WIRRAL COUNCIL

CABINET

5 NOVEMBER 2015

SUBJECT	**TREASURY MANAGEMENT MONITORING MID-YEAR 2015/16**
WARD/S AFFECTED	**ALL**
REPORT OF	**ACTING SECTION 151 OFFICER**
RESPONSIBLE PORTFOLIO HOLDER	**COUNCILLOR PHIL DAVIES**
KEY DECISION	**YES**

1.0 EXECUTIVE SUMMARY

1.1 This report reviews Treasury Management policies, practices and activities during the first 6 months of 2015/16. It projects a £2.5 million underspend in 2015/16 and 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 Council 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, interest rate forecasts and expected economic conditions. At the end of each financial year Cabinet receives an Annual Report which details performance against the Strategy. The CIPFA Treasury Management Code also requires, as a minimum, a mid-year update report on the performance of the Treasury Management function including treasury activity and the associated monitoring and control of risk.

CURRENT ECONOMIC ENVIRONMENT

2.2 The economy has remained resilient over the last six months. Although economic growth slowed in the first quarter of 2015 to 0.4%, year on year growth to March 2015 was a relatively healthy 2.7%. The second quarter of 2015 saw the UK's Gross Domestic Product (GDP) growth bounce back and was confirmed at 0.7%, with year/year growth showing slight signs of slowing, decreasing to 2.4%. GDP has now increased for ten consecutive quarters, breaking a pattern of slow and erratic growth from 2009.

2.3 The annual rate for consumer price inflation (CPI) briefly turned negative in April before fluctuating between 0.0% and 0.1%. In the August Quarterly Inflation Report, the Bank of England projected that GDP growth will continue around its average rate since 2013. The Bank of England's projections for inflation remained largely unchanged from the May report with inflation to expected to gradually increase to around 2% over the next 18 months.

2.4 Further improvement in the labour market saw the International Labour Organisation's unemployment rate for the three months to July fall to 5.5%. In the September report, average earnings excluding bonuses for the three months to July rose 2.9% year/year.

2.5 During the first six months, domestic economic data was largely overshadowed by events in Greece including prolonged negotiations over a third European bailout and a snap election. A Greek exit from the euro - would not be without fall-out and a detrimental impact on other economies including the UK with the risk of contagion into other Eurozone peripheral economies, such as Portugal, Ireland and Spain.

2.6 With the globalisation of many facets of the UK economy, events further afield must also be considered in their potential economic impact. The US economy, despite slowing in the earlier part of the year, has shown a large improvement in growth forecasts. However due to inflation issues, interest rates are yet to be increased, although it is forecast that rates are due to rise before the end of the year. This is worth noting as the US rate pattern is usually shadowed by the UK interest rate setting.

2.7 In China, concerns over economic growth coupled with a regulatory clampdown on investors borrowing funds to invest saw the Chinese stock markets drop significantly. This caused shockwaves throughout Asia, the US and Europe highlighting the sensitivity to domestic economic recovery to global influences.

THE COUNCIL TREASURY POSITION

2.8 The table shows how the position has changed since 31 March 2015.

Table 1: Summary of Treasury Position

	Balance 31 Mar 15 (£m)	Maturities (£m)	Additions (£m)	Balance 30 Sep 15 (£m)
Investments	61	(283)	305	83
Borrowings	(204)	3	0	(201)
Other Long-Term Liabilites	(51)	1	0	(50)
Net Debt	(194)	(279)	305	(168)

INVESTMENTS

2.9 The Treasury Management Team can invest for periods varying from 1 day to 50 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 cash flow / working capital.

2.10 At 30 September 2015 the Council held investments of £83 million. The increase to £93 million at 30 June 2015 (from £61 million as 31 March 2015) was due to the receipts for 2015/16 funding being received in advance. The level then reduced to £83 million as these funds were utilised.

