WIRRAL COUNCIL

CABINET

7 JULY 2014

SUBJECT	**TREASURY MANAGEMENT ANNUAL REPORT 2013/14**
WARD/S AFFECTED	**ALL**
REPORT OF	**DIRECTOR OF RESOURCES**
RESPONSIBLE PORTFOLIO HOLDER	**COUNCILLOR PHIL DAVIES**
KEY DECISION	**NO**

1.0 EXECUTIVE SUMMARY

1.1 This report presents a review of Treasury Management activities in 2013/14 and confirms compliance with treasury limits and prudential indicators. It fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code of Practice on Treasury Management and the Department for Communities and Local Government Investment Guidance.

1.2 The Authority achieved in-year savings from the re-profiling of the Capital Programme with the need for external borrowing offset by the temporary use of internal funds. This use of internal funds reduced the sums available for investment and low interest rates meant the income target was not achieved but, overall, Treasury Management activities underspent by £2 million in 2013/14. The Authority also complied with the Prudential Indicators.

2.0 BACKGROUND AND KEY ISSUES

2.1 Treasury management is defined as: "The management of the local authority 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 The Council has adopted the CIPFA Code of Practice on Treasury Management ("the Code"). This requires authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code recommends that Members are informed of treasury management activities at least twice a year.

2.3 Cabinet approves the Treasury Management Strategy at the start of each financial year. This identifies how it is proposed to finance capital expenditure, borrow and invest in the light of capital spending requirements, the interest rate forecasts and the expected economic conditions. During the year Cabinet receives updates on treasury management activities and at the end of the financial year this Annual Report. Scrutiny of Treasury Management activity is delegated to Transformation & Resources Policy & Performance Committee.

Economic Background

2.4 At the beginning of t2013/14 markets were concerned about lacklustre growth in the Eurozone, the UK and Japan. Lack of growth in the UK economy, the threat of a 'triple-dip' alongside falling real wages and the paucity of business investment were a concern for the Bank of England's Monetary Policy Committee. Only two major economies, the US and Germany, had growth above pre-financial crisis levels, albeit these were still below trend. The Eurozone had navigated through a turbulent period for its disparate sovereigns and the likelihood of a near-term disorderly collapse had significantly diminished. The US government had just managed to avoid the fiscal cliff and a technical default in early 2013, only for the problem to re-emerge later in the year.

2.5 The Bank of England unveiled forward guidance in August 2013 pledging to not consider raising interest rates until the ILO unemployment rate fell below the 7% threshold which the Bank did not expect to be reached in 2016. Although the Bank stressed that this level was a threshold for consideration of rate increase rather an automatic trigger, markets began pricing in a much earlier rise than was warranted and, as a result, gilt yields rose aggressively.

2.6 The recovery in the UK showed strong economic activity and growth with Q4 2014 Gross Domestic Product (GDP) showing year-on-year growth of 2.7%. This was due to the dominant service sector and an increase in household consumption buoyed by the pick-up in the housing market. Business investment had yet to recover convincingly and the recovery was not accompanied by meaningful productivity growth. Worries of a housing bubble tempered by evidence that net mortgage lending was only around 1% up.

2.7 Consumer Price Index (CPI) fell from 2.8% in March 2013 to 1.7% in February 2014, the lowest rate since October 2009. Although the fall in unemployment (down from 7.8% in March 2013 to 7.2% in January 2014) was faster than the Bank of England or many analysts had forecast, it hid a stubbornly high level of underemployment. Importantly, average earnings growth remained muted and real wage growth was negative. In February the Bank stepped back from forward guidance relying on a single indicator, the unemployment rate, to more complex measures which included spare capacity within the economy. The Bank also implied that when official interest rates were raised, the increases would be gradual – this helped underpin the 'low for longer' interest rate outlook despite the momentum in the economy.

2.8 The Office of Budget Responsibility's 2.7% forecast for economic growth in 2014 forecast a quicker fall in public borrowing over the next few years. The Chancellor resisted the temptation to spend any proceeds of higher economic growth with the 2013 Autumn Statement and 2014 Budget, retained the Government's austerity measures.

