WIRRAL COUNCIL

CABINET

2 FEBRUARY 2012

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 policies, practices and activities during the third 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 their treasury management policies, practices and activities 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, to 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. 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 third quarter of 2011/12 was dominated by the escalation of the sovereign debt crisis in the Eurozone. Despite several summits of Heads of State, the tough decisions and workable plans required to address the fundamental fiscal and economic problems were not resolved.

4.4 The lack of growth in the major economies was problematic for central bankers, not helped by the Eurozone sovereign debt crisis. Growth in the UK registered 0.5% for the 12 months to September 2011 as domestic demand was depressed by low wage growth, high inflation and the fiscal policy measures taken by the Government to address the deficit and level of debt. Inflation remained high, with the annual CPI for November 2011 at 4.8%, remaining above Monetary Policy Committee 3% upper limit for 23 consecutive months. However, the medium term outlook is that inflation rates will fall back during 2012.

4.5 Central bank policies were once again driven by the low growth outlook rather than the upward trend in inflation. The slowdown in the global economy, a deterioration in the economic outlook, the severe strains in bank funding markets and a continued lack of supply of credit were the reasons given for the Monetary Policy Committee decision in October 2011 to increase asset purchases (Quantitative Easing) by £75 billion whilst maintaining the Bank Rate at 0.5%.

4.6 The rating agencies' warnings also became more strident in this third quarter. Moody's said that it would review the ratings of all European Union sovereigns in the first quarter of 2012 after the December summit failed to produce decisive policy measures. Fitch placed the ratings of several sovereigns including Italy, Spain, Belgium and Ireland on rating watch negative based on its view that a comprehensive solution to the crisis is technically and politically beyond reach.

THE COUNCIL TREASURY POSITION

4.7 The table shows how the position has changed since 30 September 2011.

Table 1: Summary of Treasury Position

	Balance 30 Sep 11 (£m)	Maturities (£m)	Additions (£m)	Balance 31 Dec 11 (£m)
Investments	148	(185)	172	135
Borrowings	(272)	6	(5)	(271)
Other Long-Term Liabilities	(65)			(65)
Net Debt	(189)	(179)	167	(201)

INVESTMENTS

4.8 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 and money borrowed in advance of spending, Schools' Balances and daily cashflow / working capital.

