DERBY CITY COUNCIL

COUNCIL CABINET
23 November 2010

ITEM 21

Report of the Strategic Director - Resources

Treasury Management – Progress Report 2010/11

SUMMARY

1.1 This report covers the Council's treasury management activity for the period to 30 September 2010.

1.2 Treasury management activity during the half-year has generated an average rate of return on investments of 0.55% to 30 September although our forecast outturn average rate for the year is 0.48%, with the average rate of interest being charged on our loans being 4.478%.

1.3 The very low rate of return on investments relative to the interest payable on loans continues the trend begun with the 2008 credit crunch. This has put substantial upward pressure on the Council's revenue costs.

1.4 The forecast outturn for the Treasury Management budget in 2010/11 is currently £16.3m, compared with £14.7m in 2009/10. However, this will deliver an underspend currently estimated to be around £0.7m.

1.5 In response to market conditions the Council has progressively tightened its counterparty investment criteria over the past two years. The opportunity is taken with this Cabinet Report to make an amendment to the Council's Money Market Fund - MMF - criteria.

RECOMMENDATIONS

2.1 To note the progress report on Treasury Management for the period to 30 September 2010.

2.2 To approve the revised counterparty criteria in relation to Money Market Funds.

REASONS FOR RECOMMENDATIONS

3.1 It is considered good Treasury Management practice for members to monitor performance at least three times a year. This report covers treasury activity since the 2010/11 Strategy was approved in February 2010.

SUPPORTING INFORMATION

4 Investments

4.1 The Council's cash position is largely driven by capital funding: either grant received or borrowing undertaken prior to the actual expenditure once the capital scheme commences. In the past it was normal procedure for the Council to borrow enough in advance to cover the current year's capital programme. However, the prohibitive cost of holding cash balances now means that it is better to delay borrowing for as long as possible.

4.2 This means that the cash available for investment has been reduced accordingly. The average size of the Council's investment portfolio for the first half of 2010/11 was £84.9m. This is 24.5% lower than the corresponding figure of £112.4m for 2009/10. This has had a consequent impact on the Council's investment income.

4.3 Interest rates on investments have also remained consistently low over the past two years, largely mirroring the Bank of England's base rate all-time low of 0.5%, which shows no immediate sign of increasing. In its own investments the Council obtains around 0.5% when it places money in instant access Money Market Funds. Higher rates of around 1.5% can be obtained if two year fixed investments are made, but the Council's Treasury Management Strategy now proscribes such investments as not providing enough liquidity.

4.4 In 2009/10 the Council still had in its investment portfolio a number of 6%+ investments made before the credit crunch. This had the effect of raising the 2009/10 average interest rate on investments reported in the Progress Report to 2.56%. However, these investments have since matured and this year the corresponding figure is 0.55%.

4.5 The low portfolio size, together with the low rate of return on investment, means that the forecast investment income for 2010/11 is £377,000 compared with £1,743,000 in 2009/10, and £9,806,000 in 2008/09. The application of these funds has saved the Council the costs of borrowing.

5 Borrowing

5.1 In the Treasury Management Strategy Report taken to Cabinet in February 2010 it was reported that the Council's Capital Financing Requirement - CFR - for 2010/11 was forecast to be £521.1m. In other words, £521.1m is the amount that the Council should have borrowed to fund its capital programme after taking account of cash already set-aside for debt repayment.

5.2 By 30 September 2010 the CFR forecast for the year had become £463.2m. The reduction of £58m was due mainly to the actual process of recognising PFI assets (that is, schools and street lights) on the Council's balance sheet under International Financial Reporting Standards - IFRS - differing from that originally assumed. Under IFRS, assets acquired under PFI schemes are assumed to have been financed from borrowing.

5.3 The Capital Financing Requirement is therefore a key factor in the Council's borrowing strategy. In previous Treasury Management reports we have presented a borrowing strategy that aimed, either from delaying borrowing or actively redeeming debt, to reduce the Council's cash balances to around £50m. In practice, however, this has not happened since the Council is relatively 'cash rich' in the first half of the year, and poorer in the second half (due partly to the profiling of council tax and grant income, and partly to the rush to pay for capital expenditure before the end of the financial year).

5.4 Rather than try to maintain a fixed cash position, the Council's borrowing strategy tries to fix its position relative to its CFR. The target is £50m below the CFR. In other words, the strategy assumes that £50m of internal cash balances can be used to permanently defer borrowing £50m externally. The Treasury Management budget is based on this 'underborrowing' assumption, and this has created a budget saving of £50m x 5% = £2.5m which has been used to partly offset the investment income losses referred to in paragraph 4.5.

5.5 The forecast 'underborrowed' position for 2010/11 is actually £74m, ie, £24m below that assumed by the budget. This is based on a forecast of the Council's cashflow until April 2011, which shows that with a further £60m of borrowing this year the Council's cash balances will reach a low of approximately £20m by 31 March, before climbing again in April (£20m is considered to be a safe buffer for creditor payments, avoiding cashflow shortfalls). This additional deferral of borrowing is the main reason for the projected underspend in 2010/11.

