WIRRAL COUNCIL

CABINET

7 NOVEMBER 2013

SUBJECT	**TREASURY MANAGEMENT PERFORMANCE MONITORING 2013/14**
WARD/S AFFECTED	**ALL**
REPORT OF	**INTERIM DIRECTOR OF RESOURCES**
RESPONSIBLE PORTFOLIO HOLDER	**COUNCILLOR PHIL DAVIES**
KEY DECISION	**YES**

1 EXECUTIVE SUMMARY

1.1 This report presents a review of Treasury Management policies, practices and activities during the first half of 2013/14.

1.2 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.

1.3 It is estimated that there will be an underspend of £0.75 million from all Treasury Management activities in 2013/14.

2 RECOMMENDATIONS

2.1 That the Treasury Management Performance Monitoring Report be accepted in meeting the Council's obligations under the Treasury Management Code.

2.2 Members note the estimated underspend of £0.75 million in 2013/14 which has been incorporated into the Council Financial Monitoring report.

3 BACKGROUND AND KEY ISSUES

3.1 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 this Treasury Management mid-year review report is presented to Cabinet.

CURRENT ECONOMIC ENVIRONMENT

3.2 The UK economy showed some improvement, with consumer spending boosting growth. Gross Domestic Product (GDP) for the first quarter of 2013 was revised up to +0.4% and for the second quarter was +0.7%. Recent data suggests a stronger rate in quarter three. Revisions by the Office of National Statistics to GDP back-data showed the UK avoided a double-dip recession in 2012, but that the downturn in 2008/09 was deeper than previously estimated. Growth is now still over 3% below its peak back in 2007. Some positive signs for household spending emerged. The deterioration in real earnings growth i.e. earnings less inflation) slowed, which implied a slower erosion of purchasing power. Consumer confidence improved.

3.3 The annual Consumer Price Index for August (published September) was 2.7%. Inflation fell in line with expectations and is expected to remain close to this level throughout the autumn. Further out, inflation should fall back towards the 2% target as external price pressures fade and a revival in productivity growth curbs domestic cost pressures.

3.4 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%. There was no change to UK monetary policy with official interest rates and asset purchases maintained at 0.5% and £375 billion respectively. The main development for UK monetary policy was the start of Mark Carney’s tenure as Governor and the implementation of forward guidance. Within the August Inflation Report, the Bank stated its forward guidance, the main element of which is to defer monetary tightening at least until the Unemployment Rate falls to a threshold of 7% (among a raft of caveats). The Bank projected that the probability of this happening would remain below 50% until 2016.

3.5 Whilst the outlook for the global economy appeared to have improved over the first half of 2013/14, significant economic risks remain, particularly in China and the Eurozone. The Chinese banking system is facing tighter liquidity conditions as officials seek to slow down rampant credit growth, and, despite the time gained by the European Central Bank to allow individual members and the Eurozone as a whole to reform their economies, the Eurozone debt crisis has not gone away. The region appears to be dragging itself out of recession and September’s German general election passed with little incident but political uncertainties, particularly in Italy, could derail any progress towards a more balanced and stable regional economy. The US recovery appeared to be in train, but a lack of agreement on the federal budget by the end of September caused a partial government shutdown at the start of October, which could have an effect on GDP growth. Political risks also remain regarding the debt ceiling.

THE COUNCIL TREASURY POSITION

3.6 The table shows how the position has changed since 31 March 2013.

Table 1 : Summary of Treasury Position

	Balance 31 Mar 13 (£m)	Maturities (£m)	Additions (£m)	Balance 30 Sep 13 (£m)
Investments	71	(267)	267	71
Borrowings	(247)	24	0	(223)
Other Long-Term Liabilites	(56)	0	0	(56)
Net Debt	(232)	(243)	267	(208)

INVESTMENTS

3.7 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.

3.8 At 30 September 2013 the Council held investments of £71 million.

Table 2 : Investment Profile

Investments with:	31 Mar 13 £m	30 Jun 13 £m	30 Sep 13 £m
UK Banks	25	46	35
UK Building Societies	2	2	2
Money Market Funds	0	21	0
Other Local Authorities	36	24	26
Gilts and Bonds	8	8	8
TOTAL	**71**	**101**	**71**

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

Table 3 : Investment Sources

Usable Reserves	31 Mar 13 £m	30 Jun 13 £m	30 Sep 13 £m
General Fund	27	27	27
Earmarked Reserves	65	65	65
Capital Receipts Reserve	8	8	9
Capital Grants Unapplied	21	24	27
	121	**124**	**128**
Internal Borrowing in lieu of External Borrowing	(50)	(23)	(57)
Reserves Invested	**71**	**101**	**71**