2.9 The Federal Reserve announced in May 2014 that the quantitative easing (QE) programme may be 'tapered'. Investors began to factor in not just an end to QE but also rapid rises in interest rates. 'Tapering' (a slowing in the rate of QE) began in December 2013 and there was an expectation that QE would end by October 2014. This had particular implications for global markets which had hitherto benefited from, and got very accustomed to, the high levels of global liquidity afforded by QE. The impact went further than a rise in the dollar and higher US Treasury bond yields. Gilt yields also rose as a consequence and emerging markets, which had previously benefited as investors searched for yield through riskier asset, suffered large capital outflows in December and January.

2.10 With the Eurozone struggling to show sustainable growth, the European Central Bank (ECB) cut main policy interest rates by 0.25% to 0.25% and the deposit rate to zero. Markets were disappointed by the lack of action. Data pointed to an economic slowdown in China which, alongside a weakening property market and highly leveraged shadow banking sector, could prove challenging for its authorities.

2.11 Russia's annexation of the Ukraine in March 2014 heightened geopolitical tensions and risk. The response from the West which saw sanctions against Russia, which supplies nearly 30% of European natural gas needs and is also a significant supplier of crude oil, so any major disruption to their supply would have serious ramifications for energy prices.

2.12 Gilt Yields and Money Market Rates: Gilt yields ended the year higher than the start. The peak in yields was during autumn 2013 with the biggest increase in 5-year gilt yields 0.70% to 1.97%. 10-year gilt yields rose by nearly 1% ending at 2.73%. The increase was less pronounced for longer dated gilts; 20-year yields rose from 2.74% to 3.37% and 50-year yields rose from 3.23% to 3.44%. 3-month, 6-month and 12-month Libid rates remained at levels below 1% through the year.

BORROWING AND DEBT MANAGEMENT

2.13 The Authority's underlying need to borrow as measured by the Capital Financing Requirement (CFR) at 31 March 2014 was £360 million.

	Balance on 01/04/2013 £000	Maturing Debt £000	New Borrowing £000	Balance on 31/03/14 £000
CAPITAL FINANCING REQUIREMENT	**376,196**			**360,090**
Short Term Borrowing	32,914	(17,325)	0	15,589
Long Term Borrowing	214,229	(12,927)	0	201,302
TOTAL BORROWING	**247,143**	**(30,252)**	**0**	**216,891**
Other Long Term Liabilities	58,414	(3,233)	0	55,181
TOTAL EXTERNAL DEBT	**305,557**	**(33,485)**	**0**	**272,072**

2.14 The following table shows the long term loans repaid during the year.

Loans maturing in 2013/14	Principal £m	Fixed/ Variable	Rate %	Loan start date	Terms
*Landesbank Hessen	5.00	Fixed	5.94	03-Jun-98	Maturity
*Landesbank Hessen	3.00	Fixed	6.51	08-Mar-99	Maturity
*Landesbank Hessen	5.00	Fixed	5.94	05-Feb-02	Maturity
*PWLB	5.00	Fixed	5.50	15-Mar-00	Maturity
PWLB	10.00	Fixed	4.39	13-Feb-08	Maturity
PWLB	0.50	Fixed	3.04	10-Feb-10	E I P
PWLB	0.50	Fixed	2.94	03-Mar-10	E I P
PWLB	0.50	Fixed	1.89	14-Oct-10	E I P
PWLB	0.50	Fixed	2.30	09-Nov-11	E I P
Total Maturing Borrowing	**30.00**				

** Loan repaid was in respect of Merseyside Residual Debt Fund*

2.15 Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continued to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

2.16 At 31 March 2014 the Authority held £161 million of loans, as part of its strategy for funding previous years' capital programmes (compares to £173 million at 31 March 2013).

2.17 The average rate of interest paid on Council borrowings as at 31 March 2014 was 5.3% (compares with 5.8% for 2012/13). The average life of Council borrowings is 21 years (25 years for 2012/13).

2.18 The 2013/14 Treasury Strategy estimated that the Authority would have been allowed to increase its maximum borrowing requirement by up to £92 million during the year to without breaching the CFR limit. However, no new borrowing arrangements were entered into during the year.

2.19 With short-term interest rates having remained much lower than long-term rates, it was more cost effective in the short-term to use internal resources. By doing so, the Authority was able to reduce net borrowing costs despite foregone investment income and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the short term, internal resources are reducing and it is unlikely that such a policy can be sustained for much longer. The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose, the Council's Treasury Management advisors, assisted with this "cost of carry" analysis.

