 **CLLR JANETTE WILLIAMSON**	**<u>CABINET</u>** **26 NOVEMBER 2018** **<u>TREASURY MANAGEMENT</u>** **<u>MID-YEAR REPORT 2018/19</u>**

Councillor Janette Williamson (Cabinet Member for Finance and Income Generation) said:

"We continue to face huge financial pressures, as increasing demand, rising costs and ongoing austerity policies combine to place unprecedented strain on our budget, and services. The extent of ongoing government cuts mean that we are unable to carry on doing everything the way we have previously and we need to look to new and innovative ways to provide services to protect our most vulnerable.

"This is why an innovative, commercial, entrepreneurial but responsible approach to Treasury Management is so important. This report to Cabinet demonstrates that our efficient approach in this area has delivered savings to Wirral residents of almost £5 million – money which is now available to invest in the services our residents rely on.

"We will continue to capitalise on these opportunities and do all we can to make sure our money goes further to deliver the outcomes our residents want."

REPORT SUMMARY

The Authority's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires the production of annual Prudential Indicators and a Treasury Management Strategy Statement on likely financing and investment activity. The Code also recommends that Members are informed of treasury management activities at least twice a year.

This report fulfils the Authority’s legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance.

Proactive Treasury Management activity has resulted in:-

- Estimated one-off savings in year of a minimum £1.1 million from reduced 2018/19 interest payments and management of the Authority’s Capital Financing. The ongoing savings are being used to support the Council’s budget for 2019/20.

- Due to the implementation of the Council’s revised Minimum Revenue Provision (MRP) policy, approved by Council in 2017/18, the charge the Authority will pay in 2018/19 reduced by £3.8 million compared to the charge scheduled under the original MRP policy. This reduction was accounted for when setting the 2018/19 budget.

This matter affects all Wards within the Borough.

The decisions in this report are key decisions.

RECOMMENDATIONS

1 That the Treasury Management Mid-Year Report for 2018/19 be agreed.

2 That the revised Authorised Signatory List relating to Treasury Management activity be approved

SUPPORTING INFORMATION

1.0 REASON/S FOR RECOMMENDATION/S

1.1 Wirral has adopted the CIPFA Code of Practice on Treasury Management ("the Code"), which includes regular update reports to Members of treasury activity. This report is the mid-year review for 2018/19.

1.2 Under the Council's financial regulations any surplus resources are returned to balances and so used to support the delivery of other Council services.

2.0 OTHER OPTIONS CONSIDERED

2.1 No other options have been considered.

3.0 BACKGROUND INFORMATION

3.1 Treasury management is defined by CIPFA 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."

3.2 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. The Authority is able to borrow and/or invest substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy. During the year Cabinet receives a mid-year report on treasury management activities and at the end of each financial year an Annual Report.

ECONOMIC BACKGROUND

Growth & Inflation

3.3 UK Consumer Price Inflation (CPI) for August rose to 2.7% year/year, above the consensus forecast, but then fell back to 2.4% in September as the effects of a subdued economy compete with the depreciation of the pound. Cheaper food prices and a reduction in Transport costs being the main drivers in lowering inflation to its reduced level.

3.4 The most recent labour market data for August 2018 showed the unemployment rate at 4%, its lowest since 1975. The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 3.1% providing some evidence that a shortage of workers is providing support to wages. However once this figure is adjusted for the effects of inflation, 'real wages' grew by only 0.7%, a marginal increase unlikely to have had much effect on households spending power.

3.5 The rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the weakness in Q1, which was largely due to weather-related factors. However, the detail showed much of Q2 GDP growth was attributed to an increase in inventories. Year on Year GDP growth at 1.2% also remains below the expected trend as the uncertainty surrounding the conditions of the UK's exit from the European Union still remain unresolved.

3.6 Further afield the trade difficulties between the US and China, due to tariffs announced by the US, has the potential to damage not just to China but also other Asian economies in the supply chain. These tariff complications, combined domestic economic uncertainty, risks contributing to a slowdown in economic activity and growth in 2019.

