CITY OF **YORK** COUNCIL

Appendix A

Executive **16 November 2010**

Report of the Director of Customer and Business Support Services

Treasury Management Monitor 2 and Prudential Indicators 10/11

Summary

1. This report updates the Executive on the Treasury Management performance for the period 1 April 2010 to 30 September 2010 compared against the budget presented to Council on 25 February 2010.

2. The report highlights the economic environment for the first six months of the 2010/11 financial year and reviews the Council's Treasury Management performance covering:

   - Short-term investments,
   - Long-term borrowing,
   - Venture fund,
   - Treasury Management budget

3. The report also covers the implications of the Chancellor's Comprehensive Spending Review on 20 October 2010. It highlights the implications which are specific to Treasury Management which leads to the request in the Recommendations section of this report to change the Treasury Management strategy, approved by Council on 25 February 2010, for the target rate at which the council borrows from 4.5% to 5.5%.

Background

4. 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.

5. CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the revised Code of Practice for Treasury Management in November 2009. It recommended that at a minimum, a mid year review of Treasury Management strategy and performance should be undertaken which highlights any areas of concern that have arisen since the original strategy was approved. These quarterly reports therefore ensure this council is implementing best practice in accordance with the Code.

6. The Council approved the Treasury Management Strategy, budget and Prudential Indicators on 25 February 2010. This report monitors the Treasury Management activity for the first six months of 2010/11 and shows the change in the Treasury Management budget to 30 September 2010 and the forecast outturn position for the year.

Economic Background and Analysis (including the Comprehensive Spending Review)

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

   a. The first six months of 2010/11 saw:

      i. Activity indicators suggest that the recovery has faded sharply since the second quarter (1st April to 30th June) where real GDP (Gross Domestic Product) expanded by 1.2% q/q with the third quarter being just 0.4% q/q;
      ii. The pace of recovery in retail spending is slowing, but the recovery in spending off the high street gather pace;
      iii. Further doubt cast on the sustainability of the recovery in the labour market;
      iv. The recovery in the housing market falter;
      v. Disappointment that the public finances are not on a clearly improving trend;
      vi. The UK's trade deficit widen further, despite the continued weakness of sterling;
      vii. CPI inflation fall at a slower pace than in the second quarter;
      viii. The doves on the Monetary Policy Committee gain the upper hand;
      ix. Equity and bond markets respond in different ways to the news that the recovery is faltering; The recoveries in the US and euro-zone lose further pace.

   b. August's public finances figures severely dented hopes that the fiscal position is on a clearly improving trend. The public borrowing figure (on the PSNB ex. measure) of £15.9bn in August was nearly £2bn larger than at the same time a year ago. However, this figure still left a cumulative borrowing total in the first five months of the fiscal year of £58.1bn, around £4bn below last year's equivalent figure of £61.9bn. The UK's trade deficit widened further in the third quarter, despite the continued weakness of sterling. The trade in goods deficit rose from £7.5bn to £8.7bn in July which was the largest deficit on record.

   c. CPI (consumer price inflation) fell in this quarter but at a slower pace than in the previous quarter. The Bank of England's quarterly Inflation Report in August once again projected inflation to fall to below the 2% target and remain there at the two year policy horizon. The MPC (Monetary Policy Committee) voted to maintain the outstanding stock of

asset purchases under quantitative easing (QE) at £200bn at each meeting in the quarter. The minutes to September's MPC meeting revealed that for most members "the probability that further action would become necessary to stimulate the economy and keep inflation on track to hit the target in the medium term had increased."

d. The Comprehensive Spending Review announced by the Chancellor of Exchequer, George Osborne, on 20 October 2010 set out a detailed departmental spending plan for the next four years. The key announcements in the spending review are outlined below:

    i. About 490,000 public sector jobs likely to be lost
    ii. Average 19% four-year cut in departmental budgets
    iii. Structural deficit to be eliminated by 2015
    iv. £7bn in additional welfare budget cuts
    v. Police funding cut by 4% a year
    vi. Retirement age to rise from 65 to 66 by 2020
    vii. NHS budget protected; £2bn extra for social care
    viii. Schools budget to rise every year until 2015
    ix. £30bn capital spending on transport
    x. Permanent bank levy

e. The Comprehensive Spending Review highlighted the challenges the Coalition Government faces with regards to the public finances. The cuts along with the upcoming tax hikes are likely to be a major drag on the economy over the coming years

f. The total managed expenditure is expected to drop by around 3.5% in real terms between 2010 -11 and 2015-16. A point to note is that more of the cuts in total spending are outlined to come from reductions in welfare spending and from efficiency savings, rather than departmental spending. This means that unprotected Government departments will see average real cuts of 19% over the next 4 years.

g. The scale of some of these cuts casts some doubt on whether they can be realised in practice, especially if the economy turns out to be significantly weaker than the Office for Budget Responsibility's projections suggests.