4.9 At 31 December 2011 the Council held investments of £135 million.

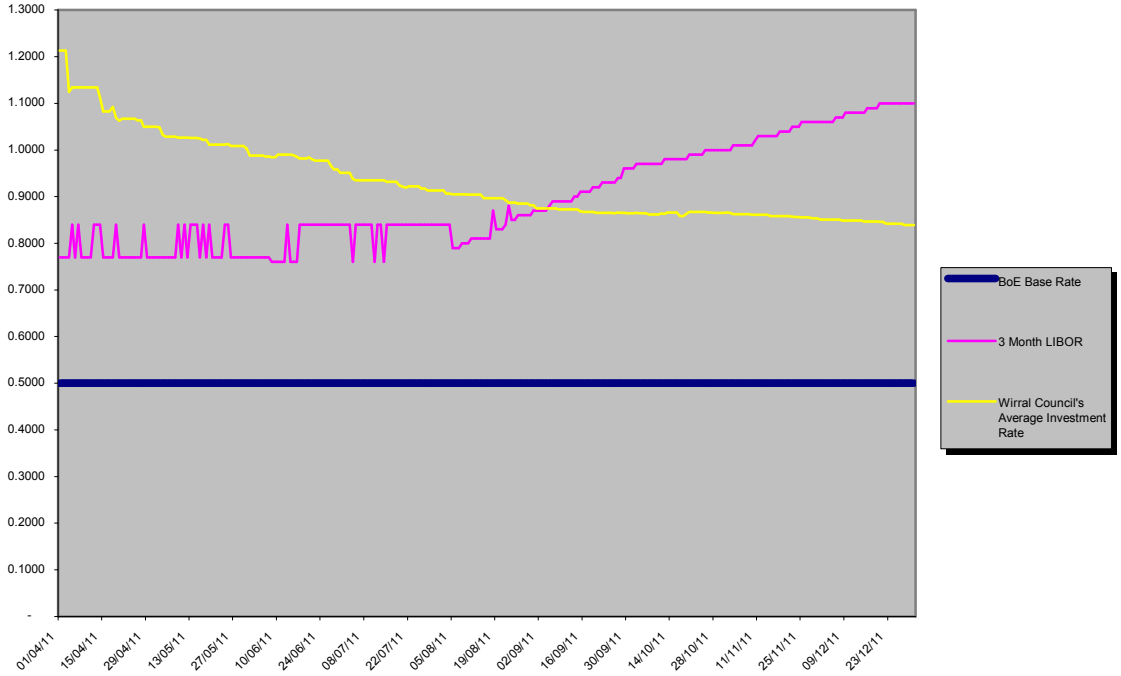
Table 2: Investment Profile

Investments with:	30 Jun 11 £m	30 Sep 11 £m	31 Dec 11 £m
UK Banks	61	60	47
UK Building Societies	15	15	6
Money Market Funds	39	29	40
Other Local Authorities	32	36	34
Gilts and Bonds	10	8	8
TOTAL	**157**	**148**	**135**

4.10 Of the above investments, £40 million is invested in instant access funds, £69 million is invested for up to 1 year and £26 million is invested for up to 5 years.

4.11 The average rate of return on investments as at 31 December 2011 is 0.84%. 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



4.12 The rate at which the Council can invest money continues to be low, in line with the low Bank of England base rate. LIBOR has begun to rise, as banks demand greater returns for the perceived increased risk in the market. The Council investment rate of return has been reducing, as money is transferred from banks to more secure investments, with this increased security coming at the cost of reduced investment returns.

4.13 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. Counterparty credit quality is also assessed and monitored with reference to: credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; sovereign support mechanisms /potential support from a well-resourced parent institution; share price.

4.14 The ratings of most of the UK banks and non-UK banks were either downgraded or placed on review for possible downgrade. The downgrades resulted in the long-term rating of several UK institutions falling below the minimum criteria of 'A+'. Even though there are no solvency issues with these institutions, they have been temporarily suspended as counterparties for new investments until a revision to the minimum credit criteria has been considered and approved by the Council. No new investments will be made with these 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.

4.15 The Council's main bank account is with Natwest Bank, and the Cabinet on 3 November 2011 agreed 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.

4.16 Investments with the residual banks on the Council list were limited to 3 months with Santander limited to overnight deposits and the use of the bank's liquidity account. To compensate for the restricted counterparty list the Council has actively sought investments with other Local Authorities as well as increasing investments in AAA rated money market funds. These sources of investment offer greater security but with a reduced investment return.

4.17 The credit rating criteria for 2012/13 are presently under review as part of the Treasury Management Strategy which will be reported to Budget Cabinet on 20 February 2012. The Treasury Management Team will continue to monitor the developing financial situation and 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.

4.18 The 2011/12 investment income budget has been set at £1.3 million, reflecting the low interest rates that are anticipated to continue throughout the financial year. However, the proactive management of investments, as well as the realisation of additional income through the maturity of a long held Gilt, means that a surplus of £0.5 million is now anticipated in 2011/12.

Icelandic Investment

4.19 The Council 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 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.

4.20 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.

4.21 To date, £1,360,645 has been received with payments due over 2011-2013.

Table 3: Heritable Bank Repayments

	£
Initial Investment	2,000,000
Actual Repayments Received	
As at 31 December 11	1,360,645
Estimate of Future Repayments	
Jan-12	133,764
Apr-12	133,764
Jul-12	133,764
Oct-12	133,764
Total	**535,056**
Estimate of Minimum Total Repayment	**1,895,701**

4.22 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.

4.23 If Heritable Bank is unable to repay in full, a pre-emptive claim has been made 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 LONG TERM LIABILITIES

4.24 Borrowing is undertaken to help fund capital expenditure and the approved Capital Programme shows that borrowing of £30 million is required in 2011/12. The use of internal resources in lieu of borrowing continues to be the most cost effective means of funding capital expenditure. This lowers overall treasury risk by reducing both external debt and temporary investments. However, this position is not sustainable over the medium term and there will be a need to borrow for capital purposes. Therefore the borrowing options and the timing of such borrowing will continue to be assessed.

