WIRRAL COUNCIL

COUNCIL EXCELLENCE OVERVIEW AND SCRUTINY COMMITTEE

17 NOVEMBER 2011

SUBJECT	**TREASURY MANAGEMENT PERFORMANCE MONITORING**
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 second 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. It was accepted by Cabinet on 3 November 2011.

2.0 RECOMMENDATION

2.1 That the Treasury Management Performance Monitoring Report be noted.

3.0 REASONS 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.

3.2 On 7 October 2011 the credit rating agency, Moody’s, downgraded the credit ratings of twelve UK Financial Institutions. Three institutions included on the Council’s approved counterparty list have fallen below the approved minimum credit criteria and have been suspended from the list. As Natwest Bank is the Council’s main bank, approval was obtained to revise the Treasury Management Strategy to allow Natwest Bank to continue to be used for short term liquidity requirements (overnight and weekends) and business continuity arrangements. The Treasury Management Team and Treasury Advisors are satisfied that this revision will help in the management of short term cash flows without creating significant exposure to increased risks.

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 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 In the second quarter of 2011/12 financial markets across the globe have continued to worsen. Future growth prospects have been revised downwards, particularly within the Eurozone where the economic crisis is escalating. The Greek debt problem is unresolved and there remains no clear consensus as to the course of action required to rectify the situation. Failure to find, and agree, a solution threatens to seriously destabilise not only the financial markets but also the foundations of the European Union. The announcement of Italy’s downgraded credit rating provides yet another example of how the crisis is spreading.

4.4 In the UK, the third and final estimate of 2011 Q2 GDP showed UK growth over the second quarter revised down to 0.1%.The first quarter GDP was also revised down to 0.4% from the previously reported 0.5%. These weaker than expected figures added further pressure to the Bank of England’s debate on another round of quantitative easing (QE).Inflation rates remain high with the CPI for August rising to 4.5% and RPI rising to 5.2%. Following further increases in energy prices in recent months, the likelihood is that there will be additional inflationary increases before the end of 2011 but these rates are expected fall back in 2012.

4.5 All of this economic uncertainty has led many analysts to assume that the UK Bank of England Base Rate will be unchanged, at 0.5%, until the final quarter of 2012.

4.6 On 6 October 2011 the Bank of England announced it will be undertaking a further £75 billion of quantitative easing as ''The deterioration in the outlook has made it more likely that inflation will undershoot the 2% target in the medium term. In the light of that shift in the balance of risks, and in order to keep inflation on track to meet the target over the medium term, the Committee judged that it was necessary to inject further monetary stimulus into the economy''

4.7 On 7 October 2011 the credit rating agency, Moody's, downgraded the credit ratings of twelve UK Financial Institutions. This does not represent deterioration in the financial strength of the UK Government or the banking system but that the Government is now more likely to allow smaller institutions to fail if they get into financial difficulty. Consequently three institutions included on the Council's approved counterparty list (Natwest Bank, Royal Bank of Scotland and Nationwide Building Society), have fallen below the approved minimum credit criteria and have been suspended from the approved list. As Natwest Bank is the Council's main bank, approval was obtained to revise the Treasury Management Strategy to allow Natwest Bank to continue to be used for short term liquidity requirements (overnight and weekends) and business continuity arrangements, despite Natwest no longer meeting the minimum credit criteria of A+ (or equivalent) long term. The Treasury Management Team and Treasury Advisors are satisfied that this revision will help in the management of short term cash flows without creating significant exposure to increased risks.

THE COUNCIL TREASURY POSITION

4.8 The table shows how the position has changed since 30 June 2011.

Table 1 : Summary of Treasury Position

	Balance 30 Jun 11 (£m)	Maturities (£m)	Additions (£m)	Balance 30 Sep 11 (£m)
Investments	157	(151)	142	148
Borrowings	(272)			(272)
Other Long-Term Liabilities	(65)			(65)
Net Financial Liabilities	(180)	(151)	142	(189)

INVESTMENTS

4.9 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.

