WIRRAL COUNCIL

COUNCIL EXCELLENCE OVERVIEW AND SCRUTINY COMMITTEE

18 NOVEMBER 2010

REPORT OF THE DIRECTOR OF FINANCE

TREASURY MANAGEMENT PERFORMANCE MONITORING QUARTER 2

1. EXECUTIVE SUMMARY

1.1 This report presents a review of Treasury Management activities during the second 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 full 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 the 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, and 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 The UK has continued to emerge from recession but the level of activity remained well below pre-crisis levels. Gross Domestic Product (GDP) registered 0.3% growth in the first quarter of 2010 and 1.2% in the second.

3.2 Inflation figures for August 2010 were 3.1% for CPI and 4.7% for RPI, still above the Bank of England Monetary Policy Committee target range. The Bank of England expects, with the forthcoming increase in VAT to 20%, that inflation will remain high throughout 2010 and 2011 but should reduce to below the target level as the spare capacity in the markets exerts downward pressure on wages and prices.

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 the use of 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 Council Treasury position has changed since the 30 June 2010:

Table 1: Summary of Treasury Position

Investments	Balance at 30 June 2010 £m	Maturing Investments £m	New Investments £m	Balance at 30 Sept 2010 £m
Internal managed investments	135	131	142	146
TOTAL INVESTMENTS	**135**	**131**	**142**	**146**

Borrowing	Balance at 30 June 2010 £m	Maturing Borrowings £m	New Borrowings £m	Balance at 30 Sept 2010 £m
Long-term fixed rate	278	1	5	282
Long-term variable rate	0	0	0	0
Temporary borrowing	0	0	0	0
TOTAL BORROWING	**278**	**1**	**5**	**282**

NET BORROWING	**143**			**136**

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 the 30 September 2010 the Council held investments of £146m. The table below details these investments:

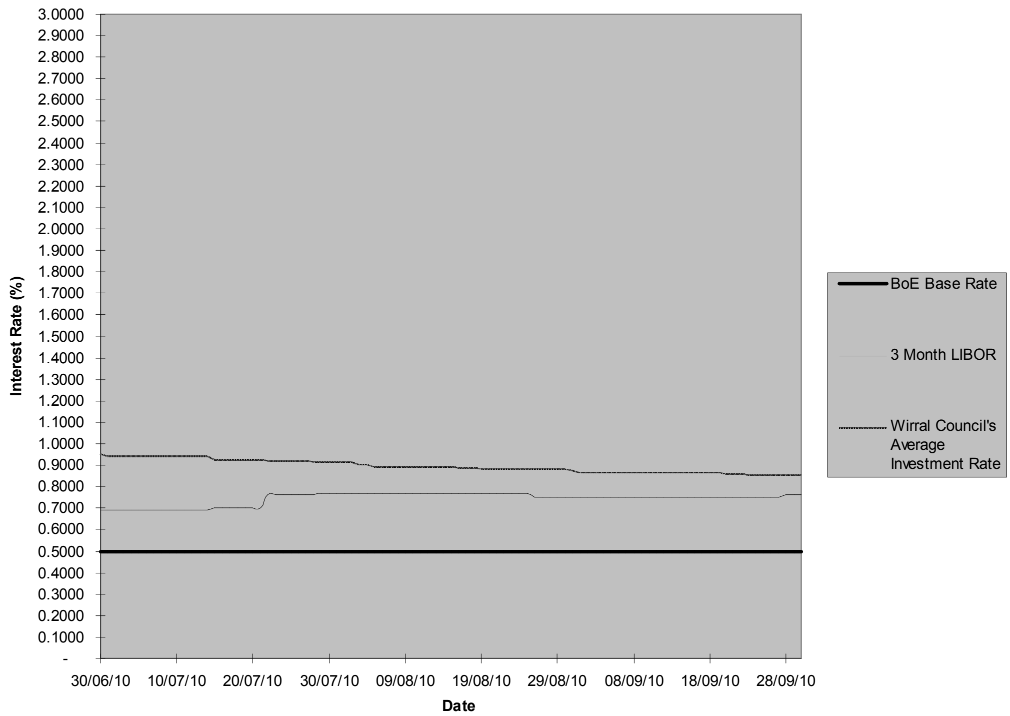
Table 2: Investments as at 30 September 2010

Investments with:	£m
UK Banks	75.8
Building Societies	15.0
Money Market Funds	46.8
Gilts and Bonds	8.5
TOTAL	**146.1**

5.3 Of the above investments, £50.5m is invested in instant access funds, £88.1m is invested for up to 1 year and £7.5m is invested for up to 5 years.