Monetary Policy

3.7 At the Bank of England there was a unanimous decision for a rate rise of 0.25% in August taking the Base Rate to 0.75%, its highest level since 2009.

3.8 In the face of Brexit-related uncertainty, our advisors Arlingclose expect the Bank of England to take only a very measured approach to any monetary policy tightening; any increase will be gradual and limited as the interest rate backdrop will have to provide substantial support to the UK economy through the Brexit transition.

Market Reaction

3.9 The UK government issues bonds to raise funding, these bonds are known as 'Gilts'. The pricing of Gilts can fluctuate and depends on market opinion on areas such as interest rate expectation and investors perception of the condition of the economy.

3.10 Over the period the yield on the benchmark 5-year Gilt only rose marginally from 1.13% to 1.16%. There was a larger increase in 10-year gilt yields from 1.37% to 1.57% and in the 20-year gilt yield from 1.74% to 1.89%. The interest rates at which the government issues bonds act as a base in rate setting for loan and investment opportunities that the council may be presented with, for example the Public Works Loan Board (PWLB) would charge the Council a rate of interest of gilts & 0.80% for any borrowing we arrange from them. It is for this reason that the gilt market is under constant review, in case any favourable borrowing conditions arise for the Council.

THE COUNCIL TREASURY POSITION

3.11 The table shows how the position has changed since 31 March 2018.

Table 1: Summary of Treasury Position

	Balance 31 Mar 18 £m	Maturities £m	Additions £m	Balance 30 Sep 18 £m
Investments	50	(271)	267	46
Borrowings	(267)	317	(292)	(242)
Other Long-Term Liabilites	(45)	1	0	(44)
Net Debt	(262)	47	(25)	(240)

Throughout the first six months of the year the level of net debt has reduced due to the repayment of debt as it fell due.

3.12 The decrease in Net Debt is the result of repaying loans as they fall due and managing Capital financing requirements via 'internal borrowing' to minimise interest costs payable by the Authority. Internal borrowing is discussed further in this report.

INVESTMENT ACTIVITY

3.13 Both the CIPFA and the MHCLG's Investment Guidance require the Authority to invest prudently and have regard to the security and liquidity of investments before seeking the optimum yield. 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.

3.14 **Table 2: Investment Profile**

Investments with:	31 Mar 18 £m	30 Jun 18 £m	30 Sep 18 £m
UK Banks	6	3	5
Non-UK Banks	6	8	9
UK Building Societies	3	1	1
Money Market Funds	22	20	23
Community Interest Companies	2	2	1
Pooled Funds	6	7	7
Other Local Authorities	5	0	0
TOTAL	**50**	**41**	**46**

At 30 September 2018 the Council held investments of £46 million. Table 2 above shows the level of investment decreasing to £41 million at 30 June 2018 (from £50 million as 31 March 2018) due to the loans being repaid. The level then increased to £46 million as income was received.

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

Table 3: Investment Sources

Usable Reserves	31 Mar 18 £m	30 Jun 18 £m	30 Sep 18 £m
General Fund	25	22	17
Earmarked Reserves	55	52	54
Capital Receipts Reserve	2	0	2
Capital Grants Unapplied	14	14	14
	96	**88**	**87**
Internal Borrowing in lieu of External Borrowing	(46)	(47)	(41)
Reserves Invested	**50**	**41**	**46**