4.25 On 9 November 2011 the Treasury Management Team assessed the market conditions as optimum for undertaking borrowing. £5 million was borrowed from the PWLB over 10 years at an interest rate of 2.30%. The PWLB remains the preferred source of borrowing given the transparency and control that its facilities continue to provide. The loan replaced maturing loans of £6 million which previously cost an average of 3.15%.

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 **Table 4: Council Debt at 31 December 2011**

Debt	Balance 30 Sep 11 (£m)	Maturities (£m)	Additions (£m)	Balance 31 Dec 11 (£m)
Borrowings				
PWLB	(98)	6	(5)	(97)
Market Loans	(174)	0	0	(174)
Other Long Term Liabilities				
PFI	(62)	0	0	(62)
Finance Leases	(3)	0	0	(3)
TOTAL	**(337)**	**6**	**(5)**	**(336)**

4.28 The level of borrowing required to fund capital schemes in 2011/12 was forecast to be £30 million. With limited external borrowing undertaken to date a saving is expected in the capital financing budget. This is due to capital expenditure being incurred later in the year and through the prudent use of internal borrowing. Consequently external borrowing is anticipated to be £20 million less than expected in 2011/12 resulting in reduced capital financing costs of £2 million for 2011/12.

MONITORING OF THE PRUDENTIAL CODE INDICATORS

4.29 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.

4.30 There follows 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 Debt and Capital Financing Requirement (CFR) Indicator

4.31 The CFR measures the underlying need to borrow money to finance capital expenditure. The Prudential Code stipulates that net debt (debt net of investments) should not, except in the short term, exceed the CFR for the previous year plus the estimated additional CFR requirement for the current and next two financial years.

Table 5: Net Debt compared with CFR

	£m
CFR in previous year (2010/11 actual)	378
Increase in CFR in 2011/12 (estimate)	14
Increase in CFR in 2012/13 (estimate)	0
Increase in CFR in 2013/14 (estimate)	0
Accumulative CFR	**392**
Net Debt as at 31 Dec 2011	**201**

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

Authorised Limit and Operational Boundary Indicators

4.33 The Authorised Limit is the amount determined as the level of debt which, while not desired, could be afforded but may not be sustainable. It is not treated as an upper limit for debt 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.

4.34 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 11 (£m)	**Nov 11 (£m)**	**Dec 11 (£m)**
AUTHORISED LIMIT	**497**	**497**	**497**
OPERATIONAL BOUNDARY	**482**	**482**	**482**
Council Borrowings	272	272	271
Other Long Term Liabilities	65	65	65
TOTAL	**337**	**337**	**336**

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

Interest Rate Exposures Indicator

4.36 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	(271)	0	**(271)**
Proportion of Borrowings	100%	0%	100%
Upper Limt	100%	0%	
Investments	19	116	**135**
Proportion of Investments	14%	86%	100%
Upper Limit	100%	100%	
Net Borrowing	**(252)**	**116**	**(136)**
Proportion of Total Net Borrowing	185%	-85%	100%

4.37 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.

4.38 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

4.39 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 31 Dec 11 (£m)	As at 31 Dec 11 (%)	2011/12 Lower Limit (%)	2011/12 Upper Limit (%)
Less than 1 year	21	8	0	20
Over 1 year under 2 years	25	9	0	20
Over 2 years under 5 years	34	13	0	50
Over 5 years under 10 years	29	11	0	50
Over 10 years	162	60	20	100
Total Borrowing	**271**	**100**		

Total Principal Sums Invested for Periods Longer than 364 Days

4.40 This indicator allows the Council to manage the risk inherent in investments longer than 364 days. The limit for 2011/12 was set at £30 million. Currently the Council has £26.5 million of investments which are for a period greater than 364 days during this period.

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 In the financial year 2011/12, treasury management activities are now projected to result in £0.5 million of additional income from investments and a saving of £2 million from capital financing costs.

9.2 There are no IT, staffing or asset implications arising from this report.

10.0 LEGAL IMPLICATIONS

10.1 There are none arising from this report.

11.0 EQUALITIES IMPLICATIONS

11.1 There are none arising from 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 from this report.

REPORT AUTHOR: Mark Goulding
Group Accountant – Treasury Management
telephone: (0151) 666 3415
email: markgoulding@wirral.gov.uk

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 (2011 Edition), CIPFA 2011.
Prudential Code for Capital Finance in Local Authorities (2011 Edition), CIPFA 2011.

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