WIRRAL COUNCIL

CABINET

8 NOVEMBER 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 second 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.

2.0 BACKGROUND AND KEY ISSUES

2.1 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 on a quarterly basis.

CURRENT ECONOMIC ENVIRONMENT

2.2 Domestically, the outlook moves to the third quarter, with renewed optimism supported by the strong employment data and declining inflation that should feed through some stability in real incomes. Whilst the effect of the Olympics undoubtedly played a part, despite its temporary nature, the underlying data pointed to a more resilient and optimistic outlook. With ongoing fragile conditions in Europe, any meaningful recovery may still be some time off.

2.3 Inflation fell back to 2.5% in August from 2.6% as measured by CPI. Looking ahead, the Office for National Statistics have said a number of factors could put upward pressure on prices including potential utility price increases and poor harvests in many parts or the world, which could impact on food prices. However, many economists say weak demand in the UK economy will outweigh these pressures, meaning the inflation rate will continue to fall towards the Bank of England target of 2%.

2.4 The Monetary Policy Committee have maintained the Quantitative Easing (QE) scheme at a total of £375 billion, whilst also maintaining the Bank Rate at 0.5%. The Government's Funding for Lending (FLS) initiative, intended to lower banks' funding costs, commenced in August. The Bank of England will assess its effects in easing the flow of credit before committing to further policy action.

2.5 The Eurozone crisis has continued over quarter two, with the Spanish economy causing increasing concern as it edges ever nearer to requesting a full IMF bailout. Funding problems, increasing debt and further austerity measures are the issues which threaten to push the Eurozone yet further into difficulty.

2.6 Further afield, Japan is embarking on another round of Quantitative Easing. It follows the U.S Federal Reserve's recent decision to inject further liquidity into its economy through the purchase of Mortgage Backed Securities. Alongside the European Central Bank's new Outright Monetary Transactions (OMT) facility - where it will buy the debt of a government in receipt of a bailout - it is clear that QE in a number of forms is very much here to stay.

THE COUNCIL TREASURY POSITION

2.7 The table shows how the position has changed since 30 June 2012.

Summary of Treasury Position

	Balance 30 Jun 12 (£m)	Maturities (£m)	Additions (£m)	Balance 30 Sep 12 (£m)
Investments	122	(164)	155	113
Borrowings	(263)	6	0	(257)
Other Long-Term Liabilities	(61)	0	0	(61)
Net Debt	(202)	(158)	155	(205)

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 September 2012 the Council held investments of £113 million.

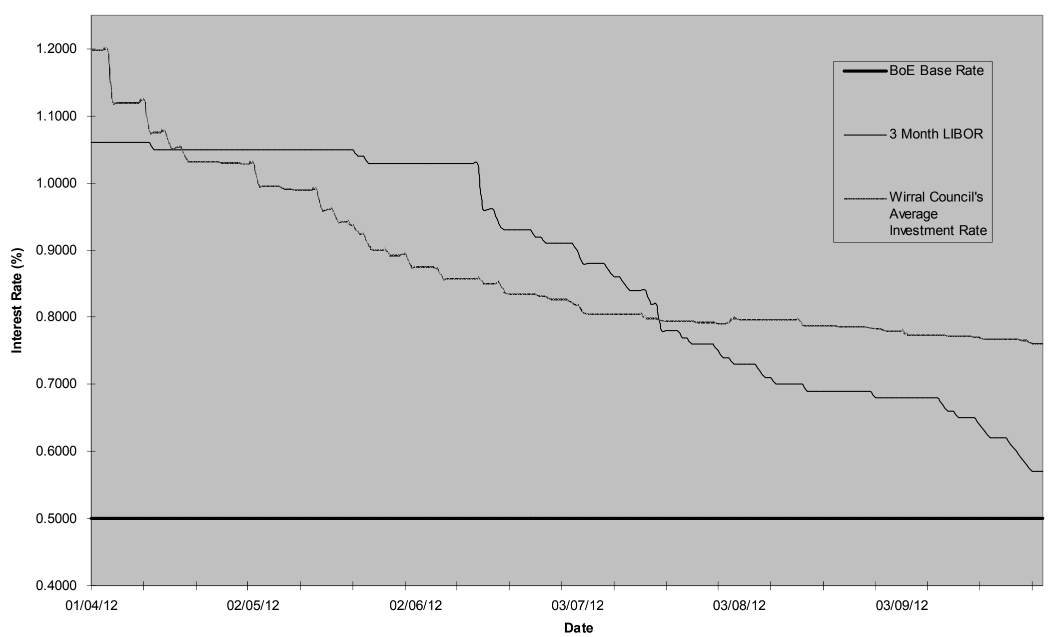
Investment Profile

Investments with:	31 Mar 12 £m	30 Jun 12 £m	30 Sep 12 £m
UK Banks	35	36	47
UK Building Societies	6	0	0
Money Market Funds	20	43	22
Other Local Authorities	34	35	36
Gilts and Bonds	8	8	8
TOTAL	**103**	**122**	**113**

2.10 Of the above investments, £51 million is invested in instant access funds, £36 million is invested for up to 1 year and £26 million is invested for up to 5 years.

