WIRRAL COUNCIL

CABINET

22 JULY 2010

REPORT OF THE DIRECTOR OF FINANCE

TREASURY MANAGEMENT QUARTERLY MONITORING

1. EXECUTIVE SUMMARY

1.1 This report presents a review of Treasury Management activities during the first 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.

2. BACKGROUND

2.1 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".

2.2 The Treasury Management Code requires public sector authorities to determine an annual Treasury Management Strategy and as a minimum, 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.

2.3 Cabinet approves the Treasury Management Strategy before the start of each financial year. This identifies proposals to finance capital expenditure, borrow and invest in the light of capital spending requirements, interest rate forecasts and expected economic conditions. At the end of each financial year Cabinet receives an Annual Report which details performance against the Strategy. During 2009/10 the Council Excellence Overview & Scrutiny Committee received quarterly monitoring reports as part of the General Financial Matters report. In 2010/11, in accordance with the revised Treasury Management Code, there will be a separate Treasury Management monitoring report presented to Cabinet and approved by Council on a quarterly basis.

3. CURRENT ECONOMIC ENVIRONMENT

3.1 With the formation of the Coalition Government comes the creation of the Office of Budget Responsibility (OBR) designed to give a more independent assessment of the economic outlook. Following the Chancellor of the Exchequer's budget on 22 June 2010 the OBR assessment is that the economy will grow by 1.2% in 2010 and by 2.3% in 2011, both of which are a downward revision on past forecasts. The reduced growth figures coupled with the large public sector borrowing figures mean that the deficit will not dissipate without structural changes occurring.

3.2 Inflation figures in May stand at 3.4% for CPI and 5.1% for RPI slightly down on April but still above the Bank of England Monetary Policy Committee target range. However, the spare capacity in the economy and the expected reduction in public sector expenditure should ensure that inflation continues to fall to around the 2% level.

3.3 The Bank of England (BoE) base rate remains at 0.5% and is forecast to remain at this level throughout 2010. The BoE has now ceased the Quantitative Easing (QE) programme but has not ruled out using more QE in the future if the economy continues to stall. The economy is in a very weak state and until it shows real signs of prolonged and stable growth the base rate will remain low.

4. THE COUNCIL TREASURY POSITION

4.1 The table below shows how the Treasury position has changed since 31 March 2010:

Table 1: Summary of Treasury Position

Investments	Balance at 31 March 2010 £m	Maturing Investments £m	New Investments £m	Balance at 30 June 2010 £m
Internal managed investments	106	181	210	135
TOTAL INVESTMENTS	**106**	**181**	**210**	**135**

Borrowings	Balance at 31 March 2010 £m	Maturing Borrowings £m	New Borrowings £m	Balance at 30 June 2010 £m
Long-term fixed rate	280	2	0	278
Long-term variable rate	0	0	0	0
Temporary borrowing	0	0	0	0
TOTAL BORROWING	**280**	**2**	**0**	**278**

NET BORROWING	**174**			**143**

5. INVESTMENTS

5.1 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
- Daily Cashflow/ Working Capital

