

WIRRAL COUNCIL

COUNCIL EXCELLENCE OVERVIEW AND SCRUTINY COMMITTEE

1 OCTOBER 2012

SUBJECT	TREASURY MANAGEMENT PERFORMANCE MONITORING
WARD/S AFFECTED	ALL
REPORT OF	DIRECTOR OF FINANCE
RESPONSIBLE PORTFOLIO HOLDER	COUNCILLOR PHIL DAVIES
KEY DECISION	YES

1.0 EXECUTIVE SUMMARY

- 1.1 This report presents a review of Treasury Management policies, practices and activities during the first quarter of 2012/13 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 for Capital Finance in Local Authorities.
- 1.2 Cabinet considered the report on 6 September 2012 and noted the report and the new lease contract entered during the period.

2.0 BACKGROUND AND KEY ISSUES

- 2.1 Treasury Management in Local Government is governed by the CIPFA Code of Practice on Treasury Management in the Public Services and in this context is the “management of the Council’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks”.
- 2.2 Cabinet approves the Treasury Management and Investment 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

- 2.3 The first quarter of 2012/13 saw the continuation of the sovereign debt crisis in the Eurozone. Despite initial positive market reaction to the political developments within the euro area substantial risks remained. It is difficult to forecast GDP making significant gains whilst uncertainty over Europe persists so it is possible that output could be roughly flat over 2012 as a whole. This implies a period of two years with little, or no, economic growth.
- 2.4 Inflation fell throughout the first three months of the year, with the annual CPI for June at 2.4%. This is the lowest level since November 2009 and is attributable to lower fuel prices and also a reduction of 4.2% regarding clothing and footwear. The medium term outlook is that inflation rates will continue to fall back throughout 2012. Due to the fall in inflation, the Bank of England has scope for further Quantative Easing, (QE) should the outlook for the economy worsen.
- 2.5 The Monetary Policy Committee's decision at its meeting in June was to increase asset purchases (QE) by £50 billion to a total of £375 billion, whilst maintaining the Bank Rate at 0.5%. Additional stimulus would come from initiatives such as the Funding for Lending Scheme (FLS) and the prospective relaxation of regulatory liquidity requirements. The impact of the FLS and other policy initiatives might alter the Committee's assessment of the effectiveness of a future reduction in the Bank Rate.
- 2.6 In Europe, the formation in Greece, after a second round of parliamentary elections, of an alliance of pro-euro parties prevented an immediate and disorderly exit from the Euro. The region suffered a renewed bout of stress when Italian and Spanish government borrowing costs rose sharply and Spain was also forced to officially seek a bailout for its domestic banks. At the European summit in June, some progress was made after it was agreed to create a Europe-wide banking regulator.

THE COUNCIL TREASURY POSITION

- 2.7 The table shows how the position has changed since 31 March 2012.

Summary of Treasury Position

	Balance 31 Mar 12 (£m)	Maturities (£m)	Additions (£m)	Balance 30 Jun 12 (£m)
Investments	103	(202)	221	122
Borrowings	(264)	1	0	(263)
Other Long-Term Liabilities	(61)	0	0	(61)
Net Debt	(222)	(201)	221	(202)

INVESTMENTS

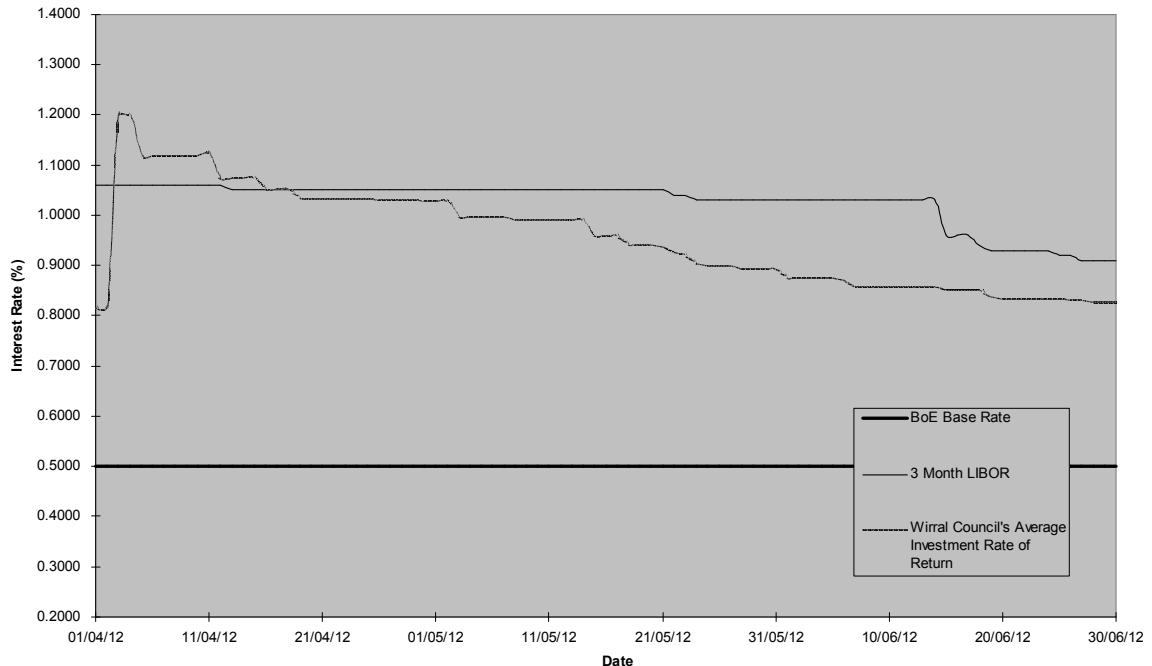
- 2.8 The Treasury Management Team can invest money for periods varying from 1 day to 10 years, in accordance with the Treasury Management Strategy, to earn interest until the money is required by the Council. These investments arise from a number of sources including General Fund Balances, Reserves and Provisions, grants received in advance of expenditure, money borrowed in advance of capital expenditure, Schools' Balances and daily cashflow/ working capital.
- 2.9 At 30 June 2012 the Council held investments of £122 million.

