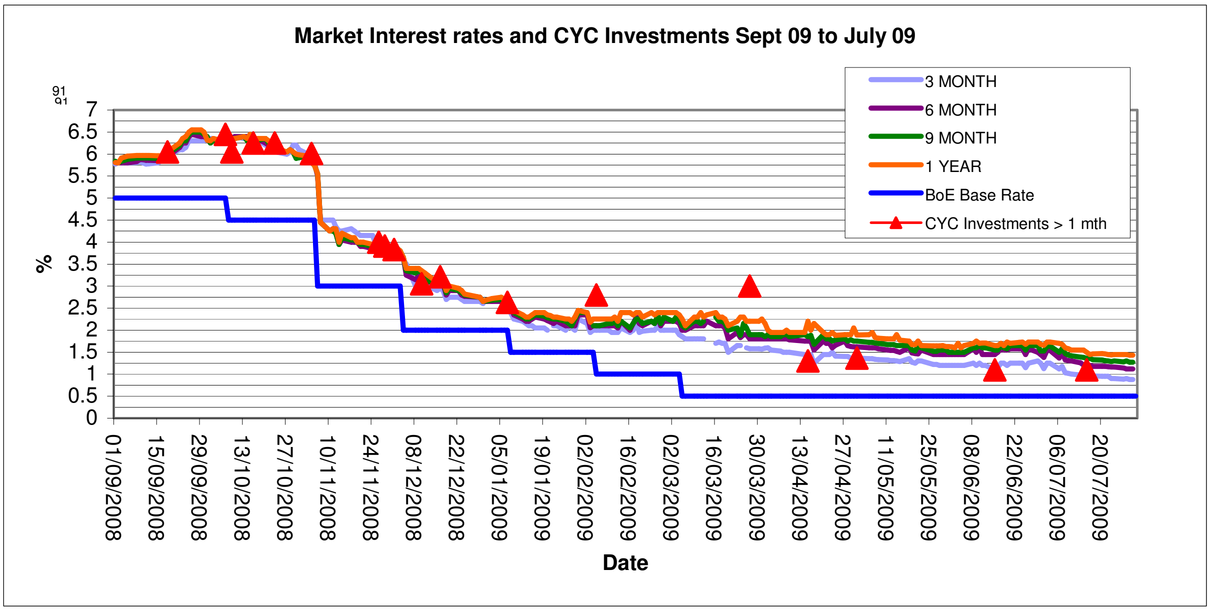

Figure 2 CYC Investments vs Money Market Rates

Long Term Borrowing

16. 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. 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 has given the Council the flexibility to borrow without Government support. Under the Code Councils are free to borrow up to a level that is deemed prudent, affordable and sustainable and within their prudential indicator limits.

17. The Councils long-term borrowing started the year at a level of £102.1m. One loan of £5m with a maturity date in May was duly repaid and a £3m loan at a rate of 3.83% was taken for 10 years on 10 August 09. The majority of loans taken are of fixed term duration, with the principal amount borrowed being repaid at the maturity date and interest payments made bi-annually.

18. A further £6m can be taken in 2009/10 to meet the remaining financing requirement and also to match the Councils level of borrowing to the Capital Finance Requirement (the Councils underlying need to borrow for capital expenditure purposes). In addition, 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 will substantially increase the Council's need to borrow over the next 3 years and therefore the markets will be closely monitored to ensure that advantage Is taken of favourable rates and the increased borrowing requirement is not as dependant on only interest rates over a 3 year period.

19. The Council's borrowing strategy is to borrow from the PWLB when rates are low and hold off from taking new borrowing when rates are high following advice taken from the Councils contracted treasury management advisors (Sector Treasury Services) subject to cash flow constraints. Long term borrowing rates started the year at a level of 4.57% and have since fluctuated between 4.39% and 4.85%. Figure 3 shows the PWLB rates since April 2006 and details when new borrowing has taken place.