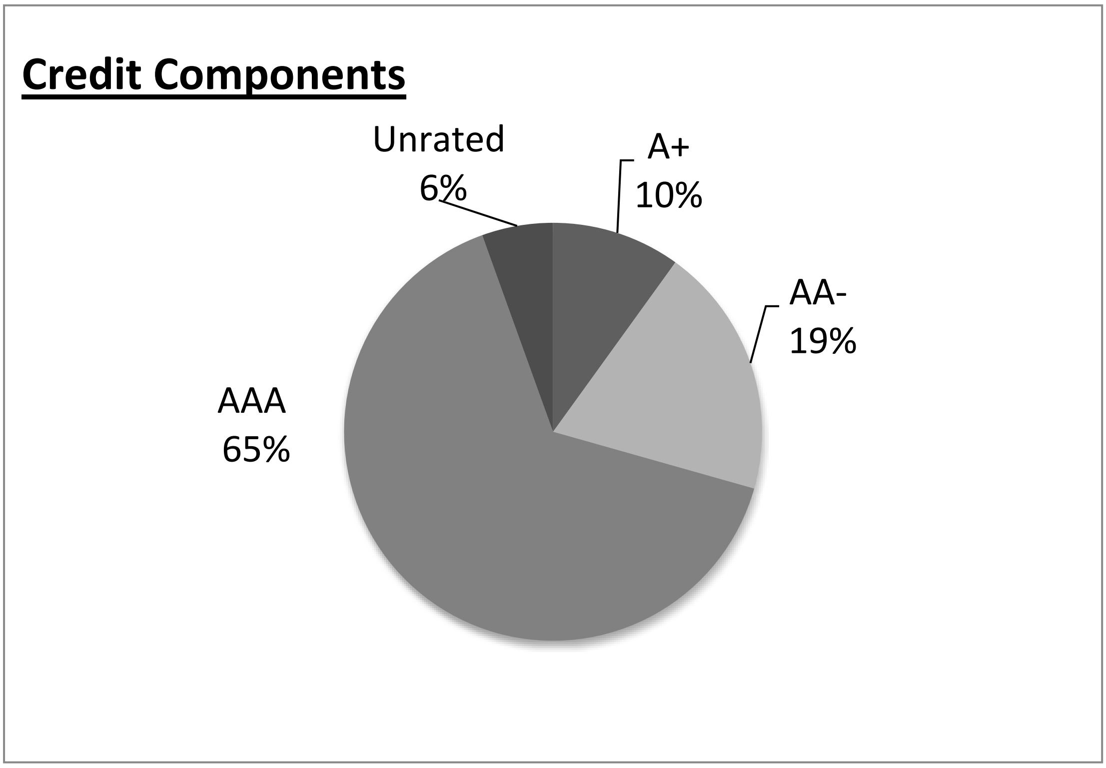
3.16 With short-term investment interest rates having remained at historic low levels, it is more cost effective in the short-term to use internal resources, rather than undertake longer term external borrowing. By doing so, the Authority is able to reduce net borrowing costs despite foregone investment 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 eventually rise.

3.17 Security of capital remains the main investment objective. This is maintained by following the counterparty policy set out in the Treasury Management Strategy Statement for 2018/19 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.

3.18 Counterparty credit quality is assessed and monitored with reference to credit ratings (the Authority’s minimum long-term counterparty rating for 2017/18 is A- across rating agencies Fitch, S&P and Moody’s); Credit Default Swap (CDS) prices, financial statements, information on potential government support and reports in the quality financial press.