5.2 As at 30 June 2010 the Council held investments of £135m. The table below details these investments;

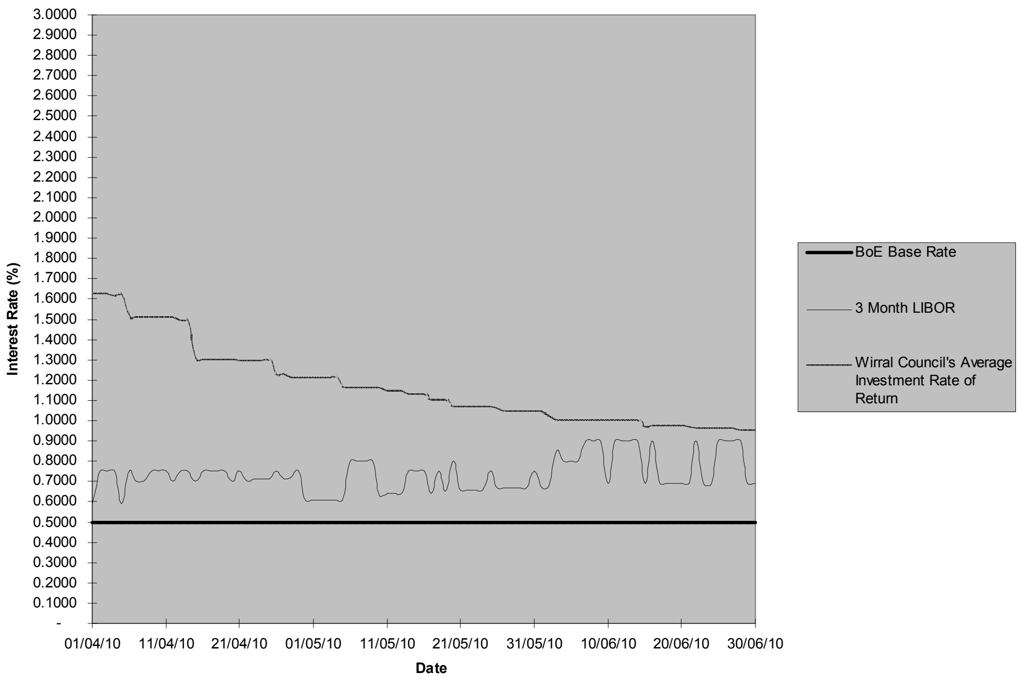
Table 2: Investments as at 30 June 2010

Investments with:	£m
UK Banks	69.8
Building Societies	15.0
Money Market Funds	41.7
Gilts and Bonds	8.5
TOTAL	**135.0**

5.3 Of the above investments £49m is invested in instant access funds, £75.5m is invested for up to 1 year, £3m is invested for up to 2 years and £7.5m is invested for up to 5 years.

5.4 The average rate of return on investments as at 30 June 2010 is 1.16%. The graph below 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);

Chart 1: Investment Rate of Return in 2010/11



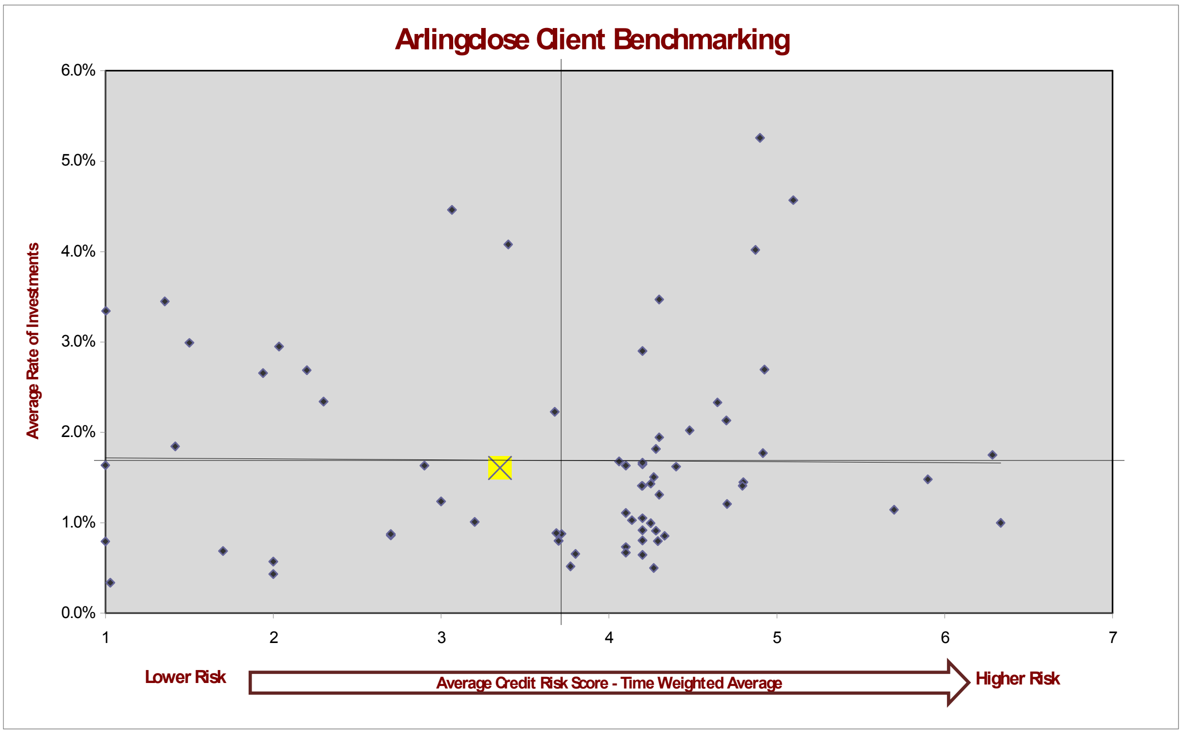
5.5 The rate at which the Council can invest money continues to be low, in line with the record low Bank of England base rate.

5.6 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.

5.7 The 2010/11 investment income budget has been reduced to £0.7m 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.

5.8 In order to provide more context to the investment activities of the Treasury Management Team the treasury management advisors have produced benchmarking data from the 71 public sector clients they work with. The graph below shows the average rate of return from investments in 2009/10 against the perceived risk of the investments. Wirral is represented by a ‘x’ on the graph while the other 70 authorities are represented by dots.

Chart 2: Average investment rate of return against credit risk



5.9 This graph demonstrates how Wirral achieves close to the average rate of return from its investments while maintaining a lower than average risk. This illustrates the Treasury Management Team work in maintaining the security of Council money while providing reasonable investment returns. The security of the investments always takes priority over the returns.