Table 2: Investment Profile

Investments with:	31 Mar 15 £m	30 Jun 15 £m	30 Sep 15 £m
UK Banks	15	24	19
Non-UK Banks	5	10	15
UK Building Societies	5	16	9
Money Market Funds	28	28	23
Other Local Authorities	7	12	13
Gilts and Bonds	1	3	4
TOTAL	**61**	**93**	**83**

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

Table 3: Investment Sources

Usable Reserves	31 Mar 15 £m	30 Jun 15 £m	30 Sep 15 £m
General Fund	19	12	12
Earmarked Reserves	87	87	87
Capital Receipts Reserve	8	8	10
Capital Grants Unapplied	10	10	10
	124	**117**	**119**
Internal Borrowing in lieu of External Borrowing	(63)	(24)	(36)
Reserves Invested	**61**	**93**	**83**

2.12 With short-term investment interest rates having remained much lower than long-term borrowing 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 Council is able to reduce net borrowing costs despite foregone investment income and also reduce overall treasury risk. Whilst this strategy is 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.

2.13 Table 2 shows that between 31 March 2015 and 30 September 2015 the level of investments increased, primarily due to the Council receiving large amounts of grant funding in advance of expenditure. Table 3 then shows the effect this has on the level of internal borrowing. As the Council has more funds available, the level to which it is internally borrowed reduces.

2.14 Of the investments, £24 million is invested in instant access funds, £59 million is invested for up to 1 year with no investments for longer than 1 year.

2.15 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.

2.16 The investment portfolio as at 30 September 2015 was £83 million, earning a weighted average rate of return of 0.58%. This rate of return is comparable against the Bank of England base rate, which stood at 0.5% and the 3 month LIBOR (the inter-bank lending rate) which stood at 0.58% at this date.

2.17 The benefit of internal borrowing to delay taking on further external debt can be illustrated by comparing the rates being achieved on investments, as above, versus the average rates of interest of new PWLB loans in the first six months of the year as follows:

5 Year PWLB Fixed Rate EIP* Loan	1.89%
15 Year PWLB Fixed Rate EIP Loan	2.77%
25 Year PWLB Fixed Rate EIP Loan	3.18%
50 Year PWLB Fixed Rate EIP Loan	3.59%

**EIP – Loans repaid via Equal Instalments of Principle over the loan term*

2.18 If the Council borrowed at these rates but had to invest at the lower rate of 0.58%, the Council would incur a net cost, the "cost of carry".

2.19 The Council maintains a restrictive policy on new investments by only investing in organisations that have a credit rating of BBB+ 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 and has the capability to invest in other creditworthy financial instruments such as gilts and bonds. Counterparty credit quality is 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 and potential support from a well-resourced parent institution; share price.

