WIRRAL COUNCIL

COUNCIL EXCELLENCE OVERVIEW AND SCRUTINY COMMITTEE

16 MARCH 2011

SUBJECT	**TREASURY MANAGEMENT PERFORMANCE MONITORING**
WARD/S AFFECTED	**ALL**
REPORT OF	**DIRECTOR OF FINANCE**
RESPONSIBLE PORTFOLIO HOLDER	**COUNCILLOR JEFF GREEN**
KEY DECISION	**YES**

1.0 EXECUTIVE SUMMARY

1.1 This report presents a review of Treasury Management activities during the third quarter of 2010/11 and confirms compliance with treasury limits and prudential indicators. It has been prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code and was presented to the Cabinet on 3 February 2011.

2.0 RECOMMENDATION

2.1 That the Treasury Management Performance Monitoring Report be noted.

3.0 REASON FOR RECOMMENDATION

3.1 The Treasury Management Code requires public sector authorities to determine an annual Treasury Management Strategy and, as a minimum, to formally report on their treasury activities and arrangements to Council mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate that they have properly fulfilled their responsibilities and enable those with responsibility/governance of the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives.

4.0 BACKGROUND AND KEY ISSUES

4.1 Treasury Management in Local Government is governed by the CIPFA Code of Practice on Treasury Management in the Public Services and in this context is the “management of the Council’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks”.

4.2 Cabinet approves the Treasury Management Strategy at the start of each financial year. This identifies proposals to finance capital expenditure, borrow and invest in the light of capital spending requirements, the interest rate forecasts and the expected economic conditions. At the end of each financial year Cabinet receives this Annual Report which details performance against the Strategy. In accordance with the revised Treasury Management Code, a Treasury Management monitoring report is presented to Cabinet and Council on a quarterly basis.

CURRENT ECONOMIC ENVIRONMENT

4.3 The Spending Review announced on 20 October 2010 set out how the Government will carry out the deficit reduction plan over the next four years, with the aim of eliminating the structural deficit by 2015. Particular focus was given to “reducing welfare costs and wasteful spending”. Departmental budgets (other than Health and Overseas Aid) are to be cut by an average of 19%, with around £81 billion cut from public spending overall, over four years. The Office of Budget Responsibility (OBR), commented that there was a better than even chance of hitting the fiscal mandates and that the rebalancing of the economy could be relatively pain-free.

4.4 The Bank of England (BoE) November Quarterly Inflation Report projected inflation to remain above the 2% target throughout 2011. In the BoE view the recovery in economic activity was likely to continue, with GDP growth more likely to be above the historical average than below it for much of the two year forecast period. Consumer Price Inflation (CPI), rose to 3.3% year-on-year to November 2010 and was expected to remain high into 2011.

4.5 The UK economy grew in the third calendar quarter of 2010 by 0.8%, twice as much as economists forecast, as services and construction helped sustain the recovery. The annual growth rate increased to 2.8%. The Monetary Policy Committee (MPC) maintained the Bank Rate at 0.5%, and although the MPC maintained Quantitative Easing at £200 billion, minutes of the MPC meetings showed the MPC was clearly ready to resume asset purchases if the economy slowed faster than expected.

THE COUNCIL TREASURY POSITION

4.6 The table shows how the position has changed since 30 September 2010.

Table 1 : Summary of Treasury Position

Investments	Balance at 30 Sep 2010 £m	Maturing Investments £m	New Investments £m	Balance at 31 Dec 2010 £m
Internal managed investments	146	158	159	147
TOTAL INVESTMENTS	**146**	**158**	**159**	**147**

Borrowings	Balance at 30 Sep 2010 £m	Maturing Borrowings £m	New Borrowings £m	Balance at 31 Dec 2010 £m
Long-term fixed rate	282	13	5	274
Long-term variable rate	0	0	0	0
Temporary borrowing	0	0	0	0
TOTAL BORROWING	**282**	**13**	**5**	**274**

NET BORROWING	**136**			**127**

INVESTMENTS

4.7 The Treasury Management Team can invest money for periods varying from 1 day to 10 years, in accordance with the Treasury Management Strategy, to earn interest until the money is required by the Council. These investments arise from a number of sources including General Fund Balances, Reserves and Provisions, Grants received in advance of expenditure, Money borrowed in advance of capital expenditure, Schools' Balances and Daily Cashflow/ Working Capital.