2.11 The average rate of return on investments as at 30 September 2012 is 0.76% (at 30 June it was 0.83%). The graph shows how the Treasury Management Team rate of return compares favourably against the Bank of England base rate and the 3 month LIBOR (the inter bank lending rate):

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. As the Council moves funds away from counterparties with increased risks and into more secure investments, the increased security comes at a price of reduced investment returns. This approach is in line with the Authority's Treasury Management & Investment Strategy:

In accordance with Investment Guidance issued by the Department for Communities and Local Government (CLG) and best practice Wirral'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.

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 have been 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+. As part of the Treasury Management and Investment Strategy 2012/15, the minimum criterion 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 criterion, limits regarding the length of investment with the affected counterparties were also reconsidered. NatWest/RBS and Santander are currently restricted to deposits no longer than 35 days, whilst Barclays, Nationwide, Lloyds TSB and Bank of Scotland have a limit of 100 days. HSBC and Standard Chartered are limited to 12 months. Where the Council had previously entered into a fixed term deposit with these institutions the investment will be allowed to mature as originally planned.

2.16 The Council's main bank account is with NatWest Bank, although in the process of transferring to Lloyds TSB, with both having an appropriate rating allowing them to be used for shorter term liquidity requirements and business continuity arrangements.

2.17 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. At present income is set to achieve the budget.

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, £1,570,528 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 Sept 12	1,570,528
Estimate of Future Repayments	325,173
Estimate of Minimum Total Repayment	**1,895,701**

2.22 If Heritable Bank is unable to repay in full, a pre-emptive claim against Landsbanki Islands HF has been made 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. However 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 The Council has not entered into any new lease agreements during the second quarter of 2012/13.

2.27 The table shows Council debt at 30 September 2012.

Council Debt at 30 September 2012

Debt	**Balance 30 Jun 12 (£m)**	**Maturities (£m)**	**Additions (£m)**	**Balance 30 Sep 12 (£m)**
Borrowings				
PWLB	(89)	6	0	(83)
Market Loans	(174)	0	0	(174)
Other Long Term Liabilities				
PFI	(59)	0	0	(59)
Finance Leases	(2)	0	0	(2)
TOTAL	**(324)**	**6**	**0**	**(318)**

2.28 Given the latest projections in respect of the capital programme and the continuing use of internal funding in lieu of external borrowing it is anticipated that in 2012/13 there will be a 'one-off' underspend of £1.5 million in respect of capital financing. This will be subject to further change as decisions are taken in respect of the capital programme in light of the Spending Freeze agreed in September 2012.

MONITORING OF THE PRUDENTIAL CODE INDICATORS

2.29 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. 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

2.30 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 Sep 2012	**205**

2.31 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

2.32 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.

2.33 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 Council to any imminent breach of the Authorised Limit.

Authorised Limit and Operational Boundary Indicator

	Jul 12 (£m)	Aug 12 (£m)	Sep 12 (£m)
AUTHORISED LIMIT	**482**	**482**	**482**
OPERATIONAL BOUNDARY	**467**	**467**	**467**
Council Borrowings	263	263	257
Other Long Term Liabilities	61	61	61
TOTAL	**324**	**324**	**318**

2.34 The table shows that neither the Authorised Limit nor the Operational Boundary was breached between July 2012 and September 2012. This is a key indicator of affordability.

<u>Interest Rate Exposure Indicator</u>

2.35 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.

Interest Rate Exposure

	Fixed Rate of Interest (£m)	Variable Rate of Interest (£m)	TOTAL
Borrowings	(257)	0	**(257)**
Proportion of Borrowings	100%	0%	100%
Upper Limt	100%	0%	
Investments	26	87	**113**
Proportion of Investments	23%	77%	100%
Upper Limit	100%	100%	
Net Borrowing	**(231)**	**87**	**(144)**
Proportion of Total Net Borrowing	160%	-60%	100%

2.36 The table shows that borrowing is at fixed rates of interest and investments are split between fixed and 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.

2.37 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

2.38 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.

Maturity Structure of Borrowing

Borrowings Maturity	As at 30 Sep 12 (£m)	As at 30 Sep 12 (%)	2012/13 Lower Limit (%)	2012/13 Upper Limit (%)
Less than 1 year	34	13	0	80
Over 1 year under 2 years	18	7	0	50
Over 2 years under 5 years	21	8	0	50
Over 5 years under 10 years	33	13	0	50
Over 10 years	151	59	0	100
Total Borrowing	**257**	**100**		

Total Principal Sums Invested for Periods Longer than 364 Days

2.39 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 £26 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 As reported in Section 2.19 the 2012/13 investment income budget has been set at £0.86 million and, at present, income is set to achieve the budget. As reported in section 2.28 the latest projections in respect of the capital programme and the continuing use of internal funding in lieu of external borrowing project that in 2012/13 there will be a ‘one-off’ underspend of £1.5 million in respect of capital financing. This will be subject to further change as decisions are taken in respect of the capital programme in light of the Spending Freeze agreed in September 2012.

7.2 There are no IT, staffing or asset implications arising directly out of this report.

8.0 LEGAL IMPLICATIONS

8.1 This report 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.

8.2 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”.

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 accepted in meeting the Council’s obligations under the Treasury Management Code.

13.0 REASONS FOR RECOMMENDATION

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.

FNCE/186/12

REPORT AUTHOR: Mark Goulding
Group Accountant – Treasury Management
Telephone: 0151 666 3415
Email: markgoulding@wirral.gov.uk

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 Report – Quarter 1 2012/13	6 September 2012