Icelandic Investment

5.10 In terms of Icelandic investments, the Council had £2 million deposited with Heritable Bank and 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.

5.11 The latest information from the Administrator projects a base case return to creditors of between 79-85p in the £ and the final recovery could be higher. To date £0.7 million has been received with further payments due in 2010/11. 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.

6. BORROWING

6.1 The Council undertakes borrowing to help fund capital expenditure. In 2010/11 the capital programme requires borrowing of £14m. However, to date no additional borrowing has been undertaken. The table below shows the total borrowing of the Council as at 30 June 2010.

Table 3: Borrowing as at 30 June 2010

Borrowing	**£m**
PWLB	104
Market Loans	174
TOTAL	**278**

6.2 The Council is able to borrow from two main sources, either from the Public Works Loan Board (PWLB), which is effectively borrowing from the Government, or from the Market, i.e. direct from the banks.

6.3 As the year progresses an assessment will be made as to the best time to borrow money. Currently, as the rate of return from investments remains low it continues to be more appropriate to reduce the level of investment. By not reinvesting as investments mature the Council is able to use this money to fund capital expenditure. This, temporarily, reduces the need to undertake new long term borrowing and also alleviates the difficulty and risk in finding a safe counterparty to invest with. This approach also helps to generate savings as borrowing money long term to fund the capital programme incurs an interest rate of approximately 4.5% while investments are only earning approximately 0.5%. It is recognised that utilising investments in lieu of borrowing clearly has a finite duration; investments are not permanent surplus money but, rather, money set aside for a specific future reason. Future borrowing would be required to support capital expenditure.

7. MONITORING OF THE PRUDENTIAL CODE INDICATORS

7.1 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.

7.2 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.

7.3 Net External Borrowing and Capital Financing Requirement (CFR) Indicator

7.3.1. 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 4 below shows the cumulative CFR and net borrowing of the Council.

Table 4: 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
C0-umulative CFR	**349**
External Borrowing as at 30 June 2010	**278**

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

7.4. Authorised Borrowing Limit and Operational Boundary Indicators

7.4.1. 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.

7.4.2. 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 5: Authorised Limit and Operational Boundary Indicator

	April 10 £m	**May 10 £m**	**June 10 £m**
Authorised Limit	484	484	484
Operational Boundary	469	469	469
Total Council Borrowing	278	278	278

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

7.5. <u>Interest Rate Exposures Indicator</u>

7.5.1. 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 6 shows the interest rate exposure as at 30 June 2010.

Table 6: Interest Rate Exposure:

Interest Rate Exposure	**Fixed Rate of Interest**	**Variable Rate of Interest**	**Total**
Borrowings	£278m	£0m	**£278m**
Proportion of Borrowings	100%	0%	**100%**
Upper Limit	100%	50%	
Investments	£2m	£133m	**£135m**
Proportion of Investments	1%	99%	**100%**
Upper Limit	100%	100%	
Net Borrowing	**£276m**	**£-133m**	**£143m**
Proportion of Total Net Borrowing	193%	-93%	**100%**

7.5.2. 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 borrowings remained stable and the investments, at variable rates of interest, generated increasing levels of income.

7.5.3. 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.

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

7.6. <u>Maturity Structure of Borrowing Indicator</u>

7.6.1. 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 7 shows the current maturity structure of borrowing.

Table 7: Maturity Structure of Borrowing

	Borrowings Maturity (years)	30 June 10 £m	30 June 10 %
Total Short Term Borrowing	Less than 1 year	**14**	**5**
Long Term Borrowing	Over 1 year under 2 years	14	5
	Over 2 years under 5 years	57	21
	Over 5 years under 10 years	28	10
	Over 10 years	165	59
Total Long Term Borrowing		**264**	**94**
Total Borrowing		**278**	**100**

8. FINANCIAL IMPLICATIONS

8.1 Currently all Treasury Management activities are expected to be achieved in line with the 2010-11 budget.

9. STAFFING IMPLICATIONS

9.1 There are none arising out of this report.

10. EQUAL OPPORTUNTIES IMPLICATIONS

10.1 There are none arising out of this report.

11. COMMUNITY SAFETY IMPLICATIONS

11.1 There are none arising out of this report.

12. LOCAL AGENDA 21 IMPLICATIONS

12.1 There are none arising out of this report.

13. PLANNING IMPLICATIONS

13.1 There are none arising out of this report.

14. ANTI-POVERTY IMPLICATIONS

14.1 There are none arising out of this report.

15. SOCIAL INCLUSION IMPLICATIONS

15.1 There are none arising out of this report.

16. LOCAL MEMBER SUPPORT IMPLICATIONS

16.1 There are none arising out of this report

17. BACKGROUND PAPERS

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

18. RECOMMENDATION

18.1 That the Treasury Management Quarterly Monitoring Report be noted.

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DIRECTOR OF FINANCE

FNCE/129/10