

## WIRRAL COUNCIL

### COUNCIL EXCELLENCE OVERVIEW & SCRUTINY COMMITTEE

26 MARCH 2012

<b>SUBJECT</b>	<b>TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2012-15</b>
<b>WARD/S AFFECTED</b>	<b>ALL</b>
<b>REPORT OF</b>	<b>DIRECTOR OF FINANCE</b>
<b>RESPONSIBLE PORTFOLIO HOLDER</b>	<b>COUNCILLOR JEFF GREEN</b>
<b>KEY DECISION</b>	<b>YES</b>

#### **1.0 EXECUTIVE SUMMARY**

- 1.1 This report sets out the Treasury Management and Investment Strategy for 2012-2015 in accordance with the CIPFA Code of Practice for Treasury Management in Public Services. It was agreed by Cabinet on 21 February 2012.

#### **2.0 RECOMMENDATION**

- 2.1 That Members note the Treasury Management and Investment Strategy for 2012-2015.

#### **3.0 REASONS FOR RECOMMENDATION**

- 3.1 The Chartered Institute of Public Finance and Accountancy Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also incorporates the Investment Strategy as required under the DCLG Investment Guidance.
- 3.2 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.
- 3.3 Following staffing changes, Cabinet approved a revised list of Officers to approve treasury management activities.

## **4.0 BACKGROUND AND KEY ISSUES**

4.1 CIPFA has defined treasury management as:

*“the management of the organisation’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 The Council endorses this definition and acknowledges that effective treasury management will provide support towards the achievement of business and service objectives. It is, therefore, committed to the principles of achieving value for money in treasury management and to employing suitable comprehensive performance measurement techniques, within the context of effective treasury management.

4.3 The purpose of the attached Treasury Management Strategy Statement is to set:

- The Treasury Management Strategy for 2012-15 - The long term direction for Council borrowing, debt rescheduling and investments.
- The Prudential Indicators – Information to ensure that capital investment is affordable, prudent and sustainable.
- The Minimum Revenue Provision (MRP) Statement – The policy on the repayment of long term debt.
- Authorised signatories for treasury management activities.

## **5.0 RELEVANT RISKS**

5.1 The Council is responsible for treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk are important and integral elements of treasury management activities. The main risks to the treasury activities are:

- Liquidity Risk (Inadequate cash resources)
- Market or Interest Rate Risk (Fluctuations in interest rate levels)
- Inflation Risk (Exposure to inflation)
- Credit and Counterparty Risk (Security of investments)
- Refinancing Risk (Impact of debt maturing in future years)
- Legal and Regulatory Risk

## **6.0 OTHER OPTIONS CONSIDERED**

6.1 There are no other options considered in this report.

## **7.0 CONSULTATION**

7.1 This Strategy has been written in consultation with the external treasury management advisors, Arlingclose. There has been no further consultation undertaken or proposed for this Strategy. 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 directly out of this report.

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

9.1 Implementation of this strategy will limit financial risks while helping to minimise financing costs and maximise investment returns.

## **10.0 LEGAL IMPLICATIONS**

10.1 There are none arising directly out of this report.

## **11.0 EQUALITIES IMPLICATIONS**

11.1 There are none arising directly out of this report.

11.2 An Equality Impact Assessment (EIA) is not required.

## **12.0 CARBON REDUCTION IMPLICATIONS**

12.1 There are none arising directly out of this report.

## **13.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS**

13.1 There are none arising directly out of this report.

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## **APPENDICES**

Treasury Management and Investment Strategic Statement 2012-2015

## **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), CIPFA 2011

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

## SUBJECT HISTORY

<b>Council Meeting</b>	<b>Date</b>
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 2012
Cabinet - Treasury Management Performance Monitoring	2 February 2012
Cabinet - Treasury Management and Investment Strategy 2012 to 2015	21 February 2012



Wirral Council

Treasury Management and  
Investment Strategy 2012-2015

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## **APPENDICES**

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## 1. BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also incorporates the Annual Investment Strategy (AIS) that is a requirement of the CLG's Investment Guidance.

