WIRRAL Council

Cabinet

6 NOVEMBER 2014

SUBJECT	**TREASURY MANAGEMENT MONITORING 2014/15**
WARD/S AFFECTED	**ALL**
REPORT OF	**DIRECTOR OF RESOURCES**
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 6 months of 2014/15. It confirms compliance with treasury limits and prudential indicators being prepared in accordance with the CIPFA Treasury Management Code and the 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 this update report is presented to Cabinet.

CURRENT ECONOMIC ENVIRONMENT

2.2 The recent strong performance of the UK economy continued with output growing at 0.8% in Q1 2014 and at 0.9% in Q2. The services sector once again grew strongly. On the back of strong consumption growth, business investment appeared to be recovering quickly, albeit from a low base. The annual CPI inflation rate fell to 1.2% year-on-year in September. Revisions to the GDP methodology, now compliant with the European System of Accounting 2010, mean that growth is now estimated to be 2.7% above its pre-recession peak in Q1 2008 rather than just 0.2% higher, the general theme being that the recession was not as deep and the recovery was earlier than initially estimated. In anticipation of these revisions, the MPC has forecast growth at 3.4% in 2014.

2.3 The labour market continued to improve, with strong employment gains and the headline unemployment rate falling to 6.2%. However, earnings growth remained very weak, rising just 0.6% for the three months May-July 2014 when compared to the same period a year earlier. The growth in employment was masked by a large number of zero-hour contracts and involuntary part-time working.

2.4 The MPC made no change to the Bank Rate of 0.50% and maintained asset purchases at £375 billion. However, there was a marked shift in tone from the Bank of England's Governor and other MPC members. In June the Governor warned that interest rates might rise sooner than financial markets were expecting and in August and September MPC there was talk of increases to the Bank Rate of 0.25%, arguing economic circumstances were sufficient to justify an immediate rise. The MPC emphasised that when Bank Rate did begin to rise, it was expected to do so only gradually and would likely remain below average historical levels for some time to come.

2.5 In the Bank of England's August Inflation Report the Bank forecast growth to be around 3.5% in 2014, easing back thereafter to around its pre-crisis historical average rate. Inflation was forecast to remain at, or slightly below, 2% before reaching the target at the end of the 2-year forecast period. The Bank's Financial Policy Committee also announced a range of measures to cool the UK's housing market to avert the potential of spiralling house prices derailing a sustainable economic recovery.

2.6 Eurozone inflation continued to fall towards zero and there was mounting evidence that the already feeble recovery was losing pace. The unemployment rate remained stubbornly high at 11.5%. The European Central Bank lowered its official benchmark interest rate from 0.15% to 0.05%. The rate it pays on commercial bank balances held with it was also cut further into negative territory. The ECB also announced a programme of acquiring Asset Backed Securities viewed as being one step away from full blown Quantitative Easing (QE) adopted by the US, UK and Japanese central banks. The minutes of the Bank of England's MPC meeting in September noted that "weakness in the euro area had been the most significant development during the month" and that, if it led once again to uncertainty about the sustainability of euro-area public and external debt, it could damage confidence and disrupt financial markets. There were no changes in policy from the US Federal Reserve as the central bank as the US economy rebounded strongly in Q2 with annualised growth of 4.6%.

THE COUNCIL TREASURY POSITION

2.7 The table shows how the position has changed since 31 March 2014.

Table 1: Summary of Treasury Position

	Balance 31 Mar 14 (£m)	Maturities (£m)	Additions (£m)	Balance 30 Sep 14 (£m)
Investments	58	(272)	308	94
Borrowings	(217)	12	(10)	(215)
Other Long-Term Liabilites	(54)	1	0	(53)
Net Debt	(213)	(259)	298	(174)

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 2014 the Council held investments of £94 million. The table below shows the level of investment increasing to £111 million at 30 June 2014 (from £58 million as 31 March 2014), this was due to the receipts for 2014/15 funding being received in advance. Since this point the level of investment has fallen to £94 million at 30 September 2014, due to these funds being utilised.

Table 2 : Investment Profile

Investments with:	31 Mar 14 £m	30 Jun 14 £m	30 Sep 14 £m
UK Banks	16	38	28
Non-UK Banks	0	18	7
UK Building Societies	7	11	14
Money Market Funds	18	27	35
Other Local Authorities	16	16	9
Gilts and Bonds	1	1	1
TOTAL	**58**	**111**	**94**

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

Table 3: Investment Sources

Usable Reserves	31 Mar 14 £m	30 Jun 14 £m	30 Sep 14 £m
General Fund	17	17	20
Earmarked Reserves	83	83	83
Capital Receipts Reserve	9	10	11
Capital Grants Unapplied	14	17	17
	123	**127**	**131**
Internal Borrowing in lieu of External Borrowing	(65)	(16)	(37)
Reserves Invested	**58**	**111**	**94**

2.11 With short-term interest rates having remained much lower than long-term rates, it is more cost effective in the short-term to use internal resources, rather than undertake longer term external borrowing. By doing so, the Authority is able to reduce net borrowing costs despite foregone investment income and also 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 long term. The benefits of internal borrowing are 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, assist with this "cost of carry" analysis.