3.19 The following chart shows the credit composition of the Council’s investment portfolio as at 30th September 2018:

Chart 1: Investment Portfolio – Credit Components



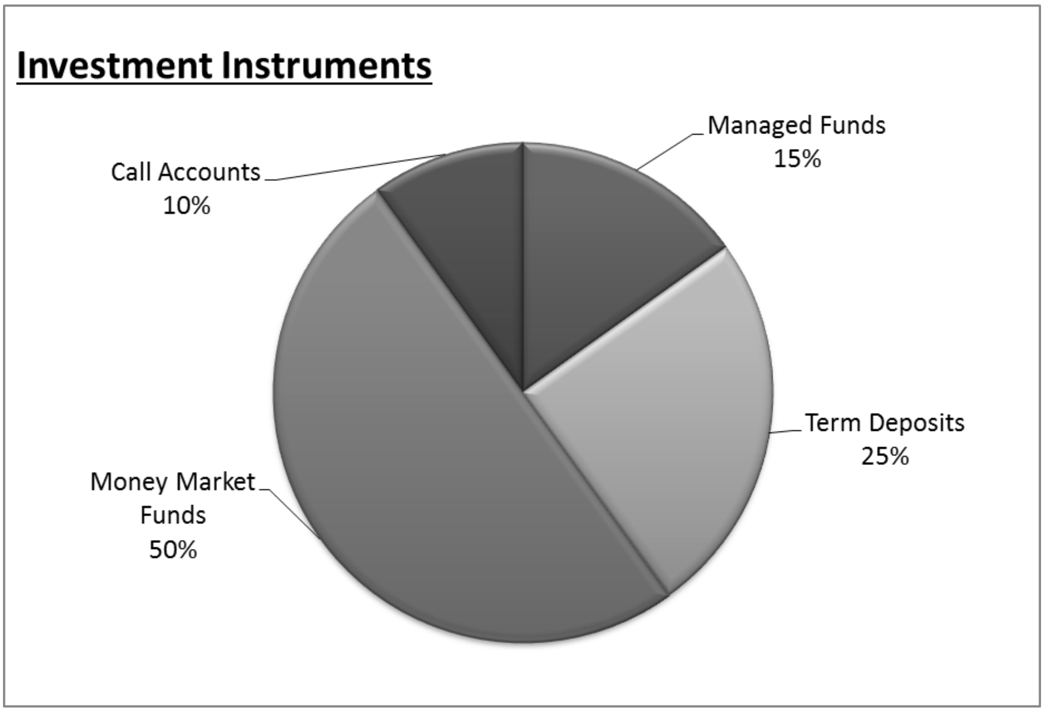
Note: *'Unrated' institutions are Building Societies that despite the absence of a formal rating, are deemed credit worthy due to analysis of their performance over a variety of credit metrics. These institutions are subject to a lower counterparty limit than those with formal credit ratings*

3.20 Investments with banks and building societies were primarily call accounts and fixed-rate term deposits. The maximum duration of any new investment was constantly reviewed in line with the prevailing credit outlook during the year as well as market conditions.

3.21 In keeping with the MHCLG Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and the use of call accounts.

3.22 For diversification purposes the Council 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



3.23 The restructure of the big four UK banks - Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc – to take account of new ring-fencing arrangements is complete. The transfer of their business lines into retail (ring-fenced) and investment banking (non-ring-fenced) is progressing and will need to be completed by the end of 2018.

3.24 There were a few credit rating changes during the period. Moody's downgraded Barclays Bank plc's long-term rating to A2 from A1. Upgrades to long-term ratings included those for Royal Bank of Scotland plc and NatWest Bank to A2 from A3 by Moody's and to A- from BBB+ by both Fitch and Standard & Poor's (S&P). Lloyds Bank plc and Bank of Scotland plc were upgraded to A+ from A by S&P and to Aa3 from A1 by Moody's.

3.25 Our treasury advisor Arlingclose will henceforth provide ratings which are specific to wholesale deposits including certificates of deposit, rather than provide general issuer credit ratings. Non-preferred senior unsecured debt and senior bonds are at higher risk of bail-in than deposit products, either through contractual terms, national law, or resolution authorities' flexibility during bail-in. Arlingclose's creditworthiness advice will continue to include unsecured bank deposits and CDs but not senior unsecured bonds issued by commercial banks.

3.26 The budget for investment income is £560,000 but achievable income will be in the region of £300,000. The shortfall of income will be offset by reduced costs in terms of interest payable on borrowings. This reduction in investment income is attributable to two key factors:

a) Low interest rates offered for investments and

b) The continuing policy of relying on internal borrowing to temporarily fund and thereby delay borrowing for the capital programme, which reduces balances available to put into investments but generates larger savings in interest incurred.

3.27 The UK Bank Rate was increased from 0.50% to 0.75% in August 2018. The average income return on investments at the end of September was 0.81%, with the portfolio invested in secure counterparties with a good level of liquidity. However this does not reflect the savings of an estimated 2.5% on delayed borrowing for amounts internally borrowed.