1.2 Wirral Council defines its treasury management activities as:

*"the management of the organisation'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."*

1.3 The Council will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement (see Appendix A), stating the policies, objectives and approach to risk management of its treasury management activities.
- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.4 Treasury Management is about the management of risk. The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk.

1.5 As per the requirements of the Prudential Code, the Authority has adopted the CIPFA Treasury Management. All treasury activity will comply with relevant statute, guidance and accounting standards.

1.6 The purpose of this Treasury Management Strategy Statement is to approve:

- Treasury Management Strategy for 2012/13; including the adoption of the revised CIPFA Treasury Management Code of Practice.
- Annual Investment Strategy for 2012/13
- Minimum Revenue Provision (MRP) Statement
- Treasury Management Policy Statement
- Prudential Indicators for 2012/13, 2013/14 and 2014/15
- Authorised Signatories for Treasury Management Activity

## 2. CAPITAL FINANCING REQUIREMENT

- 2.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR, together with Usable Reserves are the core drivers of treasury management activity.
- 2.2 The Authority's current level of debt and investments are set out in Appendix B.
- 2.3 The Authority is able to borrow funds in excess of the current level of its CFR up to the projected level in 2014/15. The Authority is likely to only borrow in advance of need if it felt the benefits of borrowing at interest rates now compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing was actually required.
- 2.4 The forecast movement in the CFR in coming years is one of the Prudential Indicators (PIs). The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years.

**Table 1: Balance Sheet Summary Analysis**

	<b>31-Mar-12 Estimate £m</b>	<b>31-Mar-13 Estimate £m</b>	<b>31-Mar-14 Estimate £m</b>	<b>31-Mar-15 Estimate £m</b>
Capital Financing Requirement (CFR)	392	384	383	374
Less: Existing Profile of Borrowing and Other Long Term Liabilities	327	307	274	258
<b>Cumulative Maximum External Borrowing Requirement</b>	<b>65</b>	<b>77</b>	<b>109</b>	<b>116</b>
Usable Reserves	113	89	86	81
<b>Cumulative Net Borrowing Requirement / (Investments)</b>	<b>(48)</b>	<b>(12)</b>	<b>23</b>	<b>35</b>

- 2.5 Table 1 shows that the capital expenditure plans of the Authority over the next three years cannot be funded entirely from other sources and external borrowing would eventually be required.



### **3. BORROWING STRATEGY**

- 3.1 Treasury management and borrowing strategies in particular continue to be influenced not only by the absolute level of borrowing rates but also the relationship between short and long term interest rates. The interest rate forecast, provided in Appendix C, indicates that an acute difference between short and longer term interest rates is expected to continue for the foreseeable future. This difference creates a “cost of carry” for any new longer term borrowing. Cost of carry is the difference between what is paid on the borrowing and the investment income that can be earned while the borrowed monies are temporarily held as investments until needed to fund capital expenditure. Whilst the cost of carry can be assumed to be a reasonably short term issue, since borrowing is often for longer dated periods (anything up to 50 years), it cannot be ignored against a backdrop of uncertainty and affordability constraints in the Authority’s wider financial position.
- 3.2 As indicated in Table 1, the Authority has a gross borrowing requirement, with an underlying potential to borrow, from internal or external sources, of up to £77m in 2012/13. The Authority will adopt a flexible approach to this borrowing in consultation with its treasury management advisers. The following issues will be considered prior to undertaking any external borrowing:
- Affordability;
  - Maturity profile of existing debt;
  - Interest rate and refinancing risk;
  - The borrowing source.

#### **Borrowing source**

- 3.3 In conjunction with advice from Arlingclose, the Authority will keep under review the following borrowing sources:
- PWLB
  - Local authorities
  - Commercial banks
  - European Investment Bank
  - Money markets
  - Capital market (stock issues, commercial papers and bills)
  - Structured finance
  - Leasing
- 3.4 At present, the PWLB remains the Council’s preferred source of borrowing given the transparency and control that its facilities continue to provide

## **Type of borrowing**

- 3.5 As the cost of carry remains high there is a greater reliance upon shorter dated and variable rate borrowing. This type of borrowing injects volatility into the debt portfolio in terms of interest rate risk but is counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Authority's exposure to shorter dated and variable rate borrowing is kept under regular review by reference to the spread between variable rate and longer term borrowing costs. A narrowing in the spread by 0.5% will result in an immediate review of the borrowing strategy to determine whether the exposure to short dated and variable rates is maintained or altered.