Other Long-Term Liabilities

2.20 Other Long-Term Liabilities include the Schools Private Finance initiative (PFI) scheme and Finance Leases used to purchase vehicles plant and equipment. Under the International Financial Reporting Standards (IFRS) these items are shown on the Balance Sheet as a Financial Liability and need to be considered within any Treasury Management decision making process.

2.21 As at 31 March 2014 the PFI liability was valued at £55 million to be repaid by 2031 and there were three finance leases with a total liability of £72,000 repayable over 1-5 years.

Minimum Revenue Provision (MRP)

2.22 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.

2.23 The MRP policy for 2013/14 was approved by Cabinet on 18 February 2013. In the absence of any Supported Borrowing, Option 3 the asset life method is applied to the funding of assets and where that life is greater than 25 years a default asset life of 25 years is applied. MRP in respect of PFI and leases brought on Balance Sheet under International Financial Reporting Standards (IFRS) is also calculated using Option 3 and will match the annual principal repayment for the associated deferred liability.

2.24 In 2013/14 the decision to use internal resources in lieu of borrowing for capital purposes and the beneficial timing of the new borrowing helped to generate in-year savings of £2.3 million whilst complying with the Regulations. In future years the temporary use of internal resources will ultimately have to be replaced by increased external borrowing.

INVESTMENT ACTIVITY

2.25 Both the CIPFA Code and the CLG Investment Guidance require the Authority to invest prudently and have regard to the security and liquidity of investments before seeking the optimum yield. The following table summarises the investment activity during the year.

Investment Counterparty	Balance on 01/04/2013 £000	Investments Made £000	Maturities £000	Balance on 31/03/2014 £000	Credit Rating
Local Authorities	35,500	2,000	(21,500)	16,000	A+
Banks	15,150 9,390	143,825 40,145	(143,015) (49,535)	15,960 0	A BBB+
Building Societies	2,000	5,000	0	7,000	A
Money Market Funds	0	335,949	(317,449)	18,500	AAA
Gilts & Bonds	8,500	0	(7,500)	1,000	AAA
TOTAL INVESTMENTS	70,540	526,919	(538,999)	58,460	

2.26 Security of capital remained the Authority's main investment objective. This was maintained by following the counterparty policy as set out in the Treasury Management Strategy Statement for 2013/14 which defined "high credit quality" organisations as those having a long-term credit rating of [A-] or higher that are domiciled in the UK or a foreign country with a sovereign rating of [AA+] or higher.

2.27 Counterparty credit quality was assessed and monitored with reference to credit ratings (minimum long-term counterparty rating of A- across all three rating agencies, Fitch, S&P and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; any potential support mechanisms and share price.

2.28 The Council continues to invest in other local authorities and is a practice that was commended in the CIPFA Professional Magazine as an example of good practice. However, with investments maturing and as a consequence of the use of internal borrowing referred to earlier this saw a reduction in the sums available for investment.

2.29 There were material changes to UK Banks. In July 2013 Moody's placed the A3 long-term ratings of Royal Bank of Scotland and NatWest Bank on review for downgrade and in March 2014 the long-term ratings of both banks were revised to Baa1. This is below the Authority's minimum credit criterion of [A-], so the Banks were withdrawn from the counterparty list for further investment. The Authority no longer holds any investments with either. The Co-op Banks long-term ratings were downgraded by Moody's and Fitch to Caa1 and B respectively, both sub-investment grade ratings. Again no investments are held with this Bank.

2.30 The Financial Services (Banking Reform) Act 2013 gained Royal Assent in December 2013, legislating for the separation of retail and investment banks and for the introduction of mandatory bail-in in the UK to wind up, or restructure, failing financial institutions. European Union finance ministers agreed further steps towards banking union, and the Single Resolution Mechanism (SRM) for resolving problems with troubled large banks which will shift the burden of future restructurings/rescues to the institution's shareholders, bondholders and unsecured investors.

2.31 In keeping with the DCLG Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and the use of call accounts. Investments with banks and building societies were primarily call accounts and fixed-rate term deposits. The maximum duration of these investments was 12 months in line with the prevailing credit outlook during the year as well as market conditions.