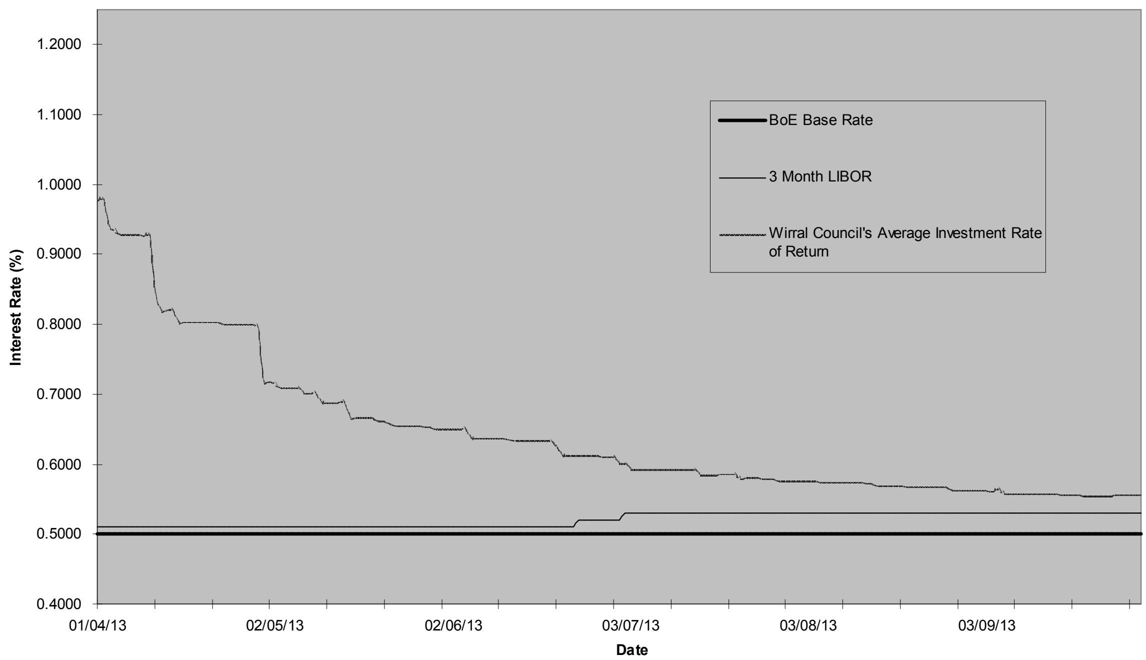
3.10 Of the investments, £30 million is invested in instant access funds, £33 million is invested for up to 1 year and £8 million is invested for longer than 1 year.

3.11 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 in more secure investments and this security brings a reduced investment return. This includes investing with other local authorities being 'low risk yet allows for considerable returns' when Wirral's approach was recognised in Public Finance magazine in October 2013. 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.

3.12 The average rate of return on investments as at 30 September 2013 was 0.65% (at 31 March it was 0.79%). 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 2013/14



3.13 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.

3.14 In April 2013 Fitch downgraded the UK’s long-term sovereign rating by one notch from AAA to AA+, the second of the rating agencies to do so (Moody’s had downgraded the UK’s ratings in February to Aa1). In May Moody’s downgraded the long-term rating of Co-op Bank by six notches from A3 to Ba3 which is sub-investment grade. The downgrade reflected the agency’s opinion that the bank faced the risk of further substantial losses. In June the Co-op announced it had a £1.5 billion regulatory capital shortfall. Moody’s downgraded the bank’s long-term rating a further four notches to Caa1 whilst Fitch downgraded the long-term from BBB- to BB-.

3.15 The credit rating of the approved counterparties and the duration of which an investment may be made are under constant review. Moody's placed on review for downgrade Royal Bank of Scotland plc's and National Westminster Bank plc’s long-term and standalone bank financial strength ratings. New investments with Royal Bank of Scotland plc and NatWest Bank plc are consequently restricted to a maximum period of **overnight.** Santander, 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.

3.16 The Council’s main bank account has now been transferred to Lloyds. Although, the Council’s old current account with NatWest continues to operate 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.

3.17 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.

3.18 The 2013/14 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 a figure of £0.61 million. The shortfall of £0.25 million is referred to in the Month 6 Revenue Monitoring Report.

Icelandic Investment

3.19 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.

3.20 To date, £1,980,321 has been received with further payments due from the administrators, Ernst & Young. The amounts and timings of future payments are estimates as favourable changes in market conditions could lead to higher than estimated repayments.

Table 4 ; Heritable Bank Repayments

	£
Initial Investment	2,000,000
Actual Repayments Received	
As at 30 Sep 13	1,980,321
Remaining Principal	**19,679**

3.21 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

3.22 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.

3.23 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.

3.24 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.