## **LOBOs**

- 3.6 The Authority has £174m of exposure to LOBO loans (Lender's Option Borrower's Option) of which £169m of these can be called within 2012/13. A LOBO is called when the Lender exercises its rights to amend the interest rate on the loan at which point the Borrower can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Authority since the decision to call a LOBO is entirely at the lender's discretion.
- 3.7 Any LOBOs called will be discussed with Arlingclose prior to acceptance of any revised terms. The default position will be the repayment of the LOBO without penalty i.e. the revised terms will not be accepted.

## **Debt Rescheduling**

- 3.8 The Authority's debt portfolio can be restructured by prematurely repaying loans and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs.
- 3.9 The lower interest rate environment and changes in the rules regarding the premature repayment of PWLB loans has adversely affected the scope to undertake meaningful debt restructuring although occasional opportunities arise. The rationale for undertaking debt rescheduling would be one or more of the following:
- Savings in risk adjusted interest costs
  - Rebalancing the interest rate structure of the debt portfolio
  - Changing the maturity profile of the debt portfolio
- 3.10 The affordability, prudence and sustainability of borrowing plans will be regulated by a range of Prudential Indicators, which can be found in Appendix C.
- 3.11 Borrowing and rescheduling activity will be reported to Cabinet in the Annual Treasury Management Report and the regular treasury management reports.

#### 4. ANNUAL INVESTMENT STRATEGY

- 4.1 In accordance with Investment Guidance issued by the CLG and best practice this Authority's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yields earned on investments are important but are secondary considerations.
- 4.2 Credit markets remain volatile as a result of the level and cost of debt within financial markets. In some instance, Greece and Italy being the most notable examples, the extent and implications of the cumulative debt has lead to a sovereign debt crisis and a banking crisis with the outcome still largely unknown. It is against this backdrop of uncertainty that the Authority's investment strategy is framed.
- 4.3 Investments are categorised as 'Specified' or 'Non Specified' investments based on the criteria in the CLG Guidance. Specified investments are sterling denominated investments with a maximum maturity of one year. They would also not be deemed capital expenditure investments under Statute. Non-specified investments are effectively, everything else. Both types of investment would have to meet the high credit quality as determined by the Authority.
- 4.4 The types of investments that will be used by the Authority and whether they are specified or non-specified are as follows:

**Table 2: Specified and Non Specified Investments**

<b>Investments</b>	<b>Specified</b>	<b>Non-Specified</b>
Term deposits with banks & building societies	✓	✓
Term deposits with other UK local authorities	✓	✓
Certificates of deposit with banks & building societies	✓	✓
Gilts	✓	✓
Treasury Bills (T-Bills)	✓	✗
Bonds issued by Multilateral Development Banks	✓	✓
Local Authority Bills	✓	✗
Commercial Paper	✓	✗
Corporate Bonds	✓	✓
AAA rated Money Market Funds	✓	✗
Other Money Market and Collective Investment Schemes	✓	✓
Debt Management Account Deposit Facility	✓	✗