Investment Profile

Investments with:	31 Dec 11 £m	31 Mar 12 £m	30 Jun 12 £m
UK Banks	47	35	36
UK Building Societies	6	6	0
Money Market Funds	40	20	42
Other Local Authorities	34	34	35
Gilts and Bonds	8	8	9
TOTAL	135	103	122

- 2.10 Of the above investments, £57 million is invested in instant access funds, £47 million is invested for up to 1 year and £18 million is invested for up to 5 years.
- 2.11 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). The average rate of return on investments as at 30 June 2012 is 0.83%. This compares to the Bank of England base rate of 0.5% and the LIBOR of 0.9%.

Investment Rate of Return in 2012/13



- 2.12 The rate at which the Council can invest money continues to be low, in line with the record low Bank of England base rate. LIBOR fell sharply - from 0.99% to 0.90% - in mid-June after the Bank of England announced its £130 billion plan to boost bank lending. At the same time the Council's own investment rate of return has been reducing, as the Council moves monies away from banks with increased risks and into more secure investments. The increased security comes at a price of reduced investment returns.
- 2.13 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.
- 2.14 The ratings of most of the UK banks, Nationwide Building Society and non-UK banks were either downgraded or placed on review for possible downgrade. For the UK banks, the downgrades largely reflected the reassessment by the agencies of the extent of future systemic support that would be forthcoming from the sovereign. For Eurozone banks, the worsening sovereign debt crisis and poor growth outlook led to pressure on sovereign ratings and consequently on bank ratings.
- 2.15 The downgrades resulted in the long-term rating of several UK institutions falling below the Council's previous minimum criteria of A+ and, as part of the Treasury Management and Investment Strategy 2012/15, the minimum criteria was revised to A-. Counterparties with a credit rating of A- are defined as having high credit quality, low credit risk and a strong ability to repay. Along

with the revision of the minimum criteria, limits regarding the length of investment with the affected counterparties were also reconsidered. NatWest/RBS, Bank of Scotland/Lloyds TSB Bank were restricted to overnight deposits and Barclays and Nationwide have a limit of 100 days. 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.

- 2.16 As the Council's main bank account is with NatWest Bank, this reassessment allows this bank to be used for short term liquidity requirements (overnight and weekends) and business continuity arrangements.
- 2.17 Investments with the residual banks on the Council's list (HSBC and Standard Chartered) were limited to 6 months, and Santander UK plc has been 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 its investments in AAA rated money market funds. These sources of investment offer greater security but with a reduced investment return.
- 2.18 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.
- 2.19 The 2012/13 investment income budget has been set at £0.86 million, reflecting the low interest rates that are anticipated to continue throughout the financial year.

Icelandic Investment

- 2.20 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 the Council acted, and continued to act, prudently and properly in its investment activities.
- 2.21 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. To date, £1,510,484 has been received with further payments due 2012/13. The amounts and timings of future payments are estimates as favourable changes in market conditions could lead to higher than estimated repayments.

Heritable Bank Repayments

	£
Initial Investment	2,000,000
Actual Repayments Received	
As at 30 June 12	1,510,484
Estimate of Future Repayments	
Jul-12	192,608
Oct-12	192,608
Total	385,217
Estimate of Minimum Total Repayment	1,895,701

- 2.22 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 LONG TERM LIABILITIES

- 2.23 The Council undertakes borrowing to fund capital expenditure and the latest forecast for the capital programme shows borrowing of £9 million is required in 2012/13. The use of internal resources in lieu of borrowing, in the main, 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, it is acknowledged that this position is not sustainable over the medium term and the Council expects to borrow for capital purposes. Therefore the borrowing options and the timing of such borrowing will continue to be assessed in conjunction with the Council's treasury advisor.
- 2.24 The Public Works Loans Board (PWLB) remains the Council's preferred source of borrowing given the transparency and control that its facilities continue to provide.
- 2.25 Other Long-Term Liabilities include the schools Private Finance Initiative (PFI) scheme and finance leases used to purchase vehicles plant and equipment. Under International Financial Reporting Standards (IFRS) these are shown on the Balance Sheet as a Financial Liability and therefore need to be considered within any Treasury Management decision making process.
- 2.26 During the first quarter of 2012/13 the Council entered into a finance lease with Siemens. This was for IT and catering equipment within schools with the equipment valued at £138k and the lease for a three year period. The annual repayments of £46k will be met from the schools revenue budgets.