3.25 The Council has not entered into any new lease agreements during the first half of 2013/14.

3.26 The table shows Council debt at 30 September 2013.

Table 5 : Council Debt at 30 September 2013

Debt	Balance 31 Mar 13 (£m)	Maturities (£m)	Additions (£m)	Balance 30 Sep 13 (£m)
Borrowings				
PWLB	(76)	11	0	(65)
Market Loans	(171)	13	0	(158)
Other Long Term Liabilities	(56)	0	0	(56)

3.27 Given the latest projections and re-profiling in respect of the capital programme and the continuing use of internal funding in lieu of external borrowing, it is anticipated that in 2013/14 there will be a 'one-off' underspend of £1.0 million in respect of capital financing. £0.2 million relates to Minimum Revenue Provision saving in 2012/13, which has already been reported to this committee, therefore an additional £0.8 million is in respect of additional savings relating to 2013/14.

MONITORING OF THE PRUDENTIAL CODE INDICATORS

3.28 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

3.29 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.

Table 6 : Net Debt compared with CFR

	£m
CFR in previous year (2012/13 actual)	367
Increase in CFR in 2013/14 (estimate)	0
Increase in CFR in 2014/15 (estimate)	0
Increase in CFR in 2015/16 (estimate)	0
Accumulative CFR	**367**
Net Debt as at 31 Sep 2013	**208**

3.30 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

3.31 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.

3.32 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.

Table 7 : Authorised Limit and Operational Boundary Indicator

	Apr 13 (£m)	Jun 13 (£m)	Sep 13 (£m)
AUTHORISED LIMIT	**440**	**440**	**440**
OPERATIONAL BOUNDARY	**425**	**425**	**425**
Council Borrowings	247	228	223
Other Long Term Liabilities	56	56	56
TOTAL	**303**	**284**	**279**

3.33 The table shows that neither the Authorised Limit nor the Operational Boundary was breached between April 2013 and September 2013. This is a key indicator of affordability.

Interest Rate Exposure Indicator

3.34 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.

Table 8 ; Interest Rate Exposure

	Fixed Rate of Interest (£m)	Variable Rate of Interest (£m)	TOTAL
Borrowings	(223)	0	**(223)**
Proportion of Borrowings	100%	0%	100%
Upper Limt	100%	0%	
Investments	8	63	**71**
Proportion of Investments	11%	89%	100%
Upper Limit	100%	100%	
Net Borrowing	**(215)**	**63**	**(152)**
Proportion of Total Net Borrowing	141%	-41%	100%

3.35 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.

3.36 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

3.37 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.

Table 9 : Maturity Structure of Borrowing

Borrowings Maturity	As at 30 Sep 13 (£m)	As at 30 Sep 13 (%)	2013/14 Lower Limit (%)	2013/14 Upper Limit (%)
Less than 1 year	18	8	0	80
Over 1 year under 2 years	5	2	0	50
Over 2 years under 5 years	26	12	0	50
Over 5 years under 10 years	24	11	0	50
Over 10 years	150	67	0	100
Total Borrowing	**223**	**100**		

Total Principal Sums Invested for Periods Longer than 364 Days

3.38 This indicator allows the Council to manage the risk inherent in investments longer than 364 days. The limit for 2013/14 was set at £30 million. Currently the Council has £8 million of investments which are for a period greater than 364 days during this period.

4 RELEVANT RISKS

4.1 All relevant risks have been discussed within Section 3 of this report.

5 OTHER OPTIONS CONSIDERED

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

6 CONSULTATION

6.1 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.

7 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

7.1 There are none arising directly out of this report.

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

8.1 As reported in Section 3.18 the 2013/14 investment income budget has been set at £0.86 million and, at present, income is set to achieve a figure of £0.61 million representing a shortfall of £0.25 million.

8.2 As reported in section 3.27 the latest projections in respect of the capital programme and the continuing use of internal funding in lieu of external borrowing project that in 2013/14 there will be a 'one-off' underspend of £1 million in respect of capital financing.

8.3 A net saving of £0.75 million is projected. Of this sum £0.2 million relates to 2012/13 and has already been included in previous Council Financial Monitoring reports. The additional £0.55 million is reported in the Month 6 monitoring as a 'one off' saving for 2013/14.

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

9 LEGAL IMPLICATIONS

9.1 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.

9.2 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".

10 EQUALITIES IMPLICATIONS

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

11 CARBON REDUCTION IMPLICATIONS

11.1 There are none arising directly out of this report.

12 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

12.1 There are none arising directly out of this report.

13 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.

APPENDIX

Through a lens, safely – article in Public Finance October 2013

SUBJECT HISTORY

Council Meeting	Date
Cabinet - Treasury Management and Investment Strategy 2013/16	18 February 2013
Cabinet - Treasury Management Annual Report 2012/13	10 October 2013