h. The Comprehensive Spending Review specifically affected Treasury Management in two areas:
    i. The HM Treasury has instructed the Public Works Loans office (PWLB) to increase the average interest rate on all new loans to an average of 1.00% above the Government's cost of borrowing . This will take effect immediately.
    ii. Tax Increment Financing (TIF). New borrowing powers will be introduced following legislation to allow Tax Increment Financing to proceed and councils will be able to borrow against future uplifts within their business rates base.

i. The affect of increasing all PWLB rates to approximately 1% above gilts will increase PWLB rates which is where Local authorities obtain the majority of their new borrowing. Therefore this will lead to a revision in the Council's Treasury Management strategy approved by Council on 25 February 2010 as the requirement now exists to increase the target rate of all new borrowing being below 4.5% to a target rate of 5.5%. This is in line with the increase of the 1% by the HM Treasury. Further information is detailed in paragraph 7r of this report and also in the recommendations section paragraph 49.

j. HM Treasury has also confirmed that the methodology for determining rates for early repayment remains unchanged. Early repayment rates which are the rates that the Council uses for premature repayment of debt to restructure the debt portfolio have remained at the same level that they were prior to the spending review. This therefore makes early repayment of debt more expensive to the Council than previously. However, opportunities in a volatile market could always be available and therefore restructuring possibilities are reviewed on a regular basis, to ensure the Treasury Management budget remains at the lowest levels possible.

k. Finally, the Government recognises that local authority decisions on borrowing can commit electors to repaying loans for up to 50 years. Therefore, to ensure that borrowing decisions are transparent and consistent with measures adopted elsewhere in the public sector, HM Treasury has determined that a detailed monthly list of individual local authority loans sourced from PWLB will be published on the PWLB website, including the type, amount, term and rate applying to each loan. The first list will be published on 1 November.

l. Tax Increment Financing. New borrowing powers to enable authorities to carry out Tax Increment Financing (TIF) are being introduced. This will require legislation. In determining the affordability of borrowing for capital purposes, local authorities take account of their current income streams and forecast future income. Currently, this does not factor in the full benefit of growth in local business rates income.

m. TIF will enable local authorities to borrow against future additional uplift within their business rates base. Councils can use that borrowing to fund key infrastructure and other capital projects, which will further support locally driven economic development and growth. They will need to manage the costs and risk of this borrowing alongside wider borrowing under the prudential code. Further information will be included in the Local Government Resource Review expected in January 2011, which will finally lead to the required legislation in due course.

n. From the economic analysis and the Comprehensive Spending Review outcomes above, figure 1 shows the actual and projection of the base rate, which remains at historically low levels through much of 2010. The Council's Treasury Management advisers – Sector – forecast the position of the base rate in February 2010 and this is compared to their

forecast along with other economists in July 2010. The graph highlights the shift in the position of the base rate which is aligned with the slower growth now forecast. The base rate will now slowly start to rise at the beginning of 2011/12 and continue gradually out to 2013. UBS forecast a rise in the base rate earlier than Sector, where as Capital Economics remain pessimistic about economic recovery to the end of 2011 and they forecast the base rate to remain at 0.5% for the near future.

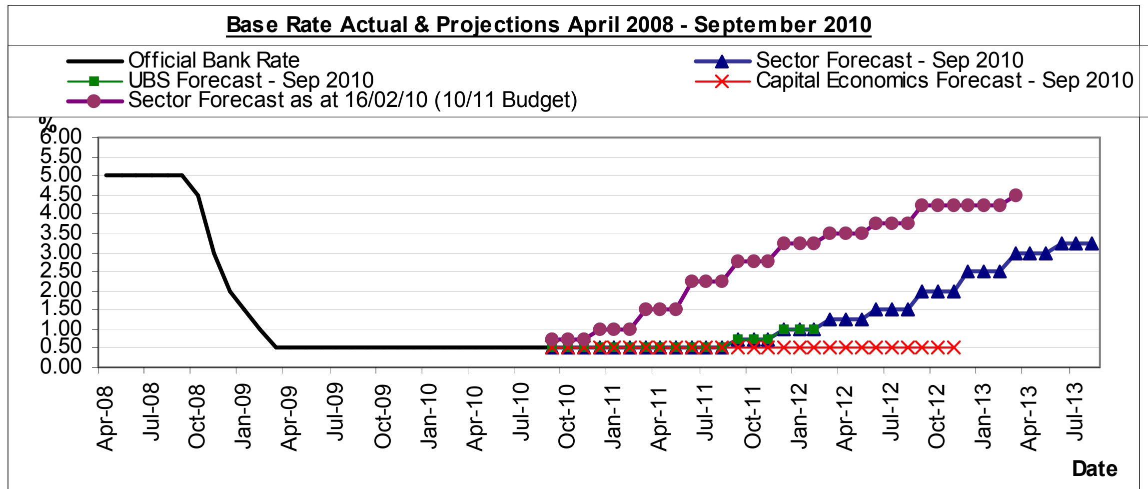

Figure 1: Base Rate 2008 to 2013 - latest forecast August

o. Table 1 provides the Council's Treasury Advisers, Sector, forecast of the base rate and Public Works Loan Board (PWLB) rates as at 29 October 2010:

	Now	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Bank rate	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.50%	3.00%	3.25%
5yr PWLB rate	2.71%	3.05%	3.05%	3.25%	3.45%	3.65%	3.85%	4.15%	4.45%	4.65%	4.95%	5.25%
10yr PWLB rate	4.06%	4.15%	4.15%	4.25%	4.55%	4.75%	4.85%	5.15%	5.25%	5.45%	5.45%	5.75%
25yr PWLB rate	5.03%	5.05%	5.15%	5.15%	5.25%	5.35%	5.55%	5.55%	5.65%	5.85%	5.85%	5.85%
50yr PWLB rate	5.08%	4.95%	5.05%	5.05%	5.15%	5.25%	5.45%	5.45%	5.55%	5.75%	5.75%	5.75%

Table 1 – Sector's forecast interest rates as at 29 October 2010

p. The Treasury Management monitor 1 report, as at July 2010, saw long term borrowing, the Public Works Loan Board (PWLB), rates across all ranges forecast to steadily increase. During August, September and the beginning of October there was a major fall in bond yields which dragged down PWLB rates. The lowest 50 year PWLB rate was at 3.92%.

q. The major fall in rates was due to the fall in the forecast GDP growth for 2011 from 3.4% to 2.8%, increase in the risk of further quantitative easing in the UK and US, the knock on affect of the sovereign debt crisis in the EU which peaked in May and the coalition government's emergency budget to accelerate the speed of reduction in the public sector deficit.

r. However, since the Comprehensive Spending Review on 20 October 2010 as stated above in paragraph 7h, PWLB rates are now to be set at 1% above the governments gilt level. This is approximately 0.85% increase across the board on all PWLB rates. Table 1 above is Sector's revised forecast of interest rates as a result of the Comprehensive Spending Review. The 50 year PWLB rate from 20 October 2010 to 31 October 2010 has ranged between 5.05% and 5.23%.

s. The 1 year investment rate started the financial year at 1.19% and on 30 September 2010 had risen to 1.36%. Figure 2 below shows the positions of market interest rates available for investments, which have all marginally risen in the first six months of 2010/11.

Investment Policy

8. The Treasury Management Strategy Statement for 2010/11 was approved by Council on 25 February 2010. 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 suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information provided by Sector, the Council's Treasury Management advisors.

10. Investments held at 30 September 2010 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.

Short Term Investments

11. Investment rates available in the market continue to remain at a historical low point. The average level of funds available for investment purposes in the first six months of 2010/11 was £59.925m. 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. The authority holds some core cash balances for investment purposes, i.e. funds available for a year or more, however to date in 10/11 no funds have been invested for periods greater than one year due to the limited institutions available for investment in accordance with the credit criteria policy. This is a continuation of similar market conditions which prevailed through the majority of 2008/09 and through the whole of 2009/10, due to the credit crunch.

12. Treasury Management investment activity during the first six months earned interest £349.7k, equivalent to a 1.17% rate of return. This is 0.74% better than the average 7 day London Inter-Bank Deposit rate (LIBID) of 0.42% and 0.67% higher than the average base rate for the period of 0.50%.

13. 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 longer term rates when they become available, using short term call deposit accounts where interest rates are higher and using Money Market Funds as a slightly alternate investment deposit.

14. The rate of return continues to be approximately half of that seen in 2009/10 due to (a) interest rates remaining historically low on the market throughout 09/10 and into 2010/11 and (b) core balances invested for more than 1 year back in 2008/09 when rates were higher at 5.75% have matured early in 2010/11 so do not benefit 2010/11. The interest earned for the first six months of the year is slightly higher than the Treasury Management budget estimated but can be seen to be substantially lower than in previous years. This thereby increases the requirement of the Treasury Management budget, (as detailed in paragraph 34 below) due to a reduced affect the investment earned has in netting off interest paid out on borrowing.

15. The Council has made 13 fixed term investments during the first six months of 2010/11, 2 directly with the Bank of Scotland and 11 via the money market brokers. Five of these investments have been made for periods of 6 months where value was shown at between 1.15% and 1.35% and 1 made for a year at 1.50%. The rates available are shown in Figure 2 below. Investing for 6 months allows favourable rates to be taken and also allows the flexibility of funds becoming liquid when interest rates were predicted to start to rise in the second half of 2010/11. In accordance with the Treasury Management Strategy investments have been kept short due to the low levels of interest rates available and the limited number of institutions available in the market which the council can invest in complying with its credit rating policy.

16. A proportion of investments have been placed in call accounts where funds are secure and are able to be liquidated if more advantageous rates become available. The council operates 4 call accounts – Bank of Scotland (0.75%), Alliance & Leicester (0.80%), Yorkshire bank 15 day (0.80%) and Yorkshire Bank call (0.50%) – but has found during the first six months of 2010/11 that better rates have been available on the market and in money market funds. Therefore, funds held in the call accounts have been reduced with the average balance for the first 6 months in 2010/11 being £7.824m compared to £14.348m in 2009/10. Two money market funds are also being utilised – Prime rate MMF offering rates around 0.85% and Ignis offering rates around 0.65%. The MMF are needed to diversify the investment portfolio as the banks offering the most favourable fixed deposit rates are also the banks which offer the call accounts which the council

uses. In 2010/11 the average balance in the money market funds for the first 6 months is £22.179m.