5.4 The average rate of return on investments as at 30 September 2010 is 1.03%. 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



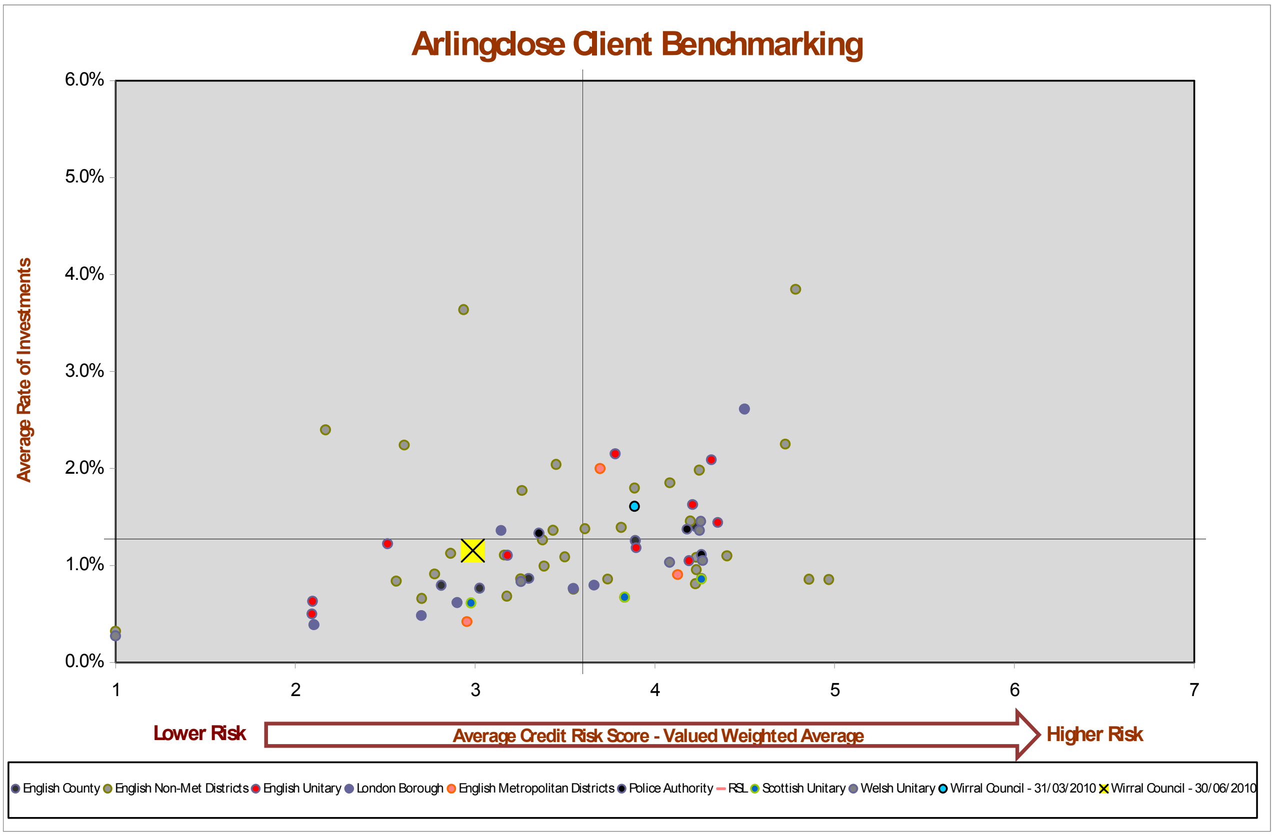
5.5 The rate at which the Council can invest money continues to be low, in line with the record low Bank of England base rate.