2.12 Table 3 shows that between 31 March 2014 and 30 June 2014 the level of investments increased, this effectively reduced the amount that was being used from internal resources. Moving towards 30 September 2014, the level of investment decreased as the use of internal resources in lieu of external borrowing increased.

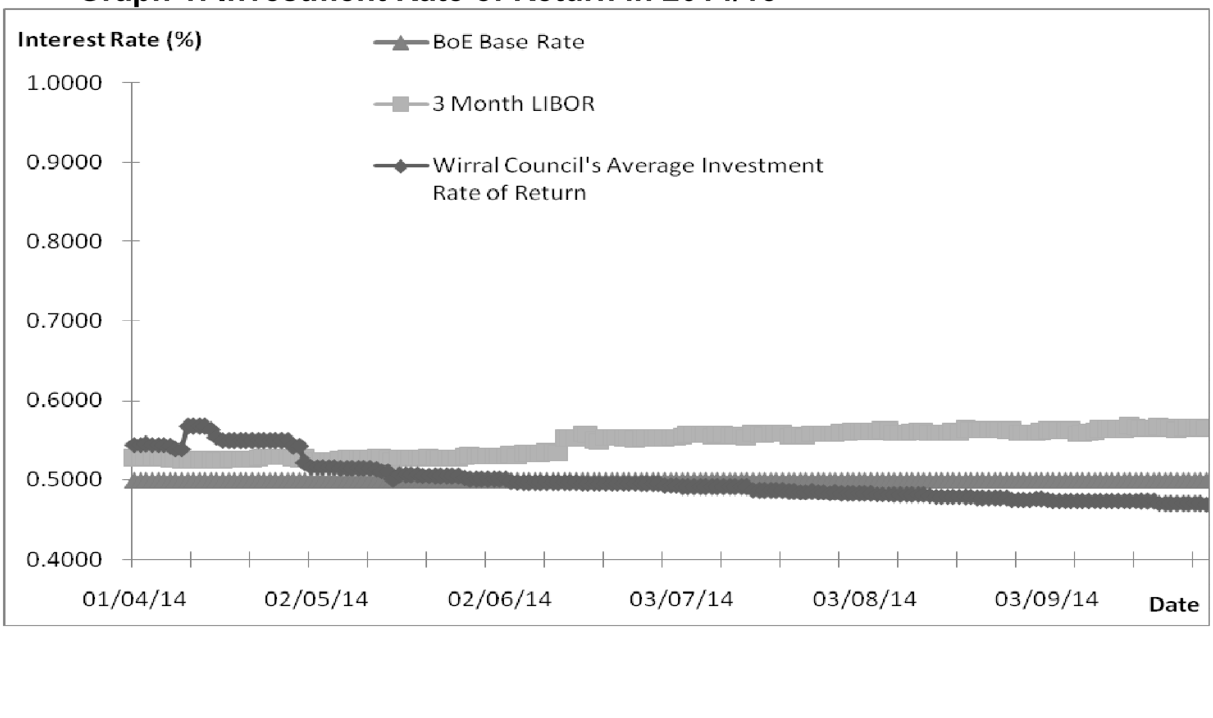
2.13 Of the above investments, £35 million is invested in instant access funds, £59 million is invested for up to 1 year with no investments for longer than 1 year.

2.14 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 0.50%. 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.

2.15 The yearly average rate of return on investments as at 30 September 2014 was 0.50% The graph shows how the Treasury Management Team rate of return is comparable against the Bank of England base rate and the 3 month LIBOR (the inter bank lending rate).

Graph 1: Investment Rate of Return in 2014/15



2.16 The Council maintains a restrictive policy on new investments by only investing in organisations that have a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. The Council 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.

2.17 The European Parliament approved the EU Bank Recovery and Resolution Directive (BRRD) on April 15, 2014. Potential extraordinary government support available to banks' senior unsecured bondholders will likely diminish, leading to two Ratings Agencies, Standard & Poor's and Moody's changing the outlook from stable to negative. These institutions have not been downgraded.

2.18 The credit rating of the approved counterparties and the duration of which an investment may be made are under constant review. Current duration limits are as follows:

- Close Brothers Limited, Goldman Sachs International Bank, Leeds Building Society, Cumberland Building Society, Scottish Building Society and Vernon Building Society are limited to a maximum of 100 days.
- Deutsche Bank and all remaining approved Building Societies (excluding Nationwide BS) are limited to a maximum of 6 months.
- Lloyds Bank, Bank of Scotland, HSBC, Standard Chartered, Barclays, Nationwide BS, Santander, Svenska Handelsbank and other approved Non-UK banks to a maximum of 13 months.

2.19 Where the Council had previously entered into a fixed term deposit with an institution that no longer meets the criteria above, the investment will be allowed to mature as originally planned. As in accordance with the Treasury Management Investment Strategy, new counterparties may be considered for investment, if they are acceptable under the Authority's criteria and after consultation with the Councils Treasury Management Advisor.