4.8 At 31 December 2010 the Council held investments of £147 million

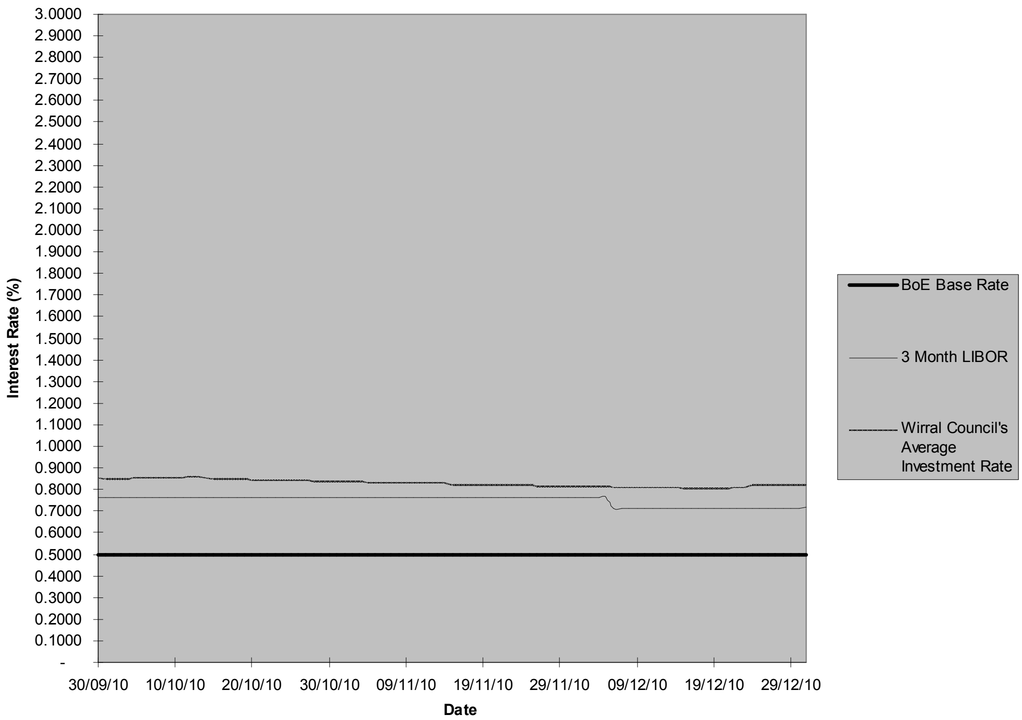
Table 2 : Investments at 31 December 2010

Investments with:	£m
UK Banks	72,200
Building Societies	12,700
Money Market Funds	50,550
Other Local Authorities	3,500
Gilts and Bonds	8,500
TOTAL	**147,450**

4.9 Of the above investments, £55 million is invested in instant access funds, £81 million is invested for up to 1 year and £11 million is invested for up to 5 years.

4.10 The average rate of return on investments as at 31 December 2010 is 0.97%. The graph shows the Treasury Management Team rate of return against the Bank of England base rate and the 3 month LIBOR (the inter bank lending rate):

Investment Rate of Return in 2010/11



4.11 The rate at which the Council can invest money continues to be low, in line with the record low Bank of England base rate.

4.12 The Council maintains a restrictive policy on new investments by only investing in UK institutions A+ rated or above and continues to invest in AAA rated money market funds, gilts and bonds.

4.13 The 2010/11 investment income budget has been reduced to £0.7 million to reflect the low interest rates that are anticipated to continue throughout the financial year. With low interest rates it is unlikely that the Authority will achieve the large surpluses that have been made in the past few years.

Icelandic Investment

4.14 The Authority has £2 million deposited with Heritable Bank, a UK registered Bank, at an interest rate of 6.22% which was due to mature on 28 November 2008. The Company was placed in administration on 7 October 2008. Members have received regular updates regarding the circumstances and the latest situation. In March 2009 an Audit Commission report confirmed that Wirral Council had acted, and continues to act, prudently and properly in all its investment activities.

4.15 The latest creditor progress report issued by the Administrators Ernst and Young, dated 28 January 2010, outlined that the return to creditors is projected to be 85p in the £ by the end of 2012 and the final recovery could be higher.