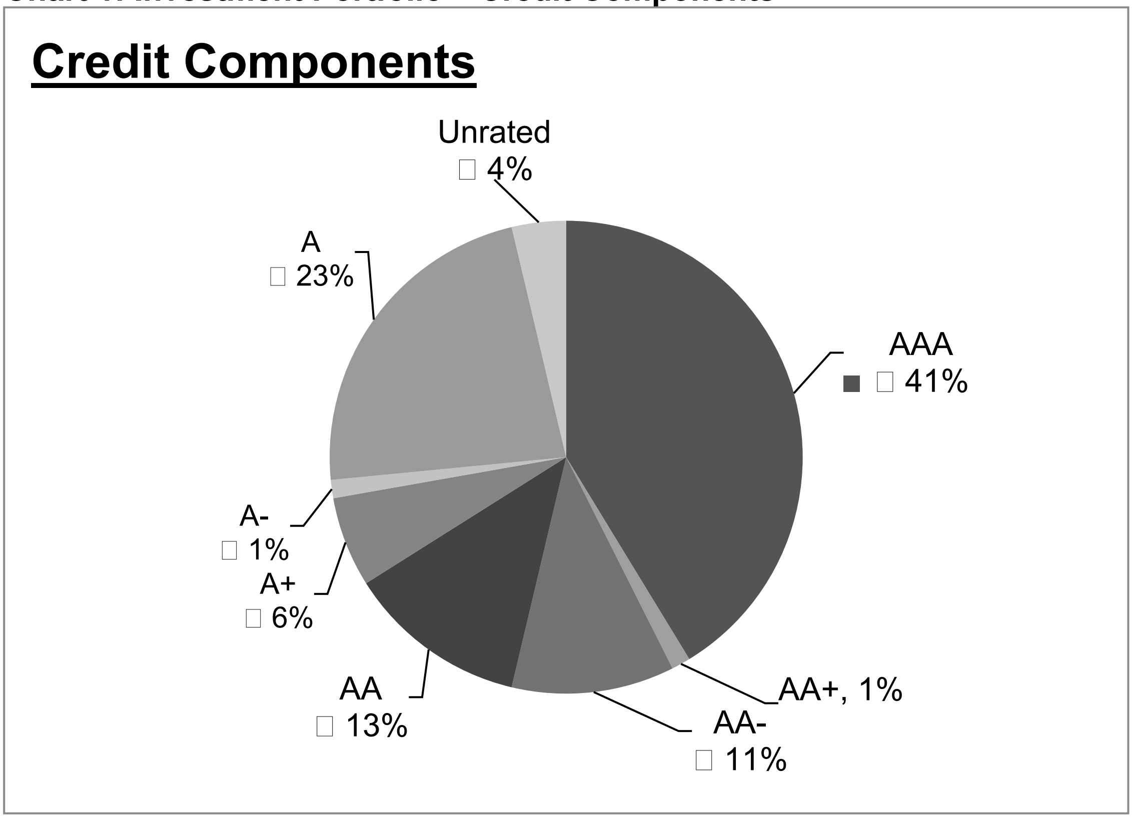
2.20 Analysis of counterparty creditworthiness is an ongoing process. As a result, controls on who is an acceptable counterparty, how much can be invested with an institution or the maximum allowable investment duration are constantly under review and altered during the course of the year. Investments are made both in accordance with our counterparty list, which is drawn up under advice from our treasury advisers and the stipulations of the Treasury Management Investment Strategy.

2.21 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 approved criteria and following consultation with the Treasury Management Advisor.

2.22 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.

2.23 The following chart shows the credit composition of the investment portfolio as at 30 September 2015:

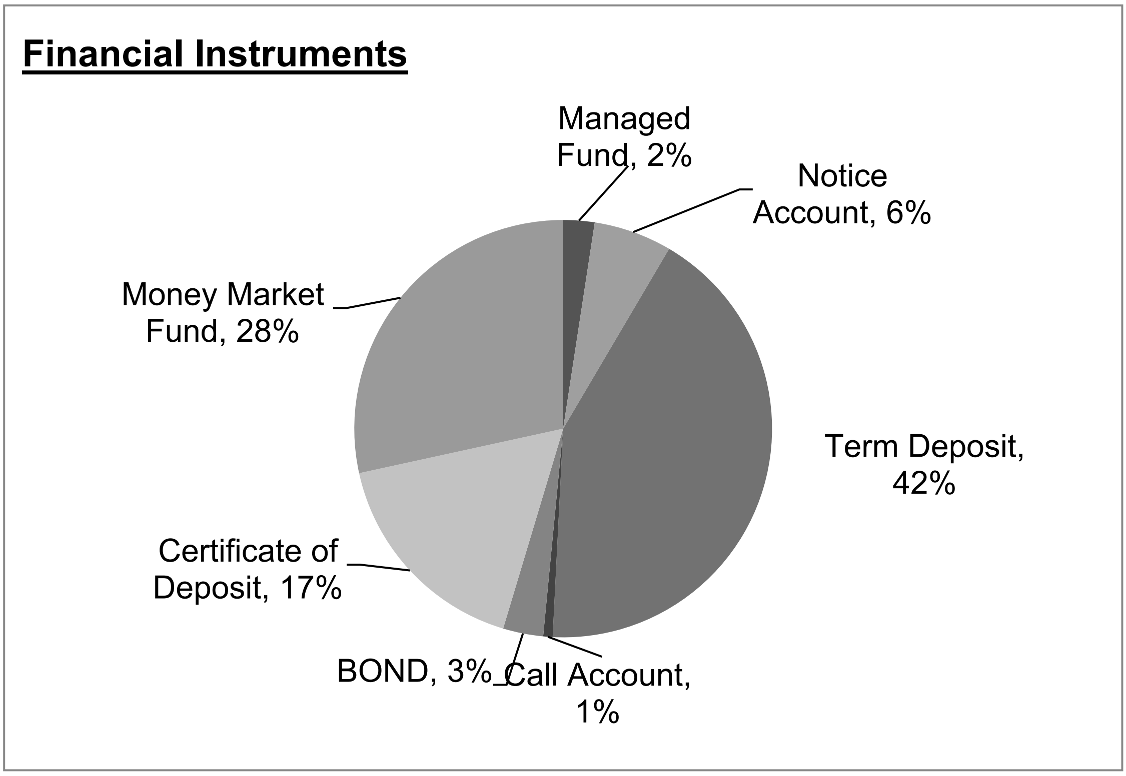
Chart 1: Investment Portfolio – Credit Components