4.10 At 30 September 2011 the Council held investments of £148 million

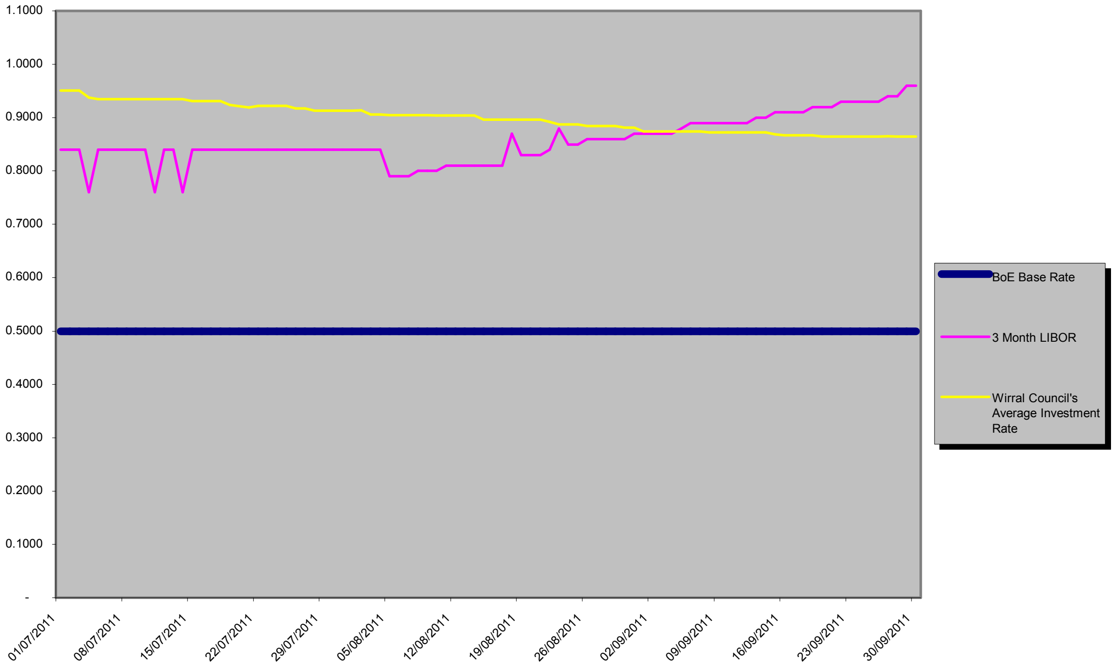
Table 2 : Investment Profile

Investments with:	30 Jun 11 £m	30 Sep 11 £m
UK Banks	61	60
UK Building Societies	15	15
Money Market Funds	39	29
Other Local Authorities	32	36
Gilts and Bonds	10	8
TOTAL	**157**	**148**

4.11 Of the above investments, £34 million is invested in instant access funds, £93 million is invested for up to 1 year and £21 million is invested for up to 5 years.

4.12 The average rate of return on investments as at 30 September 2011 is 0.86%. 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



4.13 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.

4.14 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 within Greece and the risk of these problems spreading to other European countries the maximum investment period was temporarily restricted to only one year at the start of this financial year and from August 2011 has been further restricted to only six months.

4.15 Also, following Moody's recent credit rating downgrade of various UK financial institutions, Natwest Bank, Royal Bank of Scotland and the Nationwide Building Society have now fallen below the minimum credit criteria and have been suspended from the approved counterparty list. No new investments will be made with these three financial institutions and all instant access and call account money has been redeemed. Where the Council had previously entered into a fixed term deposit with any of these institutions the investment will be allowed to mature as originally planned.

4.16 As the Council main bank account is with Natwest Bank approval is sought to allow this bank on to the approved counterparty list for short term liquidity requirements (overnight and weekends) and business continuity arrangements, despite Natwest no longer meeting the minimum credit criteria.

4.17 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

4.18 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.

4.19 The latest creditor progress report issued by the Administrators Ernst and Young, dated 28 July 2011, outlined that the return to creditors is projected to be 90p in the £ by the end of 2012 and the final recovery could be higher.

4.20 To date, £1,272,571 has been received with payments due over 2011-2013.

Table 3 : Heritable Bank Repayments

	£
Initial Investment	2,000,000
Actual Repayments Received	
As at 30 September 11	1,272,571
Estimate of Future Repayments	
Oct-11	124,626
Jan-12	124,626
Apr-12	124,626
Jul-12	124,626
Oct-12	124,626
Total	**623,130**
Estimate of Minimum Total Repayment	**1,895,701**

4.21 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.

4.22 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

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

4.24 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.

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

4.26 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.

4.27 The table shows financial liabilities at 30 September 2011.

Table 4 : Financial Liabilities at 30 September 2011

Financial Liabilities	**Balance 30 Jun 11 (£m)**	**Maturities (£m)**	**Additions (£M)**	**Balance 30 Sep 11 (£m)**
Borrowings				
PWLB	(98)	0	0	(98)
Market Loans	(174)	0	0	(174)
Other Long Term Liabilities				
PFI	(62)	0	0	(62)
Finance Leases	(3)	0	0	(3)
TOTAL	**(337)**	**0**	**0**	**(337)**

MONITORING OF THE PRUDENTIAL CODE INDICATORS

4.28 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.

4.29 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

4.30 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 Sep 11	**272**

4.31 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

4.32 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.

4.33 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 11 (£m)	**Aug 11 (£m)**	**Sep 11 (£m)**
AUTHORISED LIMIT	**497**	**497**	**497**
OPERATIONAL BOUNDARY	**482**	**482**	**482**
Council Borrowings	272	272	272
Other Long Term Liabilities	65	65	65
TOTAL	**337**	**337**	**337**

4.34 The table shows that neither the Authorised Limit nor the Operational Boundary was breached between July 2011 and September 2011. This is a key indicator of affordability.

Interest Rate Exposures Indicator

4.35 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:

	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	21	127	**148**
Proportion of Investments	14%	86%	100%
Upper Limit	100%	100%	
Net Borrowing	**(251)**	**127**	**(124)**
Proportion of Total Net Borrowing	202%	-102%	100%

4.36 The table 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.

4.37 As the environment has changed to one of low interest rates, the Treasury Management Team is working to adjust this position which 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.

Maturity Structure of Borrowing Indicator

4.38 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 : Maturity Structure of Borrowing

Borrowings Maturity	As at 30 Sep 11 (£m)	As at 30 Sep 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 discussed 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.

11.2 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.

FNCE/240/11

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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 and Investment Strategy 2011 to 2014	21 February 2011
Cabinet - Treasury Management Annual Report 2010/11	23 June 2011
Cabinet – Treasury Management Performance Monitoring	21 July 2011
Cabinet - Treasury Management Performance Monitoring	3 November 2011