17. Therefore in order to remain within the Councils lending limits, diversification of the council's portfolio is key. This ensures continued security of the council's funds, whilst operating within the bounds of the council's cash flow (liquidity) and giving consideration to the most favourable interest rates available.

18. Figure 2 shows the interest rates available on the market between 7 days and 1 year and the rate of return that the Council has achieved to 30 September 2010. It shows that favourable / competitive interest rates have been obtained for investment in line with the interest rates which are available when security of funds are of prime importance.

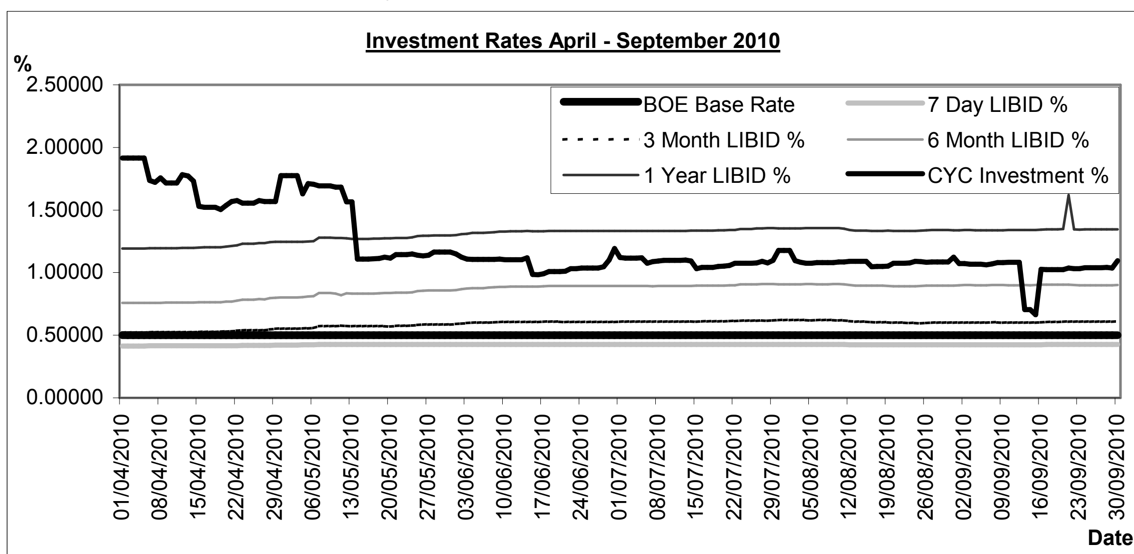

Figure 2 CYC Investments vs Money Market Rates

Long Term Borrowing

19. 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 council's 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, this is known as supported borrowing. The introduction of the Prudential Code in April 2004 has also 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. This is known as prudential borrowing.

20. 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). This takes into account supported borrowing for capital schemes supported by RSG as explained in paragraph 19, also prudential borrowing for schemes under the prudential code that are funded

from department budgets and corporate budgets– so are affordable, sustainable and prudent. In addition, due to the current economic and market environment capital receipts may not be realised when originally expected and therefore, in the short term borrowing is taken to cover this funding shortfall position of the capital programme.

21. 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 is substantially increasing the Council's need to borrow over the next 3 years and therefore the markets will continue to be closely monitored to ensure that advantage is taken of favourable rates in 2010/11 and the increased borrowing requirement is not as dependant on interest rates in any one year over the 3 year period.

22. 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. Prior to the Comprehensive Spending Review loans have been taken as borrowing rates were seen to be good value for the longer term. Locking into historically low borrowing rates enables some stability on the costs incurred in the Treasury Management revenue budget going forwards.

23. Equally since the Comprehensive Spending Review , borrowing rates are being closely monitored for volatility in the market for when rates are deemed to be favourable, market loans are being considered in addition to PWLB loans and a balance is being taken between increasing borrowing and the lower levels of interest being earned on investments. The Sector Treasury Management advisors forecast that future PWLB rates will also rise - in addition to the increase from the Comprehensive Spending Review - which is also being taken into account.