2.20 The Council's main bank account is with Lloyds, which has an appropriate credit rating and will therefore continue to be used for shorter term liquidity requirements and business continuity arrangements.

2.21 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.

2.22 The budget for investment income is £860,000. Given the prevailing low interest rates and the temporary use of internal resources in lieu of borrowing, which produces greater reduced financing costs, forecast achievable income is £460,000.

BORROWING AND OTHER LONG TERM LIABILITIES

2.23 The Council undertakes borrowing to fund capital expenditure. 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. Affordability and the "cost of carry" remained important influences on the Authority's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates are likely to remain over the forthcoming two years, lower than long-term rates, the Authority determined it was more cost effective in the short-term to use internal resources instead.

2.24 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.

2.25 The Public Works Loans Board (PWLB) remains the Council's preferred source of longer term borrowing given the transparency and control that its facilities continue to provide.

2.26 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.

2.27 The Council has not entered into any new lease agreements during 2014/15.

2.28 The Council did take out one temporary loan for cashflow purposes in September with the Greater Manchester Combined Authority for £10 million. This loan has a duration of one month at a rate of interest of 0.28%.

2.29 The table shows Council debt at 30 September 2014.

Table 4: Council Debt at 30 September 2014

Debt	**Balance 31 Mar 14 (£m)**	**Maturities (£m)**	**Additions (£m)**	**Balance 30 Sep 14 (£m)**
Borrowings				
PWLB	(60)	12	0	(48)
Market Loans	(157)	0	(10)	(167)
Other Long Term Liabilities	(54)	1	0	(53)
TOTAL	**(271)**	**13**	**(10)**	**(268)**

2.30 The reprofiling of the capital programme following a half year review, plus previously agreed changes has reduced the borrowing requirement for 2014/15 by £8.8 million. This will result in a one-off 2014/15 financing saving of

£800,000. The full budget will be required in 2015/16 when the re-profiled spend occurs.

MONITORING OF THE PRUDENTIAL CODE INDICATORS

2.31 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

2.32 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 Capital Financing Reserve

	£m
CFR in previous year (2013/14 actual)	355
Increase in CFR in 2014/15 (estimate)	2
Decrease in CFR in 2015/16 (estimate)	-11
Decrease in CFR in 2016/17 (estimate)	-11
Accumulative CFR	**335**
Net Debt as at 30 September 2014	**174**

2.33 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

2.34 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.

2.35 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

	Mar 14 (£m)	Jun 14 (£m)	Sep 14 (£m)
AUTHORISED LIMIT	**458**	**442**	**442**
OPERATIONAL BOUNDARY	**443**	**427**	**427**
Council Borrowings	217	216	215
Other Long Term Liabilities	54	54	53
TOTAL	**271**	**270**	**268**

2.36 The table shows that neither the Authorised Limit nor the Operational Boundary was breached between March 2014 and September 2014. This is a key indicator of affordability.

Interest Rate Exposure Indicator

2.37 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	(215)	0	**(215)**
Proportion of Borrowings	100%	0%	100%
Upper Limt	100%	0%	
Investments	0	94	**94**
Proportion of Investments	0%	100%	100%
Upper Limit	100%	100%	
Net Borrowing	**(215)**	**94**	**(121)**
Proportion of Total Net Borrowing	178%	-78%	100%

2.38 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.

2.39 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

2.40 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 30 Sep 14 (£m)	As at 30 Jun 14 (%)	2014/15 Lower Limit (%)	2014/15 Upper Limit (%)
Less than 1 year	15	7	0	80
Over 1 year under 2 years	11	5	0	50
Over 2 years under 5 years	17	8	0	50
Over 5 years under 10 years	25	12	0	50
Over 10 years	147	68	0	100
Total Borrowing	**215**	**100**		

Total Principal Sums Invested for Periods Longer than 364 Days

2.40 This indicator allows the Council to manage the risk inherent in investments longer than 364 days. The limit for 2014/15 was set at £30 million. Currently the Council has no 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 OUTSTANDING PREVIOUSLY APPROVED ACTIONS

6.1 There are no outstanding actions.

7.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

7.1 There are none arising directly out of this report.

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

8.1 Paragraph 2.22 refers to the reduction in investment income of £400,000. Paragraph 2.30 refers to the re-allocation of resources to partly fund the capital programme which results in an overall saving of £810,000. The net underspend is therefore estimated to be £410,000

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

9.0 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".

10.0 EQUALITIES IMPLICATIONS

10.1 An Equality Impact Assessment is not attached as there are none.

11.0 CARBON REDUCTION AND ENVIRONMENTAL IMPLICATIONS

11.1 There are none arising directly out of this report.

12.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

12.1 There are none arising directly out of this report.

13.0 RECOMMENDATION

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

14.0 REASON FOR RECOMMENDATION

14.1 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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BACKGROUND PAPERS/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 (last 3 years)

Council Meeting	Date
Cabinet - Treasury Management and Investment Strategy 2014/17	12 Feb 2014
Cabinet - Treasury Management Annual Report 2013/14	7 Jul 2014
Cabinet - Treasury Management Performance Monitoring	11 Sep 2014