- 4.5 A number of changes have been implemented to investment strategy for 2012/13 in response to changes in the CLG Guidance and evolving conditions in financial markets. This has resulted in the inclusion of corporate bonds which the CLG have indicated will become eligible non-capital investment from 1 April 2012. However, the principal amendments are in relation to the individual institutions with which the Authority is prepared to lend its funds.
- 4.6 The Authority and its advisors, Arlingclose Ltd, select countries and financial institutions after analysis and ongoing monitoring of:
- Published credit ratings for financial institutions - **minimum long term rating of A- or equivalent for counterparties; AA+ or equivalent for non-UK sovereigns**. This is lower than the A+ minimum adopted in 2011/12 and is in response to downgrades in credit ratings below A+ of many institutions considered to be systemically important to the financial system. Counterparties with a credit rating of A- are defined as having high credit quality, low credit risk and a strong ability to repay.
  - Credit Default Swaps (where quoted)
  - Economic fundamentals (for example Net Debt as a percentage of GDP)
  - Sovereign support mechanisms
  - Share Prices
  - Corporate developments, news, articles, markets sentiment and momentum
  - Subjective overlay – or, put more simply, common sense.
- 4.7 Any institution can be suspended or removed should any of the factors identified above give rise to concern.
- 4.8 It remains the Authority's policy to make exceptions to counterparty policy established around credit ratings, but this is conditional and directional. What this means is that an institution that meets criteria may be suspended, but institutions not meeting criteria will not be added.
- 4.9 The Authority currently banks with Natwest. During 2012 the Authority will be undertaking a tender exercise for its banking services which could result in a change of bank. At present Natwest meets the proposed minimum credit criteria of A-. If the credit rating of Natwest or any other bank supplying the main banking services did fall below the Authority's minimum credit criteria, the bank would continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.
- 4.10 With short term interest rates forecast to remain low, an investment strategy would typically propose a lengthening of investment periods, where cash flow permits, in order to lock in higher rates of acceptable risk adjusted returns. The problem in the current environment is finding an investment counterparty providing acceptable levels of risk.

- 4.11 In order to diversify an investment portfolio largely invested in cash, investments will be placed with a range of approved investment counterparties to achieve a diversified portfolio of prudent counterparties, investment periods and rates of return. Maximum investment levels with each counterparty will be set to ensure prudent diversification is achieved.

### **Money Market Funds**

- 4.12 Money market funds (MMFs) are pooled funds that invest in short-term debt instruments. They provide the benefits of pooled investment, as investors can participate in a more diverse and high quality portfolio than they otherwise could. The principal objective of a MMF is the preservation of capital, very high liquidity and competitive returns commensurate with security and liquidity. MMFs will be utilised but good treasury management practice prevails and whilst MMFs provide good diversification the Authority will also seek to diversify any exposure by utilising more than one MMF. The Authority will also seek to restrict its exposure to MMFs with lower levels of funds under management and will not exceed 0.5% of the net asset value of the MMF. In the case of Government Liquidity Funds, the Council's exposure to a Fund will not exceed 2%.

### **Pooled Funds**

- 4.13 The Authority has evaluated the use of Pooled Funds and determined the appropriateness of their use within the investment portfolio. Pooled funds enable the Authority to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns.
- 4.14 Investments in pooled funds will be undertaken with advice from Arlingclose Ltd. The Authority's current investments in pooled funds (other than MMFs) are with the Payden and Rygel Sterling Reserve Fund: their performance and continued suitability in meeting the Authority's investment objectives are regularly monitored.

### **Derivative Instruments**

- 4.15 Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Act is not sufficiently explicit. Consequently, the Authority does not intend to use derivatives.
- 4.16 Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require full Council approval.

## **Debt Management Office**

- 4.17 In any period of significant stress in the markets, the default position is for investments to be made with the Debt Management Office or UK Treasury Bills. (The rates of interest from the DMADF are below equivalent money market rates, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.)
- 4.18 The Director of Finance and Deputy Chief Executive, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to Cabinet meetings.

## **5. INTEREST RATE FORECAST**

- 5.1 The economic interest rate forecast provided by the Authority's treasury management advisor is attached at Appendix D. The Authority will reappraise its strategies from time to time in response to evolving economic, political and financial events.