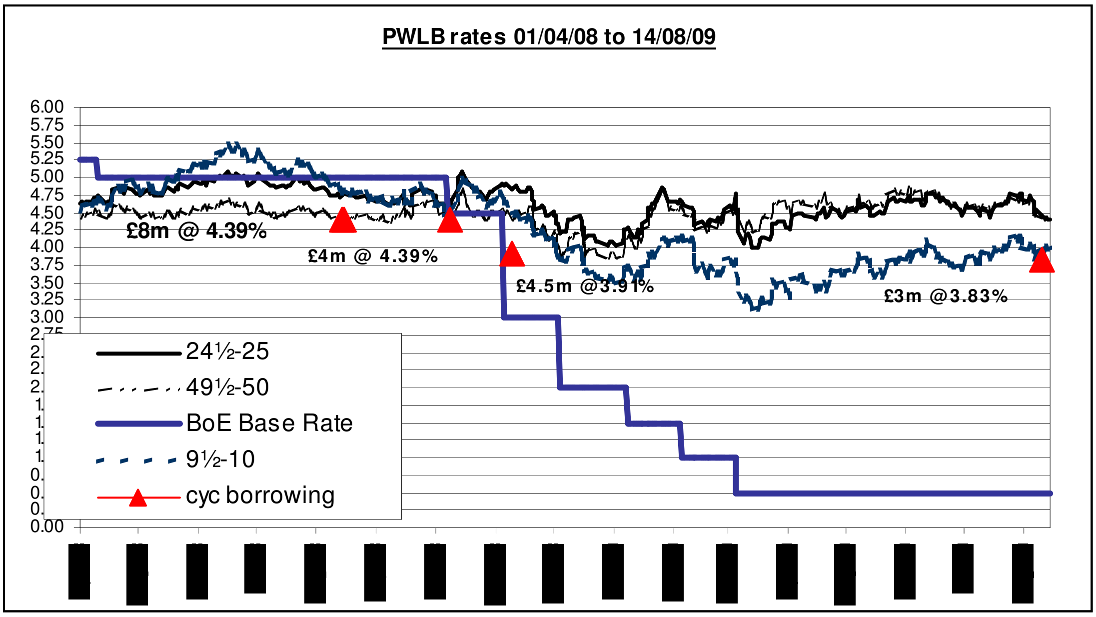

Figure 3 – PWLB rates vs CYC Borrowing Levels

20. Figure 4 illustrates the 2009/10 maturity profiles of the Council's debt portfolio updated to reflect the borrowing this year.

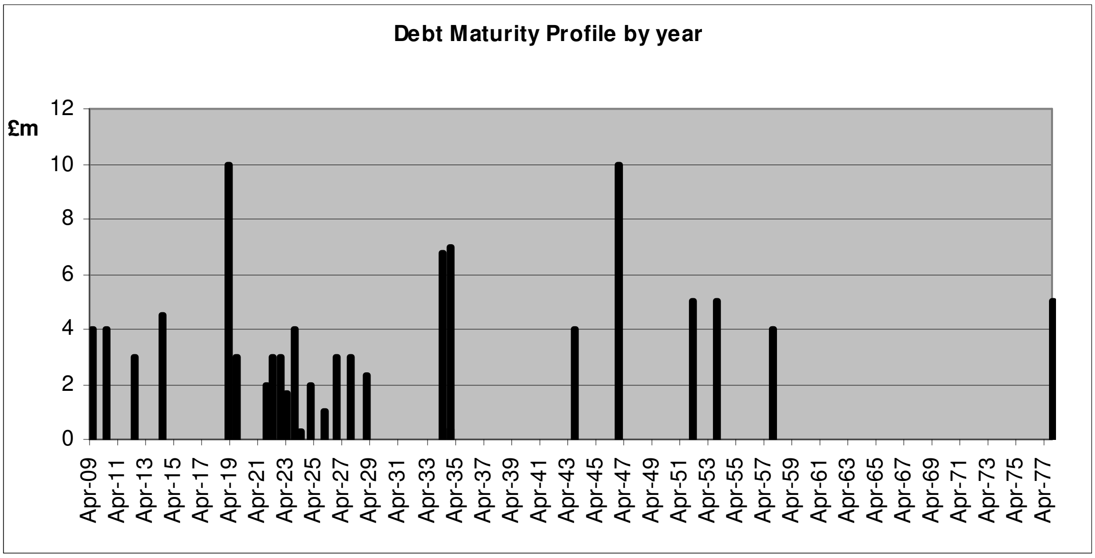

Figure 4 – Debt Maturity Profile 09/10

Venture Fund

21. The Venture Fund is used to provide short to medium term investment for internal projects which provide new revenue streams or generate budget savings and contribute to operational benefits of policy objectives. The projected movements on the Venture Fund for the year are shown in table 2 below.