2.32 Proposals were also announced for EU regulatory reforms to Money Market Funds which may result in these funds moving to a VNAV (variable net asset value) basis and losing their 'triple-A' credit rating wrapper in the future.

2.33 In respect of Icelandic investments the Council had £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 Wirral Council had acted, and continues to act, prudently and properly in all its investment activities.

2.34 The latest creditor progress report issued by the Administrators Ernst and Young, dated 25 March 2014, outlined that the return to creditors now stands at 94p in the £ with over £1.9 million now received.

2.35 In summary the budgeted investment income for the year had been estimated at £0.86 million and the actual interest earned was £0.58 million with this reduction principally due to:-

- Low interest rates offered by institutions which meet the eligibility criteria within the Treasury Management Strategy and;
- The continuing policy of relying on internal borrowing which reduces the sums available for investment.

2.36 The average return on investments for 2013/14 was 0.5% (which compares with 0.8% for 2012/13). The UK Bank Rate was maintained at 0.5% throughout the year, short-term money market rates remained at very low levels and the average 3-month LIBID rate during 2013/14 was 0.45%. The return on the Authority investments reflects prevailing market conditions and the Authority's objective of optimising returns commensurate with the principles of security and liquidity.

COMPLIANCE WITH PRUDENTIAL INDICATORS

2.37 The Authority confirms that it has complied with its Prudential Indicators for 2013/14, which were approved on 18 February 2013 as part of the Council's Treasury Management Strategy Statement. Details can be found in the Appendix.

2.38 In compliance with the requirements of the CIPFA Code of Practice this report provides Members with a summary report of the treasury management activity during 2013/14. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

3.0 RELEVANT RISKS

3.1 The Council is responsible for treasury decisions and activity and none of these decisions are without risk. The successful identification, monitoring and control of risk are important and the main risks 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.

4.0 OTHER OPTIONS CONSIDERED

4.1 There are no other options considered in this report.

5.0 CONSULTATION

5.1 There has been no consultation undertaken or proposed for this 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 out of this report.

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

7.1 In the financial year 2013/14 the treasury management activities resulted in a saving of £2 million from capital financing activities. This sum has been returned to the General Fund balances.

8.0 LEGAL IMPLICATIONS

8.1 The Council's has adopted the CIPFA Code of Practice on Treasury Management. This requires the annual production of Prudential Indicators and a Treasury Management Strategy Statement and the reporting of treasury management activities at least twice a year.

9.0 EQUALITIES IMPLICATIONS

9.1 There are none arising out of this report and an Equality Impact Assessment (EIA) is not required.

10.0 CARBON REDUCTION IMPLICATIONS

10.1 There are none arising out of this report.

11.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

11.1 There are none arising out of this report.

12.0 RECOMMENDATIONS

12.1 The Treasury Management Annual Report for 2013/14 be agreed.

12.2 The compliance with Prudential Indicators in 2013/14 be noted.

12.3 The saving of £2 million from capital financing activities in 2013/14 be noted.

13.0 REASON FOR RECOMMENDATIONS

13.1 Wirral has adopted the CIPFA Code of Practice on Treasury Management ("the Code"), which includes regular reports to Members of treasury activity.

13.2 Under the Council Financial Regulations surplus resources are returned to General Fund Balance so are available to support other Council services.

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APPENDIX

Prudential Indicators 2013/14.

REFERENCE MATERIAL

DCLG Local Authority Investment Guidance 2004.
CIPFA Code of Practice for Treasury Management in Public Services 2011.
CIPFA Prudential Code for Capital Finance in Local Authorities 2011.

SUBJECT HISTORY

Council Meeting	Date
Cabinet - Treasury Management and Investment Strategy 2013/2016	18 February 2013
Cabinet – Treasury Management Annual Report 2012/13	10 October 2013
Cabinet - Treasury Management Performance Monitoring	7 November 2013

APPENDIX

PRUDENTIAL INDICATORS 2013/14

(a) Capital Financing Requirement (CFR)

Estimates of the Authority's cumulative maximum external borrowing requirement for 2013/14 to 2015/16 are shown in the table below:

Capital Financing Requirement	31/03/2014 Approved £m	**31/03/2014 Actual £m**	31/03/2015 Estimate £m	31/03/2016 Estimate £m
General Fund	365.0	**360.1**	349.0	332.0

