WIRRAL COUNCIL

COUNCIL EXCELLENCE OVERVIEW AND SCRUTINY COMMITTEE

30 JANUARY 2013

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

1.0 EXECUTIVE SUMMARY

1.1 This report, which is being considered by Cabinet on 7 February 2013, presents a review of Treasury Management policies, practices and activities during the third quarter of 2012/13. It confirms compliance with treasury limits and prudential indicators being 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 The end of the calendar year brings to an end an eventful and economically challenging 2012. The Autumn Statement by the Chancellor of the Exchequer acknowledged that since 2008/09 (the onset of what was known as the Credit Crunch) the UK economy had contracted by 6.3% making it the largest change to the economy since World War II. A sustained trend of anything approaching economic growth still appears some way off, as the path to recovery continues to be difficult with the Office for Budget Responsibility expecting the economy to have shrunk by 0.1% in 2012.

2.3 Annual Consumer Price index (CPI) fell to 2.2% in September before rising to 2.7% at the year-end due largely to a bigger-than-expected contribution from university tuition fees. Inflation is expected to remain above the Bank of England's 2% target for the next year or so, as the planned utility price rises take effect and as a result of the rise in food prices earlier this year. The latest market statistics released by the Office for National Statistics show the UK labour market continuing to grow but the pace of expansion slowing. Wage growth remains weak, rising at an annual rate of 1.8% so with inflation at 2.7%, real wage growth remains negative.

2.4 The Bank of England's Monetary Policy Committee have continued to hold the Quantitative Easing (QE) scheme at a total of £375 billion, whilst also maintaining the Bank Rate at 0.5%.

2.5 In Europe, Greece has managed to obtain some respite from its lenders as European Finance Ministers eased the terms on its emergency aid financing. Yields on Spanish, Italian and even Portuguese government debt eased despite the Eurozone sliding back into economic recession. In the U.S, the 'Fiscal Cliff' was averted at the eleventh hour, preventing the US economy from returning to recession. An agreement was reached, however tougher decisions regarding spending cuts must be addressed in 2013. Future developments in overseas economies will continue to impact on market conditions and consequently the U.K's own economic recovery.

THE COUNCIL TREASURY POSITION

2.6 The table shows how the position has changed since 30 September 2012.

Table 1 : Summary of Treasury Position

	Balance 30 Sep 12 (£m)	**Maturities (£m)**	**Additions (£m)**	**Balance 31 Dec 12 (£m)**
Investments	113	(158)	145	100
Borrowings	(257)	7	0	(250)
Other Long-Term Liabilites	(61)	0	0	(61)
Net Debt	(205)	(151)	145	(211)

INVESTMENTS

2.7 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.

2.8 At 31 December 2012 the Council held investments of £100 million.

Table 2 : Investment Profile

Investments with:	30 Jun 12 £m	30 Sep 12 £m	31 Dec 12 £m
UK Banks	36	47	47
UK Building Societies	0	0	2
Money Market Funds	41	22	4
Other Local Authorities	35	36	39
Gilts and Bonds	8	8	8
TOTAL	**120**	**113**	**100**

2.9 The table below shows approximately where the investments came from.

Table 2 : Investment Sources

Usable Reserves	£m
General Fund	21
Earmarked Reserves	88
Capital Receipts Reserve	9
Capital Grants Unapplied	32
	150
Internal Borrowing in lieu of External Borrowing	(50)
Reserves Invested	**100**

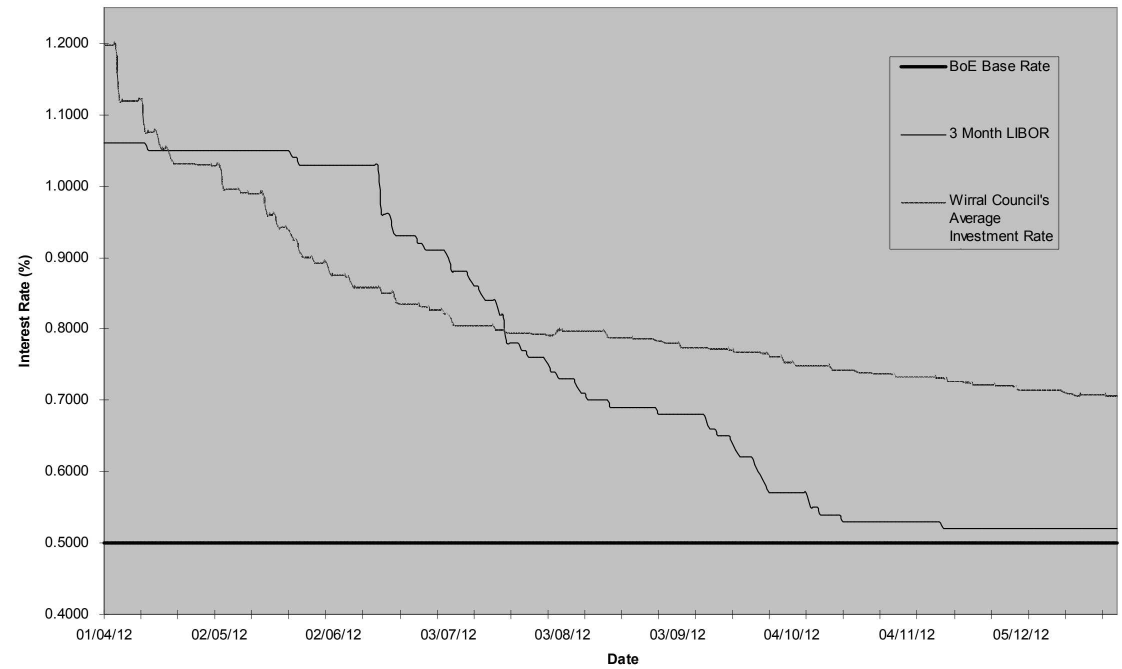
2.10 Of the above investments, £42 million is invested in instant access funds, £35 million is invested for up to 1 year and £23 million is invested for up to 5 years.