	£'000
Balance at 1st April 2009	**2,275**
New Loan Advances	(750)*
Loan Repayments	678
Net Interest Received	18
Balance at 31st March 2010	**2,221**

Table 2 – Projected Venture Fund Movement 2009/10

22. The asterisk above indicates there are approvals for the loan advancements of £650k for the easy programme which reflects funding required for internal resources associated with the transformation programme – More for York - work and £100k for the street lighting capital scheme approved by Council on 21 February 2009. The easy programme loan is a prudent estimate of the amount which will potentially be required by year-end. 7 schemes contribute to loan repayments of which five will be completed at the end of 2009/10.

Treasury Management Budget

23. Treasury Management activity had a Corporate Budget approved at Council on 21 February 2009 of £7,727k. In August 2009, the current approved budget was £8,557k. The projected outturn is £9,086k resulting in an estimated over spend of £529k. Table 3 details the individual components that make up this overspend.

	(Under)/Over Spend £000
Increase in financing expenditure (interest paid)	150
Provision to repay debt	0
Decrease in interest receivable	379
Total Overspend	**529**

Table 3 – Treasury Management Budget 2008/09

24. The expected Treasury Management overspend is driven by the two main areas listed above:
    a. The increase in financing expenditure is due to an increase in the interest rates available for new borrowing being higher than was estimated in February 2009 as a result of unpredictable market conditions. Also the timing of when new borrowing in 09/10 will be

undertaken has been brought forward as potential interest rates will be lower in the first half of the year. The market is continually monitored to obtain most favourable rates available.

b. The decrease in interest receivable is due to the continued fall in market interest rates available for investment with the 1-year rate starting the year at 2.15% and continuing to fall to 1.43% in the first 4 months. Also there are lower cash balances than originally anticipated, therefore the majority of cash is being invested in line with cash flow requirements with only 4 investments occurring for greater than 1 months in the first 4 months.

25. There is little action that can be taken to mitigate the overspend during 2009/10 due to the current economic environment. It is expected that growth will be slow until 20010/11, resulting in lower market interest rates being available for investments. This is evidenced by the increased quantitative easing announced by the Bank of England to a further £175bn at the beginning of August. Lower interest rates on investments will therefore be earned for the foreseeable future. This is compounded by the prudent Council's approved credit criteria limits set for the security of funds, which reduces the favourable interest rates available for investment.

26. In the longer term, the economy is forecast to recover and interest rates will become more favourable for investment purposes. The market environment will improve and cash balances should grow with the increase of capital receipts. The borrowing market is continually monitored and in the future there maybe the opportunity to restructure the debt portfolio to make savings overall. It should be noted that this is not an ongoing problem but one caused by the current economic market environment.

Prudential Indicators Update

27. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Strategy. Prudential Indicators are attached at Annex A. Prudential Indicators were not breached during the first 4 months of 2009/10.

Human Resources Implications

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

Equalities

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 level of large money transactions that take place. As a result of this there are procedures as set out in the Treasury Management Practices statement that aim to reduce the risk associated with high volume high value transactions.

Recommendations

35. Members are requested to:
    - Note the performance of the Treasury Management Activity;
    - Note the projected overspend of £529k.

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

Contact Details

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Wards Affected: n/a

Specialist Implication Officers:

None

For further information please contact the author of the report

Background Papers

Cash-flow Model 09/10, Investment Register 09/10, PWLB Debt Register, Capital Financing Requirement 09/10, Venture Fund 09/10, Statistics 09/10.

Annexes

Annex A – Prudential Indicators