4.16 To date, £956,073 has been received with payments due over 2010/12.

Table 3 : Heritable Bank Repayments

	£
Initial Investment	2,000,000
Actual Repayments Received	
As at 31 Dec 10	956,073
Estimate of Future Repayments	
Dec-10	104,289
Mar-11	104,289
Jun-11	104,289
Sep-11	104,289
Dec-11	104,289
Mar-12	104,289
Jun-12	104,289
Sep-12	104,289
Total	**834,312**
Estimate of Minimum Total Repayment	**1,790,385**

4.17 Please note that the amounts and timings of future payments are estimates and are not definitive. Favourable changes in market conditions could lead to higher than estimated repayments.

4.18 If Heritable Bank is unable to repay in full, I have also made a pre-emptive claim against Landsbanki Islands HF for the difference. When the original investment was made it was with Landsbanki Islands HF providing a guarantee to reimburse the Council should Heritable be unable to repay. It should be noted that Landsbanki Islands HF is also in Administration.

BORROWING

4.19 The Council undertakes borrowing to help fund capital expenditure. In 2010/11 the capital programme requires borrowing of £14 million.

4.20 As at 31 December 2010 the Council had borrowed £10 million from the Public Works Loan Board (PWLB); £5 million borrowed over 50 years at a rate of 3.92%, repayable at maturity and £5 million borrowed over 10 years at a rate of 1.89% repayable in equal instalments over the life of the loan. To put the rate of interest paid on these loans into context, existing borrowings incur an average rate of interest of 5.6%.

4.21 Both of these loans were taken out before the announcement in the Spending Review from HM Treasury to the PWLB to increase the interest rate on all new loans by an average of 1% above UK Government Gilts. The new borrowing rates for fixed loans increased by approximately 0.87% across all maturities, and variable rates by 0.90%. Premature repayment rates did not benefit from the corresponding increase and the PWLB methodology remained unchanged. HM Treasury determined that these changes ensured that the rate at which loans are made available to local authorities better reflected the availability of capital funding post-Spending Review and would encourage optimal borrowing and investment decisions.

4.22 Whilst competitive, comparable equivalents to PWLB are readily available, the Council will adopt a cautious and considered approach to future borrowing. The treasury adviser, Arlingclose, is actively consulting with investors, investment banks, lawyers and credit rating agencies to establish the attraction of different sources of borrowing, including bond schemes, loan products and their related risk/reward trade off. A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Prudential Indicators.

4.23 The table shows the total borrowing as at 31 December 2010.

Table 4 : Total borrowing at 31 December 2010

Borrowing	**Balance 1 Apr 2010 (£m)**	**Debt Maturing (£m)**	**New Borrowing (£m)**	**Balance 31 Dec 10 (£m)**
PWLB	106	16	10	100
Market Loans	174	0	0	174
TOTAL	**280**	**16**	**10**	**274**

5.0 MONITORING OF THE PRUDENTIAL CODE INDICATORS

5.1 The introduction of the Prudential Code in 2004 gave Local Authorities greater freedom in making capital strategy decisions. The prudential indicators allow the Council to establish prudence and affordability within the capital strategy.

5.2 Below is a selection of prudential indicators which demonstrate that the treasury management decisions are in line with the capital strategy, which is prudent and affordable.

Net External Borrowing and Capital Financing Requirement (CFR) Indicator

5.3 The CFR measures the underlying need to borrow money to finance capital expenditure. The Prudential Code stipulates that net external borrowing should not exceed the CFR for the previous year plus the estimated additional CFR requirement for the current and next two financial years. Table shows the accumulative CFR and net borrowing of the Council.

Table 5 : Net External Borrowing compared with CFR

	£m
CFR in previous year (2009/10 actual)	387
additional CFR in 2010/11 (estimate)	2
Reduced CFR in 2011/12 (estimate)	-20
Reduced CFR in 2012/13 (estimate)	-20
Accumulative CFR	**349**
External Borrowing as at 31 Dec 2010	**274**

5.4 Net external borrowing does not exceed the CFR and it is not expected to in the future. This is a key indicator of prudence.

Authorised Borrowing Limit and Operational Boundary Indicators

5.5 The Authorised Borrowing Limit is the amount determined as the level of borrowing which, while not desired, could be afforded but may not be sustainable. It is not treated as an upper limit for borrowing for capital purposes alone since it also encompasses temporary borrowing. An unanticipated revision to this limit is considered to be an exceptional event and would require a review of all the other affordability indicators.

5.6 The Operational Boundary is the amount determined as the expectation of the maximum external debt according to probable events projected by the estimates and makes no allowance for any headroom. It is designed to alert the Authority to any imminent breach of the Authorised Limit.

