WIRRAL COUNCIL

CABINET

21 JULY 2011

SUBJECT	**TREASURY MANAGEMENT PERFORMANCE MONITORING- QUARTER 1**
WARD/S AFFECTED	**ALL**
REPORT OF	**DIRECTOR OF FINANCE**
RESPONSIBLE PORTFOLIO HOLDER	**COUNCILLOR STEVE FOULKES**
KEY DECISION	**YES**

1.0 EXECUTIVE SUMMARY

1.1 This report presents a review of Treasury Management activities during the first quarter of 2011/12 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.

2.0 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 treasury activities and arrangements to Council mid-year and after the year-end. This enables 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 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 an 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 first quarter of 2011-12 has brought a further reminder that the global financial crisis has not gone away through the difficulties being experienced in Greece. There is still a risk that the Greek debt problems may spread across Europe and this is an issue which can not be ignored in Treasury Management decisions.

4.4 In the UK, high street sales continue to suffer with further announcements of companies entering administration and/or cutting jobs The May 2011 inflation figures were 5.3% for RPI and 4.5% for CPI whilst growth in the first quarter GDP was 0.5%. The Monetary Policy Committee (MPC) has the task of deciding whether inflation or growth poses the greater threat to the economy.

4.5 To date, the MPC has viewed tackling low growth as the priority, and has continued to vote for the Bank of England Base Rate to remain at 0.5%. The MPC view of inflation is that temporary external factors are keeping inflation high and these should subside as the year progresses but the longer that growth remains low and inflation high then the more difficult the decision.

THE COUNCIL TREASURY POSITION

4.6 The table shows how the position has changed since 31 March 2011.

Table 1: Summary of Treasury Position

	Balance 31 Mar 11 (£m)	Maturities (£m)	Additions (£m)	Balance 30 Jun 11 (£m)
Investments	136	(169)	190	157
Borrowings	(274)	2	0	(272)
Other Long-Term Liabilities	(65)	0	0	(65)
Net Financial Liabilities	(203)	(167)	190	(180)

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 30 June 2011 the Council held investments of £157 million

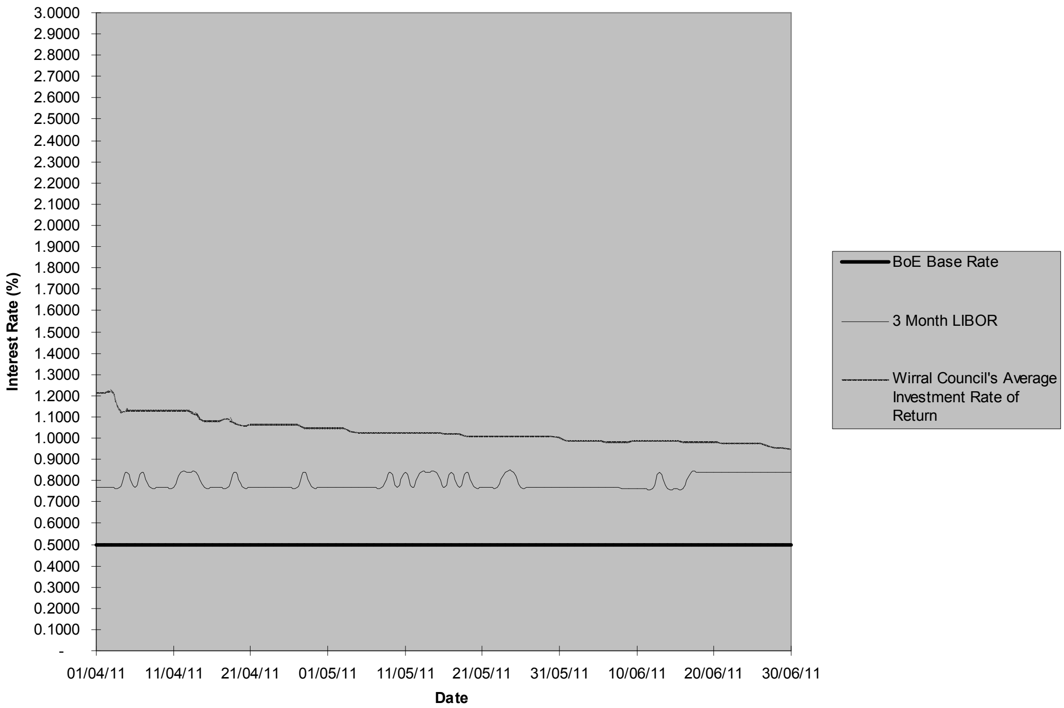
Table 2 :Investments at 30 June 2011

Investments with:	£m
UK Banks	61
UK Building Societies	15
Money Market Funds	39
Other Local Authorities	32
Gilts and Bonds	10
TOTAL	**157**

4.9 Of the above investments, £44 million is invested in instant access funds, £98 million is invested for up to 1 year and £15 million is invested for up to 5 years.

4.10 The average rate of return on investments as at 30 June 2011 is 0.95%. 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 2011/12



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. The 2011/12 investment income budget has been set at £1.3 million, reflecting the low interest rates that are anticipated to continue throughout much of the financial year.

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. The current strategy has been to limit the maximum investment period to two years. However, in light of the financial problems in Greece and the risk of these problems spreading to other European countries the maximum investment period has been temporarily restricted to one year.

4.13 The Treasury Management Team will continue to monitor the developing financial situation and will make appropriate operational adjustments, within the approved Treasury Management Strategy, to maintain the security of public money, and manage the associated risks while also maximising returns within these constraints.