3.28 In terms of enhancing the interest return we are in the process of opening further ‘External Pooled Funds’ with a view to increasing investment duration for a section of the portfolio. Investment in this type of fund is subject to more volatility compared to traditional terms deposits. This longer duration is to smooth out any potential drops in the market of that particular asset and should result in a commensurate interest rate increase, with the funds concerned generating a return of approximately 4%. Pooling funds in such a way and the resultant diverse pool of assets is a less risky way of gaining access to different investment sectors, such as bond markets, equities and property without taking on the additional risks if the Council were the sole holders of such assets.

3.29 The return on investments, along with our policy of internally borrowing, reflects prevailing market conditions and the objective of optimising returns commensurate with the overriding principles of security and liquidity.

BORROWING AND DEBT MANAGEMENT

3.30 The Council undertakes borrowing to fund 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.

3.31 The use of internal borrowing will not be sustainable over the medium term. Elements of the Capital programme the Council will ultimately require funding via borrowing 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. Internal borrowing does not remove the need to externally borrow, it merely delays incurring the debt and consequently the financing costs.

3.32 The decision to continue to use internal resources in lieu of borrowing for capital purposes, thereby reducing borrowing costs will generate savings in 2018/19. The level of savings will be dependent upon the borrowing requirement of Capital schemes delivered within the financial year. In future years, as cash flows diminish through use of reserve and/or interest rates rise, external borrowing will have to increase. The Treasury Management team will continue to proactively manage the Authority's cash flow to delay external borrowing for as long as is possible and prudent to generate savings.

3.33 With external longer term borrowing reducing, the annual cost of financing this debt has fallen year on year, generating savings, as illustrated below. These cost reductions, the deferral of further borrowing costs through internal borrowing and policy amendments have provided substantial one-off savings to the Council:

Table 4: Debt Costs and Savings Achieved

Year	Capital Financing Loans £m	Annual Interest Costs £m	Contribution to General Fund £m
2015/16	199.4	9.2	4.0
2016/17	190.9	9.1	9.4
2017/18	181.8	9.0	6.8

3.34 Effective utilisation of the short term Local Authority loan market has further delayed the need to enter into more costly longer term loans. At 30th September the Council had £67 million borrowed via such loans running at an average rate of 0.68%. These temporary, short dated loans, from other local authorities remain affordable and attractive for periods of low cash flow, with rates available between 0.7% and 0.85% for one and three month periods.

3.35 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.

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

3.37 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.

3.38 The Council has not entered into any new lease agreements during 2018/19.

3.39 The table shows Council debt at 30 September 2018:

Table 5: Council Debt at 30 September 2018

Debt	Balance 31 Mar 18 £m	Maturities £m	Additions £m	Balance 30 Sep 18 £m
Borrowings				
PWLB	(23)	6	0	(17)
Market Loans	(157)	0	0	(157)
Interest Free Loans	(2)	1	0	(1)
Total Capital Finance Loans	**(182)**	**7**	**0**	**(175)**
Other Long Term Liabilities	(45)	1	0	(44)
Temporary Cashflow Loans	(85)	310	(292)	(67)
TOTAL	**(312)**	**318**	**(292)**	**(286)**

The reduction in total debt is due to a combination of repaying temporary cashflow loans that were required over the latter part of 2017/18 and the repayment of longer term PWLB loans, through the use of internal resources rather than arranging new loans to replace the maturing debt.

REGULATORY UPDATES

CIPFA Consultation on Prudential and Treasury Management Codes

3.40 Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice. In England MHCLG published its revised Investment Guidance which came into effect from April 2018.

3.41 The updated Prudential Code include the production of a new high-level Capital Strategy report to full council which will cover the basics of the capital programme and treasury management. There is a requirement to demonstrate to Council that capital decisions are taken in line with service objectives. Property acquisition and investment is an area which CIPFA has identified as requiring tighter guidelines and increased governance requirements to ensure secure stewardship of public funds, value for money, prudence, sustainability and affordability. These principles should not be neglected for pure commercialisation.

3.42 Amongst the changes to the Treasury Management Code is the treatment of non-treasury investments such as commercial investments in properties to be included in the definition of “investments” as well as loans made or shares brought for service purposes. Such investments will be covered by an Investment Strategy, separate to the Treasury Strategy.