Table 6 : Authorised Limit and Operational Boundary Indicator

	Oct 10 £m	Nov 10 £m	Dec 10 £m
Authorised Limit	484	484	484
Operational Boundary	469	469	469
Total Council Borrowing	287	279	274

5.7 The table above shows that neither the Authorised Limit nor the Operational Boundary was breached between October 2010 and December 2010. This is a key indicator of affordability.

Interest Rate Exposures Indicator

5.8 The Prudential Code also requires Local Authorities to set limits for the exposure to the effects of interest rate changes. Limits are set for the amount of borrowing/ investments which are subject to variable rates of interest and the amount which is subject to fixed rates of interest. Table shows the interest rate exposure as at 31 December 2010.

Table 7 : Interest Rate Exposure:

Interest Rate Exposure	**Fixed Rate of Interest**	**Variable Rate of Interest**	**Total**
Borrowings	£274m	£0m	**£274m**
Proportion of Borrowings	100%	0%	**100%**
Upper Limit	100%	50%	
Investments	£11m	£136m	**£147m**
Proportion of Investments	7.5%	92.5%	**100%**
Upper Limit	100%	100%	
Net Borrowing	**£263m**	**£-136m**	**£127m**
Proportion of Total Net Borrowing	207%	-107%	**100%**

5.9 The table above shows that borrowing is mainly at fixed rates of interest and investments are mainly at variable rates of interest. This was considered to be a good position while interest rates were rising as the cost of existing borrowing remained stable and the investments, at variable rates of interest, generated increasing levels of income.

5.10 As the environment has changed to one of low interest rates, the Treasury Management Team is working to adjust this position. This work is, unfortunately, restricted by a number of factors:

- the level of uncertainty in the markets makes investing for long periods at fixed rates of interest more risky and, therefore, the Council continues to only invest short term at variable rates of interest;
- Many of the Council loans have expensive penalties for early repayment or rescheduling which makes changing the debt position difficult.

5.11 The Treasury Management Team will continue to work to improve the position within these limiting factors.

Maturity Structure of Borrowing Indicator

5.12 The maturity structure of the borrowing has also been set to achieve maximum flexibility with the Authority being able to undertake all borrowing with a short maturity date or a long maturity date. Table 8 shows the current maturity structure of borrowing:

Table 8 : Maturity Structure of Borrowing

	Borrowings Maturity (years)	31 Dec 10 £m	31 Dec 10 %
Total Short Term Borrowing	Less than 1 year	**14**	**5**
Long Term Borrowing	Over 1 year under 2 years	15	6
	Over 2 years under 5 years	44	16
	Over 5 years under 10 years	34	12
	Over 10 years	167	61
Total Long Term Borrowing		**260**	**95**
Total Borrowing		**274**	**100**

6.0 RELEVANT RISKS

6.1 All relevant risks have been discussed within Section 4 of this report.

7.0 OTHER OPTIONS CONSIDERED

7.1 There are no other options considered in this performance monitoring report.

8.0 CONSULTATION

8.1 There has been no consultation undertaken or proposed for this performance monitoring report. There are no implications for partner organisations arising out of this report.

9.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

9.1 There are none arising out of this report.

10.0 RESOURCE IMPLICATIONS: FINANCIAL; IT; STAFFING; AND ASSETS

10.1 Currently Treasury Management activities are expected to generate a surplus of £600,000 in 2010-11 due to increased investment income.

11.0 LEGAL IMPLICATIONS

11.1 There are none arising out of this report.

12.0 EQUALITIES IMPLICATIONS

12.1 There are none arising out of this report.

12.2 Equality Impact Assessment (EIA) is not required.

13.0 CARBON REDUCTION IMPLICATIONS

13.1 There are none arising out of this report.

14.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

14.1 There are none arising out of this report.

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APPENDICES

None

REFERENCE MATERIAL

Code of Practice for Treasury Management in Public Services – CIPFA 2009.
Prudential Code for Capital Finance in Local Authorities – CIPFA 2009.

SUBJECT HISTORY

Council Meeting	**Date**
Cabinet - Treasury Management and Investment Strategy 2010 to 2013	22 February 2010
Cabinet - Treasury Management Annual Report 2009/10	24 June 2010
Cabinet - Treasury Management Performance Monitoring	22 July 2010
Cabinet - Treasury Management Performance Monitoring	14 October 2010
Cabinet - Treasury Management Performance Monitoring	3 February 2011