Note: *'Unrated' institutions are Building Societies that despite the absence of a formal rating, are deemed credit worthy due to analysis of their performance over a variety of credit metrics. These institutions are subject to a lower counterparty limit than those with formal credit ratings.*

2.24 For diversification purposes the Treasury Management Team invest in a variety of counterparties and financial instruments to help mitigate counterparty and liquidity risks. A summary of the instruments invested in follows:

Chart 2: Investment Portfolio – Financial Instruments



2.25 The Treasury Management Team continue to monitor developments in the financial environment 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.

2.26 The budget for investment income is £860,000 however achievable income will be in the region of £360,000. This reduction in investment income is attributable to the prevailing low interest rate environment but more specifically due to the strategy of internal borrowing. This forgoes investment interest in the aim of reducing external borrowing costs, as explained previously. and has contributed towards the significant saving on borrowing costs of £3 million.

BORROWING AND OTHER LONG TERM LIABILITIES

2.27 The Council undertakes borrowing to fund capital expenditure. As explained in paragraph 2.12, the use of internal resources in lieu of borrowing, in the main, continues to be the most cost effective means of funding capital expenditure. As short-term investment interest rates have remained, and are likely to remain at least over the immediate future, lower than long-term borrowing rates, the Authority determined it was more cost effective in the short-term to use internal resources instead.

2.28 However, it is acknowledged that this position is not sustainable over the medium term and as part of the Capital programme the Council expects to borrow from external sources. As reserves are called upon the resources temporarily available to use in lieu of external borrowing diminish, meaning the Council will reach a point when it is no longer possible to delay borrowing any further. To reiterate internal borrowing does not remove the need to externally borrow, it merely delays incurring the debt and consequently the financing costs.

2.29 Borrowing options and the timing of such borrowing will continue to be assessed in conjunction with the Council's treasury advisor.

2.30 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.

2.31 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.

2.32 The Council has not entered into any new lease agreements during 2015/16.

2.33 The Council did take out any temporary loans for cashflow purposes during April to September 2015.

2.34 The table shows Council debt at 30 September 2015.

Table 4: Council Debt at 30 September 2015

Debt	**Balance 31 Mar 15 (£m)**	**Maturities (£m)**	**Additions (£m)**	**Balance 30 Sep 15 (£m)**
Borrowings				
PWLB	(46)	3	0	(43)
Market Loans	(158)	0	0	(158)
Other Long Term Liabilities	(51)	1	0	(50)
TOTAL	**(255)**	**4**	**0**	**(251)**

MINIMUM REVENUE PROVISION (MRP)

2.35 Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Department for Communities and Local Government's Guidance (DCLG) on Minimum Revenue Provision most recently issued in 2012.