## **6. POLICY ON DELEGATION**

- 6.1 The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Director of Finance who will act in accordance with the Council's Strategy Statement, Treasury Management Practices (TMPs) and CIPFA's Standard of Professional Practice on Treasury Management.
- 6.2 On a day to day basis the Treasury Management Team within the Accountancy Section carries out the treasury management activities.
- 6.3 Decisions on short term investments and short term borrowings may be made on behalf of the Director of Finance by the Group Accountant for Treasury Management or any of the members of the Treasury Management Team who are empowered to agree deals subject to their conforming to the Authority's Treasury Management Strategy and policies outlined in this report.
- 6.4 Actual authorisation of payments from the Authority's bank account will be made by the Director of Finance, the Deputy Director of Finance, the Finance Heads of Service or the Chief Accountants, listed in Appendix E.
- 6.5 Decisions on long term investments or long term borrowings (i.e. for periods greater than one year) may be made on behalf of the Director of Finance by the Group Accountant or the Senior Assistant Accountants on the Treasury Management Team and will be reported to Cabinet.

6.6 All officers will act in accordance with the policies contained within this document.

6.7 The Council nominates the Council Excellence Overview and Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

## **7. BALANCED BUDGET REQUIREMENT**

7.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

## **8. 2012/13 MINIMUM REVENUE POSITION (MRP) STATEMENT**

8.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

8.2 The four MRP options available are:  
Option 1: Regulatory Method  
Option 2: CFR Method  
Option 3: Asset Life Method  
Option 4: Depreciation Method  
NB this does not preclude other prudent methods

8.3 MRP in 2012/13: Options 1 and 2 may be used only for supported expenditure. Methods of making prudent provision for self financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses).

8.4 The MRP Statement will be submitted to Council before the start of the 2012/13 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Council at that time.

8.5 The Council will apply Option 1 in respect of supported capital expenditure and Option 3 in respect of unsupported capital expenditure.

8.6 For prudence, when Option 3, the asset life method, is applied to the funding of an asset with a life greater than 25 years the Council will apply a default asset life of 25 years. Estimating assets lives over 25 years is difficult to achieve accurately; therefore, using a default of 25 years is considered the most prudent approach and is in keeping with the Regulations.

- 8.7 MRP in respect of PFI and leases brought on Balance Sheet under International Financial Reporting Standards (IFRS) will also be calculated using Option 3 and will match the annual principal repayment for the associated deferred liability.

## **9. PERFORMANCE MONITORING AND REPORTING**

- 9.1 The Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close in the form prescribed in its TMPs.
- 9.2 To ensure adherence to this, the Director of Finance will report to Cabinet on treasury management policies, practices and activities activity / performance as follows :
- Quarterly against the strategy approved for the year.
  - The Council will produce an Outturn Report on its treasury activity no later than 30 September after the financial year end.
  - Council Excellence Overview and Scrutiny Committee will be responsible for the scrutiny of treasury management activity and practices.

## **10. TREASURY ADVISORS**

- 10.1 The Authority continues to use Arlingclose Ltd. for external, independent treasury management advice. The Treasury Management Team within Accountancy monitor the quality of the service provided.



**TREASURY MANAGEMENT POLICY STATEMENT**

**1. Introduction and background**

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.

1.3 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The Council (i.e. full Council) will receive reports on its treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

1.4 The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Director of Finance who will act in accordance with the Council's Strategy Statement, Treasury Management Practices (TMPs) and CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Council nominates the Council Excellence Overview and Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

**2. Policies and objectives of treasury management activities**

2.1 The Council defines its treasury management activities as:

“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 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.
- 2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.
- 2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.
- 2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations.

## EXISTING INVESTMENT &amp; DEBT PORTFOLIO POSITION

	<b>Current Portfolio</b> as at 31 Dec 11 <b>£m</b>
<b>External Borrowing:</b>	
Fixed Rate – PWLB	97
Fixed Rate – Market	174
Variable Rate – PWLB	0
Variable Rate – Market	0
<b>Total External Borrowing</b>	<b>271</b>
<b>Other long-term liabilities:</b>	
PFI	62
Finance Leases	3
<b>Total Other Long-Term Liabilities</b>	<b>65</b>
<b>Total External Debt</b>	<b>336</b>
<b>Investments:</b>	
<i>Managed in-house</i>	
Deposits with Banks and Building Societies	52
Deposits with Money Market Funds	40
Deposits with other Public Sector Bodies	34
Deposits in Supranational Bonds and Gilts	8
<i>Managed externally</i>	
Payden Sterling Reserve	1
<b>Total Investments</b>	<b>135</b>
<b>Net Borrowing Position</b>	<b>201</b>

## PRUDENTIAL INDICATORS 2012/13 – 2014/15

1. **Background**

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "Prudential Code") when setting and reviewing their Prudential Indicators. In 2011 the CIPFA Prudential Code was revised and the changes have been incorporated into the Prudential Indicators below.