24. The Councils long-term borrowing started the year at a level of £116.1m. One loan of £4m was duly repaid in May 2010 in line with its maturity date. New Borrowing totalling £24m has been taken to the end of October 2010 as follows:
    - £5m market LOBO loan at 3.60% 50 years with options every 5 years on 12 May 10
    - £5m PWLB loan at 3.70% 10 years on 25 May 10
    - £5m market loan at 0.70% 1 year on 28 May 10
    - £3m PWLB loan at 2.95% 7 years on 12 August 10
    - £3m PWLB loan at 4.01% 14 years on 12 August 10
    - £3m PWLB loan at 3.92% 50 years on 31 August 10

25. The loans taken in 2010/11 have been below the target of 4.5% set in the Council approved 2010/11 strategy. The loans are of fixed term duration, have targeted periods that offer the best rates available and also take into consideration the debt maturity portfolio. In the first seven months, 45-50 year PWLB rates started 2010/11 at 4.65%, rose to a high of 4.75% during April 2010 and were at a minimum of 3.92% on 31 August 2010. Since the Comprehensive Spending Review on 20 October 2010, PWLB rates have substantially risen and at 28 October 2010 were at 5.23%. 9.5-10 year PWLB started at 4.14% and at the end of August fell to a minimum of 3.05%. During October the 9.5-10 year rate has increased to 4.26% on 28 October 2010.

26. Figure 3 shows the fluctuation in PWLB rates since April 2009 and details when new borrowing has taken place, taking into account the borrowing maturity profile.

27. The Council's borrowing strategy is to borrow at a target rate of 4.5% from the PWLB or the money market when rates are low and hold off from taking new borrowing when rates are high. This following advice taken from the Councils contracted Treasury Management advisors (Sector Treasury Services) subject to cash flow constraints. Since the Comprehensive Spending Review, PWLB rates have risen by approximately 0.85%. (This is due to the government stating that PWLB rates will be 1% above the gilt level, in the past PWLB rates were between 0.15% and 0.25% above gilt levels) .

28. Therefore, in accordance with the revised Treasury Management code of practice it is advised to review part way through the year, the 2010/11 strategy set at the beginning of the year. In the circumstances due to the increase in PWLB rates as a result of the Comprehensive Spending Review, it is recommended that the borrowing strategy is revised to increase the borrowing target rate to 5.5%, this is requested in the recommendations section paragraph 49. (It is not intended that borrowing rates will be taken at this level as it is forecast that the market is still volatile and there will remain opportunities for rates below 4.5%, every attempt will be made to keep rates at the lowest levels possible.)

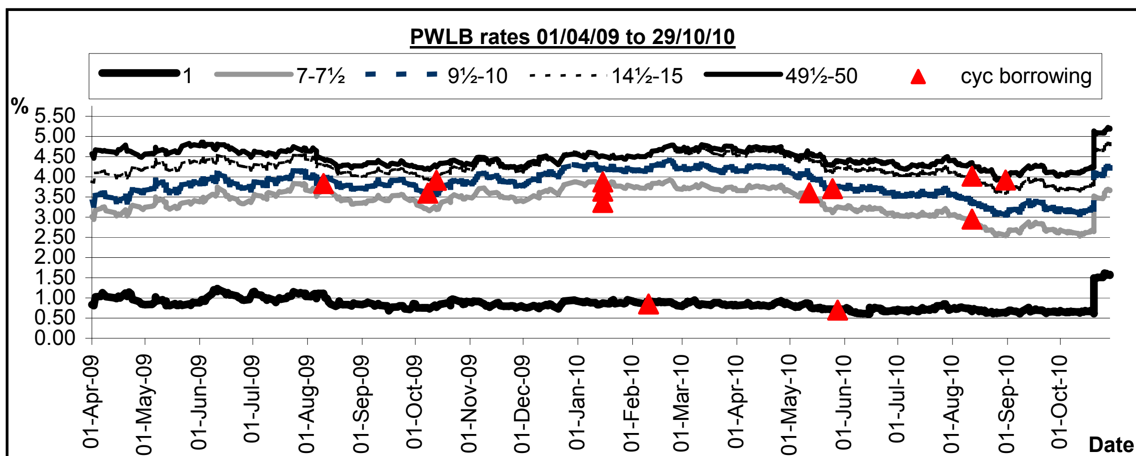

Figure 3 – PWLB rates vs CYC Borrowing Levels

29. Figure 4 illustrates the 2010/11 maturity profile of the Council's debt portfolio updated to reflect the borrowing this year. The borrowing portfolio totals £136.1m and the maturity profile shows that there is no large concentration of loan maturity, thereby spreading the interest rate risk dependency in any one year.