Gross Debt and the Capital Financing Requirement:

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

Debt	31/03/2014 Approved £m	**31/03/2014 Actual £m**	31/03/2015 Estimate £m	31/03/16 Estimate £m
Borrowing	217.3	**216.9**	204.0	197.0
Finance leases	0.1	**0.1**	0.0	0.0
PFI liabilities	55.6	**55.1**	53.0	51.0
Total Debt	**273.0**	**272.1**	257.0	248.0
Borrowing in excess of CFR?	**No**	**No**	**No**	**No**

Total debt is expected to remain below the CFR during the forecast period.

(b) Authorised Limit and Operational Boundary for External Debt

The Operational Boundary for External Debt is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance leases and the Private Finance Initiative that are not borrowing but form part of the Authority's debt.

The Authorised Limit for External Debt is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

There were no breaches to the Authorised Limit and the Operational Boundary during 2013/14.

	Operational Boundary (Approved) 31/03/2014 £m	Authorised Limit (Approved) 31/03/2014 £m	**Actual External Debt 31/03/2014 £m**
Borrowing	345.0	355.0	216.9
Other Long-term Liabilities	80.0	85.0	55.2
Total	**425.0**	**440.0**	**272.1**

(c) Upper Limits for Fixed and Variable Interest Rate Exposure

These allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on the portfolio of investments.

Interest Rate Exposure	**Fixed Rate of Interest**	**Variable Rate of Interest**	**Total**
Borrowings	£217m	£0m	**£217m**
Proportion of Borrowings	100%	0%	**100%**
Upper Limit	100%	100%	
Investments	£24m	£34m	**£58m**
Proportion of Investments	41%	59%	**100%**
Upper Limit	100%	100%	
Net Borrowing	**£193m**	**£-34m**	**£159m**
Proportion of Total Net Borrowing	121%	-21%	**100%**

(d) Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing as at 31 Mar 14 £m	% of Fixed Rate Borrowing as at 31 Mar 14 %
under 12 months	80	0	13	6
12 months and within 24 months	50	0	10	5
24 months and within 5 years	50	0	23	11
5 years and within 10 years	50	0	21	10
10 years and above	100	20	150	69
			217	**100**

(e) Total principal sums invested for periods longer than 364 days

This indicator allows the Council to manage the risk inherent in investments longer than 364 days and for 2013/14 the limit was set at £30 million.

As at 31 March 2014 the Council had £2 million of investments longer than 364 days, all with other Local Authorities.

(f) Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and in particular, to consider the impact on Council Tax. The projections for 2014/15 and 2015/16 were reported to Cabinet on 12 February 2014.

Expenditure	31/03/14 Approved £m	31/03/14 Revised £m	**31/03/14 Actual £m**	31/03/15 Estimate £m	31/03/16 Estimate £m
General Fund	37.5	35.9	**25.6**	48.2	17.5

Capital expenditure has or will be funded as follows:

Capital Financing	31/03/14 Approved £m	31/03/14 Revised £m	**31/03/14 Actual £m**	31/03/15 Estimate £m	31/03/16 Estimate £m
Capital receipts	3.1	3.7	**1.5**	3.0	3.0
Government Grants	25.6	19.9	**23.4**	24.2	7.7
Revenue and Reserves	0.9	1.6	**0**	0.3	0
Unsupported borrowing	7.9	10.7	**0.7**	20.7	6.8
Total Funding	37.5	35.9	**25.6**	48.2	17.5

(g) Ratio of financing costs to net revenue stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The ratio is based on costs net of investment income.

Ratio of Finance Costs to net Revenue Stream	2013/14 Estimate %	2013/14 Actual %	2014/15 Estimate %	2015/16 Estimate %
Ratio	8.36	7.96	10.01	11.3

(h) Incremental Impact of Capital Investment Decisions

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

Incremental Impact of Capital Investment Decisions	2013/14 Estimate £	2013/14 Actual £	2014/15 Estimate £	2015/16 Estimate £
Increase in Band D Council Tax	8.61	2.58	4.53	1.23

(i) Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Authority adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
Council approved the revised Cipfa's Code of Treasury Management at its meeting of 5 March 2013