3.43 The new suite of reports will be produced later in 2018/19, ahead of implementation in 2019/20.

COMPLIANCE WITH PRUDENTIAL INDICATORS

3.44 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 indicators as sown in Appendix 1 demonstrate that the treasury management decisions are in line with the Strategy, being prudent and affordable

AUTHORISED SIGNATORY LIST

3.45 A new Assistant Director for Finance & Investments will be joining the Finance Department later this year. The role will include being listed as an authorised signatory for the Authority. It is therefore recommended that the Authorised Signatory List be amended to reflect this change. (Appendix 3)

4.0 FINANCIAL IMPLICATIONS

4.1 Capital debt finance has reduced to £175 million (Table 5), a decrease of £89 million since 2012, despite additional annual Capital commitments. This has also contributed to the generation of substantial savings.

4.2 Investment income has also helped to generate resources for service delivery.

4.3 The Treasury Management team will endeavour to further reduce interest costs wherever possible during the second half of the year.

5.0 LEGAL IMPLICATIONS

5.1 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.

6.0 RESOURCE IMPLICATIONS: ICT, STAFFING AND ASSETS

6.1 There are none arising directly from this report.

7.0 RELEVANT RISKS

7.1 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.

8.0 ENGAGEMENT/CONSULTATION

8.1 There has been no specific consultation with regards to this report.

9.0 EQUALITY IMPLICATIONS

9.1 There are none arising directly from this report

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APPENDICES

Appendix 1 Prudential Indicators 2018/19
Appendix 2 Revised Authorised Signatory List

SUBJECT HISTORY

Meeting	Date
Treasury Management Strategy Statement 2018-19	**19th February 2018**
Treasury Management Annual Report 2017-18	**16h July 2018**

APPENDIX 1

PRUDENTIAL INDICATORS 2018/19

(a) Net Debt and Capital Financing Requirement (CFR) Indicator

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.

	£m
CFR in previous year (2017/18 actual)	339
Increase in CFR in 2018/19 (estimate)	10
Increase in CFR in 2019/20 (estimate)	20
Decrease in CFR in 2020/21 (estimate)	-7
Accumulative CFR	**362**

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

(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 the first half of 2018/19.

	Operational Boundary (Approved) 2018/19 £m	Authorised Limit (Approved) 2018/19 £m	**Actual External Debt 30/09/2018 £m**
Borrowing	404	414	242
Other Long-term Liabilities	58	63	44
Total	**462**	**477**	**281**

(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	£242m	£0m	**£242m**
Proportion of Borrowings	100%	0%	**100%**
Upper Limit	100%	100%	
Investments	£11m	£35m	**£46m**
Proportion of Investments	24%	76%	**100%**
Upper Limit	100%	100%	
Net Borrowing	**£231m**	**£-35m**	**£196m**
Proportion of Total Net Borrowing	118%	-18%	**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 30 Sep 18	% of Fixed Rate Borrowing as at 30 Sep 18
	%	%	£m	%
Under 12 Months	80.0	0.0	69.7	28.8
12 Months and within 24 Months	50.0	0.0	4.2	1.7
24 Months and within 5 years	50.0	0.0	18.3	7.6
5 years and within 10 years	50.0	0.0	18.7	7.7
Over 10 years	100.0	0.0	131.0	54.1
Total			**241.9**	**100.0**

(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 2018/19 the limit was set at £75 million.

As at 30 September 2018 the Council had no investments longer than 364 days.

APPENDIX 2

AUTHORISED SIGNATORIES

The following officers are authorised to make payments, either via the Council's online banking system or by signing cheques, and issue other instructions relating to Treasury Management transactions on behalf of Wirral Borough Council:

Director for Finance & Investments:	Shaer Halewood
Assistant Director for Finance & Investments:	Daniel Kirwan (From 3rd December 2018)
Senior Finance Manager:	Peter J. Molyneux
Senior Finance Manager:	Jenny Spick
Senior Finance Manager:	Peter McCann