5.6 It is tempting to build a similar underborrowed position into future year's budgets and thereby obtain a further budgetary saving. However, this would force the Council to rely more on internal cash balances and, as these will be reduced after the Spending Review (announced 20 October 2010), there is every chance the saving would not materialise. Indeed, maintaining a position of £50m below the CFR might well prove too difficult in future. If it did, this would force the Council to budget at a higher level of borrowing and incur higher revenue costs.

5.7 For information, the Council's 2010/11 mid-year borrowing positions stands at £250.823m. This is all Public Works Loan Board - PWLB - debt and its maturity profile and average weighted interest rates are shown in the table below:

Period remaining as at 30 September 2010	**%**	**£000**
Under 1 year	3.408	5,528
1 – 2 years	4.250	0
2 – 3 years	0.000	0
3 – 4 years	0.000	0
4 – 5 years	0.000	0
5 – 10 years	3.840	10,000
10 – 20 years	5.592	18,795
20 – 30 years	4.780	40,500
30 - 40 years	4.658	46,000
40 - 50 years	4.542	130,000
Total	**4.627**	**250,823**

5.8 The weighted average interest calculation above is only a snapshot of the Council's mid-year debt portfolio. Over the course of the year, taking into account loans redeemed between April and September, and the further planned borrowing of £60m, the forecast 'consolidated rate of interest' on the Council's debt portfolio for 2010/11 is projected to be 4.478%. This figure will be finalised at year-end.

5.9 When the Council's external debt is added to debt held by Derbyshire County Council on our behalf (stemming from local government reorganisation), plus that associated with the newly recognised PFI assets, this gives an overall external debt liability of approximately £335m.

5.10 For information, it is expected that the £60m further borrowing in 2010/11 will be around 4.5%. In future years rates are forecast to be higher, reaching 6% by 2013/14, but this is already included in the Treasury Management budget.

6 Counterparty Criteria

6.1 In the Treasury Management Annual Report 2009/10, taken to Cabinet in July, it was recommended that the Council's investment criteria pertaining to Money Market Funds be revised, taking account of the size of the fund and the number of ratings agencies providing ratings for it.

6.2 Since Cabinet the Council has begun using an online service called My Treasury, provided by the broker firm ICAP. My Treasury provides live information on all UK Money Market Funds and can allow the Council to more closely monitor the security, liquidity and performance of the funds.

6.3 Closer monitoring means that the Council can afford to slightly modify its MMF investment limits, in line with the table below:

Money Market Fund size	Previous investment limit £m	Revised investment limit £m
Greater than £20bn		20
Greater than £10bn		15
Greater than £5bn	15	10
Greater than £1bn	3	5
Less than £1bn	0	0

6.4 Fund size is a good indicator of security, as it means that the fund is able to spread risk factors across a wider range of investments. If any one of the fund's investments fails, then it means that investors in the fund will lose only a small fraction of their total investment. It is this spreading of risk that allows Money Market Funds to be classed as 'AAA' investments, which is the highest rating.

6.5 It is proposed to maintain the requirement, introduced in the previous Treasury Management report, that any Money Market Fund in which the Council invests is rated 'AAA' by at least two credit rating agencies.

6.6 All other counterparty investment criteria - covering fixed-term investments - remain unchanged from what has been previously reported to Cabinet.

OTHER OPTIONS CONSIDERED

7.1 None.

This report has been approved by the following officers:

Legal officer	n/a
Financial officer	Julian Kearsley, Interim Strategic Director – Resources
Human Resources officer	n/a
Service Director(s)	n/a
Other(s)	n/a

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Background papers:	• Council Cabinet report 28 July 2009 'Treasury Management – Annual Report 2008/09' • Council Cabinet report 24 November 2009 'Treasury Management Progress Report 2009/10' • Council Cabinet report 19 February 2010 'Treasury Management Strategy and Prudential Code Indicators 2009/10' • Council Cabinet report 8 June 2010 'Contract and Financial Procedure Matters Report' • Council Cabinet report 27 July 2010 'Treasury Management – Annual Report 2009/10'
List of appendices:	Appendix 1 - Implications

IMPLICATIONS

Financial

1.1 As detailed in the report.

Legal

2.1 The Council is obliged to set and review prudential indicators in order to comply with the Local Government Act 2003. The Local Government Act 2003 states that the Council must adopt the Prudential Code, which, in turn, requires local authorities to adopt the CIPFA Treasury Management Code of Practice. Unless the government uses its powers under section 4 of that Act, the Council is free to set any reasonable indicators consistent with its other policies.

2.2 The Prudential Code states that the Prudential indicators for treasury management should be considered together with the local authority's treasury management strategy and the annual report on treasury management activities.

Personnel

3.1 None.

Equalities Impact

4.1 None.

Health & safety

5.1 None.

Carbon Commitment

6.1 None.

Value for Money

7.1 As outlined in the report

Corporate objectives and priorities for change

8.1 The priorities of the Council's Treasury Management Strategy contribute to minimizing Council Tax and providing value for money.