2. **Estimates of Capital Expenditure**

It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

**Table A:**

	2011/12 Approved £000	2011/12 Revised £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000
Capital Expenditure	49,259	73,696	33,737	29,109	12,825

Capital expenditure is expected to be financed and funded as follows:

Capital Financing	2011/12 Approved £000	2011/12 Revised £000	2012/13 Estimate £000	2013/14 Estimate £000	2014/15 Estimate £000
Supported Borrowing	483	3,481	0	0	0
Unsupported Borrowing	15,422	28,496	9,135	16,610	3,305
Capital Receipts	3,000	3,000	3,000	3,000	3,000
Capital Grants	30,054	36,325	21,302	9,199	6,520
Revenue Contribution	300	2,394	300	300	0
<b>Total Financing and Funding</b>	<b>49,259</b>	<b>73,696</b>	<b>33,737</b>	<b>29,109</b>	<b>12,825</b>

3. **Incremental Impact of Capital Investment Decisions:**

As an indicator of affordability the table below shows the impact of capital investment decisions on Council Tax. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

**Table B:**

Incremental Impact of Capital Investment Decisions	2011/12 Approved £	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £
Increase in Band D Council Tax	13.54	5.30	11.93	5.37

#### 4. Ratio of Financing Costs to Net Revenue Stream

The estimate for interest payment in 2012/13 is £14m and for interest receipts is £1m. The ratio of financing costs to the Council's net revenue stream is an indicator of affordability. It highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of revenue budget required to meeting borrowing costs. The ratio is based on costs net of investment income.

**Table C:**

<b>Ratio of Finance Costs to net Revenue Stream</b>	<b>2011/12 Approved %</b>	<b>2011/12 Revised %</b>	<b>2012/13 Estimate %</b>	<b>2013/14 Estimate %</b>	<b>2014/15 Estimate %</b>
Ratio	9.31	8.64	9.34	9.57	10.48

#### 5. Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing.

**Table D:**

<b>Capital Financing Requirement</b>	<b>2011/12 Approved £m</b>	<b>2011/12 Revised £m</b>	<b>2012/13 Estimate £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>
CFR	394	392	384	383	374

#### 6. Net Debt and the Capital Financing Requirement

As part of the revision to the Prudential Code this indicator was changed from comparing net borrowing to comparing net debt. The reason behind this was a technical one. The recent move to IFRS meant that many authorities now had PFI schemes and finance leases on their balance which were then included in the CFR. By comparing this to net borrowing, which did not include the liabilities in relation to such schemes, meant that the comparison was not on a like for like basis.

Hence, the opportunity was taken to amend the indicator to compare net debt rather than net borrowing. This means that the wider definition of debt, which includes other long term liabilities, such as those relating to PFI and finance leases, enables a more like for like comparison to CFR.

Its purpose is to ensure that over the medium term, net debt will only be for a capital purpose. In order to ensure this the Authority should ensure that the net external debt does not, except in the short term exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and the next two financial years.

The Authority had no difficulty meeting this requirement in 2011/12, nor does the Director of Finance and Deputy Chief Executive envisage any difficulties meeting it in future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

**7. Gross Debt and the Capital Financing Requirement**

CIPFA is currently seeking views on proposed changes to the net debt and capital financing requirement prudential indicator. A change to the indicator to compare the gross debt position rather than the net debt position may better fulfil the indicators purpose.