2.36 The broad aim of the DCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant. DCLG prescribe various options to calculate this repayment provision.

2.37 One of the options given regarding the calculation of MRP to be charged in a year is 'Option 3' which bases the charge on the asset life of the asset funded from unsupported borrowing. It was recommended in the 2014/15 Treasury Management Outturn report that Treasury Management Strategy be amended to enable a more flexible approach to the calculation of 'Option 3'. This would enable MRP to be calculated on the basis of true asset lives or as an alternative the "Annuity Method". This produces a profile of principal repayments which starts low and increases each year reflecting the time value of money i.e. £1 in year 1 will have more purchasing power than to £1 in year 10. Whichever method is adopted the overall MRP over the life of the loan will be the same; only the profile of repayment is different.

2.38 The method used to calculate the Council's MRP charge, under DCLG Option 3, is currently under review, which may result in a lower payment profile of the debt. The total amount repayable remains the same but it is spread over a longer repayment term.

MONITORING OF THE PRUDENTIAL CODE INDICATORS

2.39 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.

<u>Net Debt and Capital Financing Requirement (CFR) Indicator</u>

2.40 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 (2014/15 actual)	338
Increase in CFR in 2015/16 (estimate)	8
Decrease in CFR in 2016/17 (estimate)	-14
Decrease in CFR in 2017/18 (estimate)	-18
Accumulative CFR	**314**

2.41 Net Debt does not exceed the CFR and it is not expected to in the future. This is a key indicator of prudence.

<u>Authorised Limit and Operational Boundary Indicators</u>

2.42 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.

2.43 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 15 (£m)	Jun 15 (£m)	Sep 15 (£m)
AUTHORISED LIMIT	**442**	**419**	**419**
OPERATIONAL BOUNDARY	**427**	**404**	**404**
Council Borrowings	204	203	201
Other Long Term Liabilites	51	51	50
TOTAL	**255**	**254**	**251**

2.44 The table shows that neither the Authorised Limit nor the Operational Boundary was breached between March 2015 and September 2015. This is a key indicator of affordability.

<u>Interest Rate Exposure Indicator</u>

2.45 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	(201)	0	**(201)**
Proportion of Borrowings	100%	0%	100%
Upper Limt	100%	0%	
Investments	0	83	**83**
Proportion of Investments	0%	100%	100%
Upper Limit	100%	100%	
Net Borrowing	**(201)**	**83**	**(118)**
Proportion of Total Net Borrowing	170%	-70%	100%

2.46 The table shows that borrowing is at fixed rates of interest and investments are at 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.

2.47 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

2.48 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 15 (£m)	As at 30 Sep 15 (%)	2015/16 Lower Limit (%)	2015/16 Upper Limit (%)
Less than 1 year	11	5	0	80
Over 1 year under 2 years	5	2	0	50
Over 2 years under 5 years	17	8	0	50
Over 5 years under 10 years	24	12	0	50
Over 10 years	144	72	0	100
Total Borrowing	**201**	**100**		

Total Principal Sums Invested for Periods Longer than 364 Days

2.49 This indicator allows the Council to manage the risk inherent in investments longer than 364 days. The limit for 2015/16 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 No consultation has been undertaken 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 2.26 refers to the reduction in investment income of £0.5 million Paragraphs 2.27 and 2.28 refer to the current approach of internal borrowing rather than taking on external debt, which results in an overall saving of £3 million. The net underspend in 2015/16 is estimated to be £2.5 million.

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/S

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/S FOR RECOMMENDATION/S

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

Council Meeting	Date
Treasury Management Strategy Statement 2014-17	25 February 2014
Treasury Management Annual Report 2013-14	7 July 2014
Treasury Management Performance Monitoring	6 November 2014
Treasury Management Strategy Statement 2015-18	24 February 2015
Treasury Management Annual Report 2014-15	13 July 2015