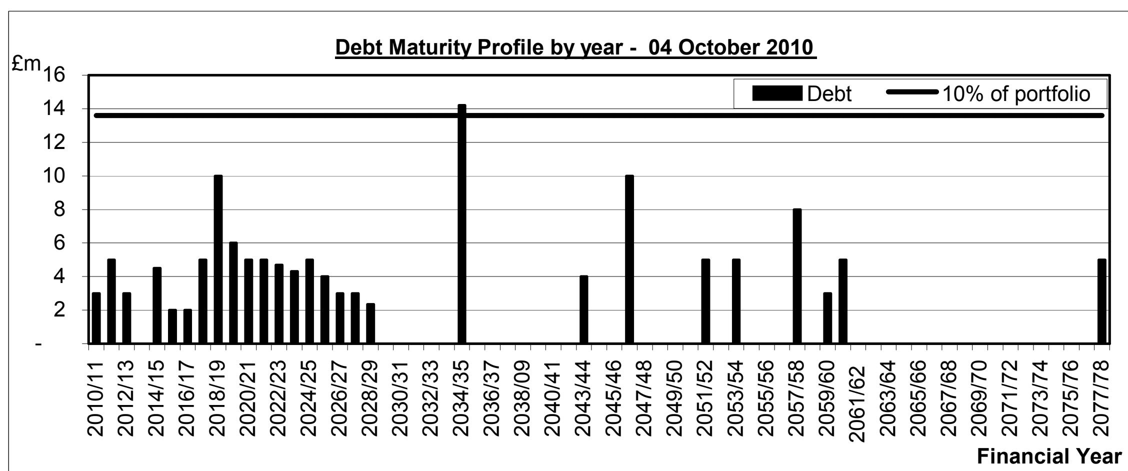

Figure 4 – Debt Maturity Profile 10/11

Venture Fund

30. 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 2010/11 are shown in table 2 below.

	£'000
Balance at 1st April 2009	**2,219**
New Loan Advances	(1,551)
Loan Repayments	48
Net Interest Received	18
Balance at 31st March 2010	**734**

Table 2 – Projected Venture Fund Movement 2010/11

31. Table 2 indicates there are approvals for new loan advances in 2010/11 of £1,551k. This is for 4 schemes, for the easy programme £650k which reflects funding required for internal resources associated with the transformation programme – More for York – work, £200k for the street lighting capital scheme approved by Council on 21 February 2009, £500k contribution to the Treasury Management budget for the economic downturn approved by Council on 25 February 2010 and £201k for the early years deficit cost for the administrative accommodation project approved by Council on 15 July 2010. The easy programme loan is a prudent estimate of the amount which will potentially be required by year-end. 3 schemes contribute to loan repayments.

32. The position of the venture fund reported at monitor 2 is no change from that reported to Members on 7 September 2010 at monitor 1.

Treasury Management Budget

33. Treasury Management activity had a Corporate Budget approved at Council on 25 February 2010 of £11,131k. In August 2010, the current approved budget stands at £11,768k. The increase of £637k is transfer of budget from departments to cover the finance costs of approved capital programme schemes funded by prudential borrowing. The projected outturn for 2010/11 is £11,618k, an estimated underspend of £150k. Table 3 details the individual components that make up this overspend.

	(Under)/Over Spend £000
Decrease in financing expenditure (interest paid)	(102)
Increase in interest receivable	(48)
Total Underspend	**(150)**

Table 3 – Treasury Management Budget 2010/11

34. The Treasury Management budget under spend at monitor 2 is forecast to be the same as at monitor 1. It is driven by the 2 factors in table 3. The reduction in finance expenditure is due to the reduced amount of interest to be paid on borrowing during 2010/11. Until the Chancellor's Comprehensive Spending Review on 20 October 2010, the borrowing interest rates available on the market were more favourable than were expected when the budget was set.

35. A significant proportion of the borrowing required during 2010/11 has already been taken as detailed in paragraph 25 and therefore a saving has resulted. In addition, even though borrowing rates have now risen since the Comprehensive Spending Review - the delay in taking further borrowing during 2010/11 and the forecast that the market remains volatile with opportunities for favourable interest rates still being available, has resulted in the forecast for the reduced under spend on interest paid being continued.

36. There is an increase in interest receivable compared to the budget. The cash balances to invest are slightly higher than anticipated and the use of various investment products - longer term deposits, short term call accounts and money market funds – are resulting in slightly better interest rates being received on investments. Of prime importance is always the security of the Council's funds.

37. It is expected that growth will continue to be slow in 2010/11, resulting in continued lower market interest rates being available for investments. It is interesting to note that in the 2010/11 strategy in February 2010 our Treasury Management advisers were forecasting the base rate to rise in September 2010 to 0.75% and in March 2011 to 1.50%. On 29 October 2010, this had been revised to 0.75% in September 2011 and 1.50% in

June 2010. This highlights that investment interest earned will continue to be at low levels for the foreseeable future.

38. A technical review of the Council's Treasury Management budget which includes the calculation of the capital financing requirement and the minimum revenue provision is currently underway. More detail on the financial impact of this will be provided in a future report.

Prudential Indicators Update

39. 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) for 2010/11 are outlined in the approved Treasury Management Strategy at Council on 25 February 2010. The monitoring of the Prudential Indicators is attached at Annex A. Prudential Indicators were not breached during the first 6 months of 2010/11.

Consultation

40. 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

41. The Council's corporate strategy has the 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.

Human Resources Implications

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

Equalities

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

Legal Implications

44. Treasury Management activities have to conform to the Local Government Act 2003 (SI 2003/3146), which specifies that the Council is required to adopt 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

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

Information Technology Implications

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

Property Implications

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

Risk Management

48. 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

49. Members are requested to:
    - Note the performance of the Treasury Management activity;
    - Note the projected underspend of the Treasury Management budget of £150k.
    - Approve the change in the Treasury Management strategy to increase the target interest rate on borrowing to 5.5% from 4.5% as detailed in the report at paragraph 28m. This is in line with the increase in PWLB rates as a result of the Comprehensive Spending Review.