The Authority would have had no difficulty in meeting this additional proposed indicator. Nor would there be any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

**8. Actual External Debt**

The Council's balance of Actual External Debt (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities) as at 31 March 2011 was **£339m**. A breakdown of this figure is provided in Table E below. This Prudential Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

**Table E:**

<b>Actual External Debt as at 31 March 2011</b>	<b>2011/12</b>
	<b>£m</b>
Borrowing	274
Other Long Term Liabilities	65
<b>Total</b>	<b>339</b>

**9. Gross and Net Debt**

The purpose of this treasury indicator is to highlight a situation where the Council is planning to borrow in advance of need. CIPFA are again currently considering if this indicator is the most effective way of highlighting borrowing in advance of need. In the interim, an upper limit, as an absolute amount, has been set for net debt based upon the Authority's CFR.

**Table F:**

<b>Gross and Net Debt</b>	<b>2012/13 Estimate</b>	<b>2013/14 Estimate</b>	<b>2014/15 Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Upper Limit for Net Debt	384	383	374

#### 10. The Authorised Limit

The Authorised Limit sets the maximum level of external debt on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external debt items on the Balance Sheet and is the statutory limit determine under Section 3 (1) of the Local Government Act 2003.

**Table G:**

<b>Authorised Limit for External Debt</b>	<b>2011/12 Approved £m</b>	<b>2011/12 Revised £m</b>	<b>2012/13 Estimate £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>
Borrowing	489	405	397	389	381
Other Long-term Liabilities	8	85	85	85	85
<b>Total</b>	<b>497</b>	<b>490</b>	<b>482</b>	<b>474</b>	<b>466</b>

#### 11. The Operational Boundary

The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included with the Authorised Limit.

**Table H:**

<b>Operational Boundary for External Debt</b>	<b>2011/12 Approved £m</b>	<b>2011/12 Revised £m</b>	<b>2012/13 Estimate £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>
Borrowing	479	395	387	379	371
Other Long-term Liability	3	80	80	80	80
<b>Total</b>	<b>482</b>	<b>475</b>	<b>467</b>	<b>459</b>	<b>451</b>

The Director of Finance and Deputy Chief Executive has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Cabinet.

- 12. Upper Limits for Fixed Interest Rate Exposure & Variable Rate Exposure**  
 The following Prudential Indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

In order to increase the understanding of this indicator, separate upper limits for the percentage of fixed and variable rates are shown for borrowing and investment activity, as well as the net limit.

**Table I:**

	<b>2011/12 Approved %</b>	<b>2011/12 Revised %</b>	<b>2012/13 Estimate %</b>	<b>2013/14 Estimate %</b>	<b>2014/15 Estimate %</b>
<b>Upper Limit for Fixed Interest Rate Exposure</b>					
Borrowings	100	100	100	100	100
Investments	100	100	100	100	100
<b>Net</b>	<b>200</b>	<b>200</b>	<b>200</b>	<b>200</b>	<b>200</b>
<b>Upper Limit for Variable Interest Rate Exposure</b>					
Borrowings	100	100	100	100	100
Investments	100	100	100	100	100
<b>Net</b>	<b>200</b>	<b>200</b>	<b>200</b>	<b>200</b>	<b>200</b>

The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's treasury management strategy.

- 13. Maturity Structure of Fixed Rate Borrowing**  
 The Council will also limit and monitor large concentrations of fixed rate debt needing to be replaced. Limits in the following table are intended to offer flexibility against volatility in interest rates when refinancing maturing debt.



**Table J:**

<b>Maturity structure of fixed rate borrowing</b>	<b>Lower Limit 2012/13 %</b>	<b>Upper Limit 2012/13 %</b>
Under 12 Months	0	80
12 months and within 24 months	0	50
24 months and within 5 years	0	50
5 years and within 10 years	0	50
10 year and above	0	100

**14. Upper Limit for Total Principal Sums Invested over 364 Days**

The Council has placed an upper limit for principal sums invested for over 364 days, as required by the Prudential Code. This limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

**Table K:**

	<b>2011/12 Approved £m</b>	<b>2011/12 Revised £m</b>	<b>2012/13 Estimate £m</b>	<b>2013/14 Estimate £m</b>	<b>2014/15 Estimate £m</b>
<b>Upper Limit for total principal sums invested over 364 days</b>	30	30	30	30	30

**15. Credit Risk**

The Authority considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Authority's assessment of counterparty credit risk. The Authority also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP;
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay.