2.27 The table shows Council debt at 30 June 2012.

Council Debt at 30 June 2012

Debt	Balance 31 Mar 12 (£m)	Maturities (£m)	Additions (£m)	Balance 30 Jun 12 (£m)
<u>Borrowings</u>				
PWLB	(90)	1	0	(89)
Market Loans	(174)	0	0	(174)
<u>Other Long Term Liabilities</u>				
PFI	(59)	0	0	(59)
Finance Leases	(2)	0	0	(2)
TOTAL	(325)	1	0	(324)

MONITORING OF THE PRUDENTIAL CODE INDICATORS

2.28 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. The following indicators demonstrate that the treasury management decisions are in line with the Strategy, being prudent and affordable.

Net Debt and Capital Financing Requirement (CFR) Indicator

2.29 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.

Net Debt compared with CFR

	£m
CFR in previous year (2011/12 actual)	375
Increase in CFR in 2012/13 (estimate)	0
Increase in CFR in 2013/14 (estimate)	0
Increase in CFR in 2014/15 (estimate)	0
Accumulative CFR	375
Net Debt as at 30 Jun 2012	202

2.30 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

- 2.31 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.
- 2.32 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 Council to any imminent breach of the Authorised Limit.

Authorised Limit and Operational Boundary Indicator

	Apr 12 (£m)	May 12 (£m)	Jun 12 (£m)
AUTHORISED LIMIT	482	482	482
OPERATIONAL BOUNDARY	467	467	467
Council Borrowings	263	263	263
Other Long Term Liabilities	61	61	61
TOTAL	324	324	324

- 2.33 The table shows that neither the Authorised Limit nor the Operational Boundary was breached between April 2012 and June 2012. This is a key indicator of affordability.

Interest Rate Exposure Indicator

- 2.34 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.

Interest Rate Exposure

	Fixed Rate of Interest (£m)	Variable Rate of Interest (£m)	TOTAL
Borrowings	(263)	0	(263)
Proportion of Borrowings	100%	0%	100%
Upper Limit	100%	0%	
Investments	57	65	122
Proportion of Investments	47%	53%	100%
Upper Limit	100%	100%	
Net Borrowing	(206)	65	(141)
Proportion of Total Net Borrowing	146%	-46%	100%

- 2.35 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.
- 2.36 As the environment is one of low interest rates, the Treasury Management Team is working to adjust this position which is restricted by:-
- 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 a costly exercise.

Maturity Structure of Borrowing Indicator

- 2.37 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.

Maturity Structure of Borrowing

Borrowings Maturity	As at 30 Jun 12 (£m)	As at 30 Jun 12 (%)	2012/13 Lower Limit (%)	2012/13 Upper Limit (%)
Less than 1 year	16	6	0	80
Over 1 year under 2 years	30	11	0	50
Over 2 years under 5 years	29	11	0	50
Over 5 years under 10 years	34	13	0	50
Over 10 years	154	59	0	100
Total Borrowing	263	100		

Total Principal Sums Invested for Periods Longer than 364 Days

2.38 This indicator allows the Council to manage the risk inherent in investments longer than 364 days. The limit for 2012/13 was set at £30 million. Currently the Council has £17.5 million of investments which are for a period greater than 364 days during this period.

3.0 RELEVANT RISKS

3.1 All relevant risks have been discussed within Section 2 of this report.

4.0 OTHER OPTIONS CONSIDERED

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

5.0 CONSULTATION

5.1 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.

6.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

6.1 There are none arising directly out of this report.

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

7.1 Currently all Treasury Management activities are expected to be achieved in line with the 2012/13 budget. There are no It, staffing or asset implications arising directly out of this report.

8.0 LEGAL IMPLICATIONS

8.1 There are none arising directly out of this report.

9.0 EQUALITIES IMPLICATIONS

9.1 This a monitoring report on Treasury Management and as there are no equalities implications an Equality Impact Assessment (EIA) is not required.

10.0 CARBON REDUCTION IMPLICATIONS

10.1 There are none arising directly out of this report.

11.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

11.1 There are none arising directly out of this report.

12.0 RECOMMENDATION

12.1 That the Treasury Management Performance Monitoring Report be noted.

13.0 REASONS FOR RECOMMENDATIONS

13.1 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.

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

FNCE/174/12

REFERENCE MATERIAL

Code of Practice for Treasury Management in Public Services CIPFA 2011.
Prudential Code for Capital Finance in Local Authorities CIPFA 2011.

SUBJECT HISTORY

Council Meeting	Date
Cabinet - Treasury Management and Investment Strategy 2012/15	21 February 2012
Cabinet - Treasury Management Annual Report 2011/12	21 June 2012
Cabinet - Treasury Management Performance Monitoring	6 September 2012