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 CBSS Keith Best Assistant Director of CBSS (Finance)			
Ross Brown Principal Corporate Accountant Corporate Finance Tel No. 551207	Report Approved	N	Date	16/11/10

Wards Affected: All None N

Specialist Implication Officers:

None

For further information please contact the author of the report

Background Papers

Cash-flow Model 10/11, Investment Register 10/11, PWLB Debt Register, Capital Financing Requirement 10/11, Venture Fund 10/11, Statistics 09/10.

Annexes

Annex A – Prudential Indicators

Annex A

	PRUDENTIAL INDICATORS – Monitor 1 2010/11		2010/11 Budget	2010/11 Monitor 2
1)	**Capital Expenditure** To allow the authority to plan for capital financing as a result of the capital programme. To enable the monitoring of capital budgets to ensure they remain within budget		£'000	£'000
		Non - HRA	66,116	64,411
		HRA	6,908	8,370
		TOTAL	73,024	72,781
2)	**Ratio of financing costs to net revenue stream** This indicator estimates the cost of borrowing in relation to the net cost of Council services to be met from government grant and council taxpayers. In the case of the HRA the net revenue stream is the income from Rents and Subsidy	Non - HRA	9.30%	8.70%
		HRA	3.11%	2.56%
3)	**Incremental impact of capital investment decisions - Council Tax**		£ p	£ p
	Shows the actual impact of capital investment decisions on council tax. The impact on council tax is a fundamental indicator of affordability for the Council to consider when setting forward plans. The figure relates to how much of the increase in council tax is used in financing the capital programme and any related revenue implications that flow from it.	Increase in Council Tax (band D) per annum	25.43	22.77
4)	**Incremental impact of capital investment decisions - Hsg Rents**		£ p	£ p
	Shows the actual impact of capital investment decisions on HRA rent. For CYC, the HRA planned capital spend is based on the government's approved borrowing limit so there is no impact on HRA rents.	Increase in average housing rent per week	0.00	0.00
5)	**Capital Financing Requirement as at 31 March** Indicates the Council's underlying need to borrow money for capital purposes. The majority of the capital programme is funded through government support, government grant or the use of capital receipts. The use of borrowing increases the CFR.	Non - HRA	128,483	144,164
		HRA	12,610	18,697
		TOTAL	141,093	147,688
6a)	**Authorised Limit for external debt -** The authorised limit is a level set above the operational boundary in acceptance that the operational boundary may well be breached because of cash flows. It represents an absolute maximum level of debt that could be sustained for only a short period of time. The council sets an operational boundary for its total external debt, gross of investments, separately identifying borrowing from other long term liabilities for 3 financial years.	borrowing	192	192
		other long term liabilities	0	0
		TOTAL	192	192
6b)	**Operational Boundary for external debt -** The operational boundary is a measure of the most likely, prudent, level of debt. It takes account of risk management and analysis to arrive at the maximum level of debt projected as part of this prudent assessment. It is a means by which the authority manages its external debt to ensure that it remains within the self imposed authority limit. It is a direct link between the Council's plans for capital expenditure; our estimates of the capital financing requirement; and estimated operational cash flow for the year.	borrowing	172	172
		other long term liabilities	0	0
		TOTAL	172	172
7)	**Adoption of the CIPFA Code of Practice for Treasury Management in Public Services** Ensuring Treasury Management Practices remain in line with the SORP.	TM Policy Statement 12 TM Practices Policy Placed Before Council Annual Review Undertaken		
8a)	**Upper limit for fixed interest rate exposure** The Council sets limits to its exposures to the effects of changes in interest rates for 3 years. The Council should not be overly exposed to fluctuations in interest rates which can have an adverse impact on the revenue budget if it is overly exposed to variable rate investments or debts	Net interest re fixed rate borrowing / investments Actual Net interest re fixed rate borrowing / investments	108%	154%
8b)	**Upper limit for variable rate exposure**			

	The Council sets limits to its exposures to the effects of changes in interest rates for 3 years. The Council should not be overly exposed to fluctuations in interest rates which can have an adverse impact on the revenue budget if it is overly exposed to variable rate investments or debts	Net interest re variable rate borrowing / investments Actual Net interest re variable rate borrowing / investments	-8%	-54%	
9)	**Upper limit for total principal sums invested for over 364 days**		£10,000	£10,000	
	To minimise the impact of debt maturity on the cash flow of the Council. Over exposure to debt maturity in any one year could mean that the Council has insufficient liquidity to meet its repayment liabilities, and as a result could be exposed to risk of interest rate fluctuations in the future where loans are maturing. The Council therefore sets limits whereby long term loans mature in different periods thus spreading the risk.				
10)	**Maturity structure of new fixed rate borrowing during 2010/11**		Upper Limit	Lower Limit	Mon 1
	The Council sets an upper limit for each forward financial year period for the level of investments that mature in over 364 days. These limits reduce the liquidity and interest rate risk associated with investing for more than one year. The limits are set as a percentage of the average balances of the investment portfolio.	under 12 months	10%	0%	6%
		12 months and within 24 months	10%	0%	2%
		24 months and within 5 years	25%	0%	6%
		5 years and within 10 years	40%	0%	23%
		10 years and above	90%	30%	63%