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 for 2010/11 up to 30 June 2010 against the perceived risk of the investments. Wirral is represented by a ‘x’ on the graph.

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 investments while maintaining a lower than average risk. This illustrates the Treasury Management Team’s excellent work in maintaining the security of Council money while also providing good value for money from investment returns. The security of the investments always takes priority over the returns.

Icelandic Investment

5.10 The Authority has £2m deposited with Heritable Bank, a UK registered Bank under English law, at an interest rate of 6.22% which was due to mature on 28 November 2008. The Bank 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.

5.11 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.

5.12 To date, £868,926 has been received with further payments due in 2010/11 and 2011/12. The table below details the payments received to date and future expected payments.

Table 3: Heritable Bank Repayments

	£
Initial Investment	2,000,000
Actual Repayments Received	
As at 30 Sept 10	868,926
Estimate of Future Repayments	
Oct-10	105,317
Dec-10	105,317
Mar-11	105,317
Jun-11	105,317
Sep-11	105,317
Dec-11	105,317
Mar-12	105,317
Jun-12	105,317
Sep-12	105,315
Total	**947,851**
Estimate of Total Repayment	**1,816,777**

5.13 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.

5.14 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. On 31 August 2010 the Public Works Loan Board (PWLB) rate of interest for borrowing 50 year fixed rate money dropped to 3.92%. This was the lowest rate of the year to date and so a decision was taken to borrow £5m. To put this rate of interest into context, existing borrowing incurs an average rate of interest of 5.6%. Against this backdrop, £5m borrowed at 3.92% over 50 years represents excellent value. The table below shows the total borrowing of the Council as at 30 September 2010.

Table 4: Council Borrowing

Borrowing	Balance on 1 Apr 10 (£m)	Debt Maturing (£m)	New Borrowing (£m)	Balance on 30 Sep 10 (£m)
PWLB	106	3	5	108
Market Loans	174	0	0	174
TOTAL	**280**	**3**	**5**	**282**

6.2 As the year progresses an assessment will be made as to the best time to borrow money. 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 approved Prudential Indicators.

6.3 In conjunction with advice from the treasury advisor, Arlingclose, the Council will keep under review the options of borrowing from the PWLB, the market and other sources up to the available capacity within the Capital Financing Requirement (CFR) and Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

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 <u>Net External Borrowing and Capital Financing Requirement (CFR) Indicator</u>

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 5 below shows the cumulative 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
Cumulative CFR	**349**
External Borrowing as at 30 Sep 2010	**282**

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 6: Authorised Limit and Operational Boundary Indicator

	Jul 10 £m	**Aug 10 £m**	**Sep 10 £m**
Authorised Limit	484	484	484
Operational Boundary	469	469	469
Total Council Borrowing	278	278	282

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

7.5 Interest Rate Exposures Indicator

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 is subject to variable rates of interest and the amount which is subject to fixed rates of interest. Table 7 shows the interest rate exposure as at 30 September 2010.

Table 7: Interest Rate Exposure:

Interest Rate Exposure	Fixed Rate of Interest	Variable Rate of Interest	Total
Borrowings	£282m	£0m	**£282m**
Proportion of Borrowing	100%	0%	**100%**
Upper Limit	100%	50%	
Investments	£7.5m	£138.6m	**£146m**
Proportion of Investments	5%	95%	**100%**
Upper Limit	100%	100%	
Net Borrowing	**£274.5m**	**£138.6m**	**£136m**
Proportion of Total Net Borrowing	202%	102%	**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 Maturity Structure of Borrowing Indicator

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 8 shows the current maturity structure of borrowing:

Table 8: Maturity Structure of Borrowing

	Borrowing Maturity (years)	30 Sep 10 £m	30 Sep 10 %
Total Short Term Borrowing	Less than 1 year	**12**	**4**
Long Term Borrowing	Over 1 year under 2 years	13	5
	Over 2 years under 5 years	54	19
	Over 5 years under 10 years	33	12
	Over 10 years	170	60
Total Long Term Borrowing		**270**	**96**
Total Borrowing		**282**	**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 Performance Monitoring Report be noted.

IAN COLEMAN
DIRECTOR OF FINANCE

FNCE/209/10