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, £1,187,107 has been received with payments due over 2010/12.

Table 3 : Heritable Bank Repayments

	£
Initial Investment	2,000,000
Actual Repayments Received	
As at 30 June 11	1,187,107
Estimate of Future Repayments	
Jul-11	100,472
Oct-11	100,472
Jan-12	100,472
Apr-12	100,472
Jul-12	100,472
Oct-12	100,472
Total	**602,832**
Estimate of Minimum Total Repayment	**1,789,939**

4.17 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 AND OTHER FINANCIAL LIABILITIES

4.19 The Council undertakes borrowing to help fund capital expenditure. In 2011/12 the capital programme requires borrowing of £16 million. As at 30 June 2011 the Council had not undertaken any new borrowing for the financial year 2011/12

4.20 Following the Spending Review on 20 October 2010, on instruction from HM Treasury, the PWLB increased the margin for new borrowing to average 1% above the yield on the corresponding UK Government Gilt. 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.

4.21 The PWLB remains the preferred source of borrowing given the transparency and control that this continues to provide.

4.22 Other Long-Term Liabilities include the Schools PFI scheme and finance leases used to purchase vehicles plant and equipment. Under the International Financial Reporting Standards (IFRS) these items are now shown on the balance sheet as a financial liability and therefore need to be considered within any Treasury Management decision making process.

4.23 The table below shows the financial liabilities as at 30 June 2011.

Table 4 : Financial Liabilities at 30 June 2011

Financial Liabilities	**Balance 1 Apr 11 (£m)**	**Debt Maturing (£m)**	**New Debt (£M)**	**Balance 30 Jun 11 (£m)**
Borrowings				
PWLB	(100)	2	0	(98)
Market Loans	(174)	0	0	(174)
Other Long Term Liabilities				
PFI	(62)	0	0	(62)
Finance Leases	(3)	0	0	(3)
TOTAL	**(339)**	**2**	**0**	**(337)**

MONITORING OF THE PRUDENTIAL CODE INDICATORS

4.24 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.

4.25 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

4.26 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 : Net External Borrowing compared with CFR

	£m
CFR in previous year (2010/11 estimate)	390
reduced CFR in 2011/12 (estimate)	(19)
reduced CFR in 2012/13 (estimate)	(18)
reduced CFR in 2013/14 (estimate)	(19)
Accumulative CFR	**334**
Net External Borrowing as at 30 Jun 11	**272**

4.27 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

4.28 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.

4.29 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

	April 11 (£m)	**May 11 (£m)**	**June 11 (£m)**
AUTHORISED LIMIT	**497**	**497**	**497**
OPERATIONAL BOUNDARY	**482**	**482**	**482**
Council Borrowings	274	274	272
Other Long Term Liabilities	65	65	65
TOTAL	**339**	**339**	**337**

4.30 The table above shows that neither the Authorised Limit nor the Operational Boundary was breached between April 2011 and June 2011. This is a key indicator of affordability.

Interest Rate Exposures Indicator

4.31 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 7 : Interest Rate Exposure at 30 June 2011

	Fixed Rate of Interest (£m)	Variable Rate of Interest (£m)	TOTAL
Borrowings	(272)	0	**(272)**
Proportion of Borrowings	100%	0%	100%
Upper Limt	100%	0%	
Investments	15	142	**157**
Proportion of Investments	10%	90%	100%
Upper Limit	100%	100%	
Net Borrowing	**(257)**	**142**	**(115)**
Proportion of Total Net Borrowing	223%	-123%	100%

4.32 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.

4.33 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.

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

Maturity Structure of Borrowing Indicator

4.35 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	As at 30 June 11 (£m)	As at 30 June 11 (%)	2011/12 Lower Limit (%)	2011/12 Upper Limit (%)
Less than 1 year	12	4	0	20
Over 1 year under 2 years	17	6	0	20
Over 2 years under 5 years	49	18	0	50
Over 5 years under 10 years	26	10	0	50
Over 10 years	168	62	20	100
Total Borrowing	**272**	**100**		

5.0 RELEVANT RISKS

5.1 All relevant risks have been outlined within Section 4 of this report.

6.0 OTHER OPTIONS CONSIDERED

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

7.0 CONSULTATION

7.1 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.

8.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

8.1 There are none arising out of this report.

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

9.1 Currently all Treasury Management activities are expected to be achieved in line with the 2011/12 budget.

10.0 LEGAL IMPLICATIONS

10.1 There are none arising out of this report.

11.0 EQUALITIES IMPLICATIONS

11.1 There are none arising out of this report.

112 Equality Impact Assessment (EIA) is not required.

12.0 CARBON REDUCTION IMPLICATIONS

12.1 There are none arising out of this report.

13.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

13.1 There are none arising out of this report.

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APPENDICES

None

REFERENCE MATERIAL

DCLG Local Authority Investment Guidance,2004
DCLG Changes to the Capital Financing System Consultation, 2009
Code of Practice for Treasury Management in Public Services (Fully Revised Second Edition), CIPFA 2009.
Prudential Code for Capital Finance in Local Authorities (Fully Revised Second Edition), CIPFA 2009.

SUBJECT HISTORY

Council Meeting	**Date**
Cabinet - Treasury Management Monitoring Report	22 July 2010
Cabinet - Treasury Management Monitoring Report	14 October 2010
Cabinet - Treasury Management Monitoring Report	3 February 2011
Cabinet - Treasury Management and Investment Strategy 2011 to 2014	21 February 2011
Cabinet - Treasury Management Annual Report 2010/11	23 June 2011