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

**15. Adoption of the CIPFA Treasury Management Code**

This indicator demonstrates that the Council has adopted the principles of best practice.

The Council previously approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 1 March 2010. The Council is now asked to adopt the revised CIPFA Treasury Management Code of Practice.

## APPENDIX D

### ARLINCLOSE'S ECONOMIC AND INTEREST RATE OUTLOOK

	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
<b>Official Bank Rate</b>													
Upside risk					0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk													
<b>3-month LIBID</b>													
Upside risk	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Central case	1.00	1.00	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>1-yr LIBID</b>													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	1.75	1.75	1.75	1.75	1.80	1.85	1.95	2.00	2.10	2.20	2.30	2.40	2.40
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>5-yr gilt</b>													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	1.30	1.35	1.40	1.50	1.60	1.70	1.80	2.00	2.10	2.30	2.40	2.50	2.50
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>10-yr gilt</b>													
Upside risk	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	2.30	2.40	2.45	2.50	2.55	2.60	2.70	2.75	2.80	2.85	2.90	3.00	3.00
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>20-yr gilt</b>													
Upside risk	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	3.05	3.05	3.10	3.20	3.25	3.30	3.35	3.40	3.45	3.50	3.60	3.75	3.75
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>50-yr gilt</b>													
Upside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	3.40	3.50	3.60	3.70	3.80	3.90	4.00	4.00	4.00	4.10	4.20	4.25	4.25
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

- The UK's status as a safe haven remains, keeping Gilt yields suppressed.
- Conventional monetary policy has become largely redundant; the Bank of England and the US Federal Reserve have signalled their respective official interest rates will be on hold through to the end of 2012. We think that it could be 2016 before official interest rates rise.
- The Bank of England's Monetary Policy Committee has returned to unconventional monetary policy and embarked on a further round of Quantitative Easing. There will be more to come.

#### Underlying Assumptions:

- Stress in financial markets continued to build. Rates within Interbank markets (where banks fund the majority of their day to day operations) continue to climb. This dynamic was a feature of the banking crisis that occurred in 2008 and whilst the authorities have flooded the markets with liquidity still provides a key barometer of rising risk within markets.
- The MPC's decision to embark on a further £75 billion of QE – which the Minutes showed was unanimously supported – is likely to be expanded in the coming months as some members of the MPC had voted for £100bn of QE.

- Inflation fell back to 4.2% from what is considered to be its peak of 5.2% reached in October. The Bank of England expects domestic inflation to subside markedly in 2012 as the twin effects of the VAT increase and surge in oil prices fall out of the twelve month series.
- Economic growth meanwhile remains largely illusive not helped by the considerable uncertainty and expansion of risks presented by the crisis in the Eurozone. Even if a credible and effective policy is implemented, the scale of the problems means that there is likely to be a prolonged period of subdued growth within the euro area. A failure to meet the challenges would almost certainly have significant implications for the global economy.
- Recent data and surveys suggest that the UK economy has lost the admittedly fragile momentum since the summer. Business and consumer surveys point to continued weakness in coming months and the situation in the euro area is likely to further undermine confidence and lead to tighter credit conditions for households and firms.
- Against this uncertain backdrop the ability of the economy (government, companies and individual consumers) to accommodate an increase in the cost of money through higher interest rates – in the absence of a deterioration in the high credit standing that the UK enjoys – remains unlikely. In fact, we believe that it is highly unlikely.

**AUTHORISED SIGNATORIES**

The following officers are authorised to make payments, either via the Council's online banking system or by signing cheques, and issue other instructions relating to Treasury Management transactions on behalf of Wirral Borough Council:

Director of Finance – Ian E. Coleman

Deputy Director of Finance – David L.H. Taylor-Smith

Head of IT Services – Geoffrey W. Paterson

Head of Benefits, Revenues and Customer Services – Malcolm J. Flanagan

Head of Financial Services – Thomas W. Sault

Chief Accountant – Peter J. Molyneux

Chief Accountant – Jenny Spick