Glossary Of Abbreviations

HRA Housing Revenue Account

CYC City of York Council

SORP Statement of Recommended Practice for Local Authorities

CFR Capital Financing Requirement

1. In accordance with the Prudential Code, the Prudential Indicators set by full Council on 25th February 2010 for the financial year 2010/11 must be monitored and reported through the financial year. The Prudential Indicators are detailed above and some of the key points are explained below:

2. Size of the **Capital Programme (Indicator 1)** - The capital programme expenditure at monitor 2 was estimated to be £72,781m and in the original budget was £73.024m. The Capital Programme Monitor 2 report provides further information with regards to the movements.

3. **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 at Monitor 2 is 8.70% compared to a budgeted level of 9.30%. This indicator has fallen slightly due to a lower amount of borrowing estimated to be repaid during 2010/11 as more capital receipts have been received in the year than originally anticipated. The Housing Revenue Account (HRA) version of the indictor at monitor 1 is 2.56% compared to the budgeted level of 3.11%, the difference is due to lower amount of interest to be paid on debt in relation to the HRA than originally anticipated.

4. **Incremental Impact on the Level of Council Tax (Indicator 3)** – This indicator shows the impact of capital investment decision on the bottom line level of Council Tax. The Council can fund its discretionary capital programme from two main sources, from unsupported borrowing or using capital receipts from the sale of surplus assets. The Council's policy is to use capital receipts to fund the Capital programme, however in the current economic environment with reduced capital receipts there is the requirement to use unsupported borrowing to support the capital programme, which has an impact on Council Tax. The unsupported borrowing is not taken unless it is affordable, sustainable and prudent and can be

supported by an existing budget. At monitor 2 the impact on council tax is estimated at £22.77 per Band D charge. This has decreased from the estimate of £25.43 due to the interest paid on new borrowing during 2010/11 being lower than expected in the budget. Borrowing rates have fallen due to the sentiment on the market that the economy is weak and a risk of a double dip recession. In addition, more capital receipts have been received in the year than originally anticipated.

5. **Capital Financing Requirement (CFR) (Indicator 5)** - The CFR at Monitor 2 is estimated at £162.861m, which is the Council's underlying need to borrow for all capital investment over time. The CFR will fluctuate as new schemes are introduced into the capital programme and the funding position changes (as a result of external contributions, reductions in grants, changes to capital receipts etc) to support the Capital investment of the Council. A technical review of the calculation of the capital financing requirement and the minimum revenue provision is currently underway. More detail on the financial impact of this will be provided in a future report.

6. **Authorised Limit / Operational Boundary (Indicator 6)** – The Council debt position at 1 April 2010 was £116.064m and currently stands at £136.064m. The Council's Operational Boundary (maximum prudent level of debt) was approved at Council as part of the budget set at £171.9m, along with the Authorised Limit (maximum allowed debt) at £191.9.m. The headroom available within these limits allows the Council the ability to borrow in advance of need in accordance with its 3 year forecast Capital programme. If these limits were breached the LG Act 2003 requires full Council approval. Debt levels have remained within the limits set.

7. **Adoption of the CIPFA Code of Practice in Treasury Management (Indicator 7)** – In accordance with the Prudential Code the Council has adopted the revised Treasury Management Code of Practice on 25 February 2010 and as detailed in the table has adhered to the requirements.

8. **Upper Limit for Fixed and Variable Interest rate Exposure (Indicator 8)** – Interest rate exposure on debt is positive due to it being in relation to interest paid on borrowing and on investments is negative as it is interest being received. When the variable and fixed interest rates are totalled, it will always be 100%. If the majority of the interest received by the Council is fixed and the interest paid on debt is fixed then the closer the actual fixed interest rate exposure will be to 100% and the variable rate exposure to zero. The limits set in the budget were not breached and at Monitor 1 fixed rate exposure was at 154% and variable rate exposure –54%.

9. **Upper Limit for total principal sums invested for over 364 days (Indicator 9)** – This has been set at £10m and is approximately 25% of the total portfolio. To date in 2010/11, no funds have been invested for longer than 364 days due to the uncertainty in the current economic environment and no value to be obtained from the longer rates available to the council within its credit criteria limits.

10. **Maturity structure of fixed rate borrowing in 2010/11 (Indicator 10)** – The borrowing portfolio is spread across different time periods to ensure that the Council is not exposed to the requirement to take new borrowing in any one year

and be exposed to interest rates in any one year. Currently in 2010/11 the borrowing portfolio maturity profile is within the limits set.