2.11 The rate at which the Council can invest money continues to be low, in line with the record low Bank of England base rate of 0.5%. The Council seeks to invest into more secure investments; the increased security comes at a price of reduced investment return. 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.

2.12 The average rate of return on investments as at 31 December 2012 was 0.71% (at 30 September it was 0.76%). 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).

Graph 1 : Investment Rate of Return in 2012/13



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 In previous months 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. Restrictions were put in place regarding the investment duration limits, to help safeguard Council funds. In November, as a result of advice from our Treasury Management consultant (Arlingclose), extensions to the duration limits of a number of investment counterparties were granted. The change came in response to continued analysis of the various metrics used to assess the creditworthiness of financial institutions, which continued to show signs of stabilisation, and in some cases, considerable improvement.

2.15 The credit rating of the approved counterparties and the duration of which an investment may be made are under constant review. Santander are currently restricted to deposits no longer than 100 days, whilst RBS, NatWest, Lloyds TSB and Bank of Scotland have a limit of 6 months. Barclays, Nationwide, 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 has now been transferred to Lloyds TSB. Although, the Council's old current account with NatWest will continue to operate for at least six months to ensure a smooth transition. Both counterparties have an appropriate credit rating and will therefore continue 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.

Table 3 ; Heritable Bank Repayments

	£
Initial Investment	2,000,000
Actual Repayments Received	
As at 31 Dec 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 third quarter of 2012/13.

2.27 The table shows Council debt at 31 December 2012.

Table 4 : Council Debt at 31 December 2012

Debt	Balance 30 Sep 12 (£m)	Maturities (£m)	Additions (£m)	Balance 31 Dec 12 (£m)
Borrowings				
PWLB	(83)	7	0	(76)
Market Loans	(174)	0	0	(174)
Other Long Term Liabilities				
PFI	(59)	0	0	(59)
Finance Leases	(2)	0	0	(2)
TOTAL	**(318)**	**7**	**0**	**(311)**

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.

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.

Table 5 : 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 31 Dec 2012	**211**

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.

Table 6 ; Authorised Limit and Operational Boundary Indicator

	Oct 12 (£m)	**Nov 12 (£m)**	**Dec 12 (£m)**
AUTHORISED LIMIT	**482**	**482**	**482**
OPERATIONAL BOUNDARY	**467**	**467**	**467**
Council Borrowings	254	254	250
Other Long Term Liabilities	61	61	61
TOTAL	**315**	**315**	**311**

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

Interest Rate Exposure Indicator

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.

Table 7 ; Interest Rate Exposure

	Fixed Rate of Interest (£m)	Variable Rate of Interest (£m)	TOTAL
Borrowings	(250)	0	**(250)**
Proportion of Borrowings	100%	0%	100%
Upper Limt	100%	0%	
Investments	23	77	**100**
Proportion of Investments	23%	77%	100%
Upper Limit	100%	100%	
Net Borrowing	**(227)**	**77**	**(150)**
Proportion of Total Net Borrowing	151%	-51%	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.

<u>Maturity Structure of Borrowing Indicator</u>

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.

Table 8 : Maturity Structure of Borrowing

Borrowings Maturity	As at 31 Dec 12 (£m)	As at 31 Dec 12 (%)	2012/13 Lower Limit (%)	2012/13 Upper Limit (%)
Less than 1 year	28	11	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	32	13	0	50
Over 10 years	151	60	0	100
Total Borrowing	**250**	**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 £23 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.

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.

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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
Cabinet - Treasury Management Performance Monitoring Report – Quarter 2 2012/13	8 November 2012