WIRRAL

CABINET

25 NOVEMBER 2019

TREASURY MANAGEMENT MID-YEAR REPORT 2019/20

Councillor Janette Williamson, Cabinet Member for Finance and Resources, said:

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

In addition, the report highlights how we have a projected balanced outturn despite the £2 million reduction in budget that has been applied to Treasury Management in 2019/20. This is the result of reduced 2019/20 interest payments and close management of the authority's capital financing."

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:-

- A projected balanced outturn despite the £2 million reduction in budget that has been applied to Treasury Management in 2019/20. This is due to reduced 2019/20 interest payments and management of the Authority's Capital Financing.

This matter affects all Wards within the Borough.

The decisions in this report are key decisions.

RECOMMENDATIONS

That the Treasury Management Mid-Year Report for 2019/20 be agreed.

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 2019/20.

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 the 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 (CPIH) fell to 1.7% year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target.

3.4 The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

3.5 The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% as Brexit uncertainties impacted on business planning and decision-making.

3.6 Further afield the trade difficulties between the US and China continue, with both sides imposing further tariffs on each other's goods. The potential remains to damage not just to China but also other Asian economies in the supply chain. These tariff complications combined with economic uncertainty both domestically and within the Eurozone, risks contributing to a pronounced global slowdown in economic activity and growth.

Monetary Policy

3.7 The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31st October.

Market Reaction

3.8 After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

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 Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 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 & a fixed margin 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 2019.

Table 1: Summary of Treasury Position

	Balance 31 Mar 19 £m	Maturities £m	Additions £m	Balance 30 Sep 19 £m
Investments	42	(250)	240	32
Borrowings	(263)	298	(287)	(252)
Other Long-Term Liabilites	(42)	1	0	(41)
Net Debt	(263)	49	(47)	(261)

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.

TREASURY 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 At 30 September 2019 the Council held investments of £32 million. Table 2 below shows the level of investment decreasing to £35 million at 30 June 2019 (from £42 million as 31 March 2019) due to the loans being repaid.

3.15 **Table 2: Investment Profile**

Investments with:	**31 Mar 19 £m**	**30 Jun 19 £m**	**30 Sep 19 £m**
UK Banks	8	4	3
Non-UK Banks	4	5	5
Money Market Funds	21	17	16
Community Interest Companies	2	2	1
Other Pooled Funds:			
- Property Funds	1	1	1
- Strategic Bond Funds	1	1	1
- Cash Plus Funds	5	5	5
TOTAL	**42**	**35**	**32**

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

Table 3: Investment Sources

Usable Reserves	31 Mar 19 £m	30 Jun 19 £m	30 Sep 19 £m
General Fund	11	11	11
Earmarked Reserves	60	60	60
Capital Receipts Reserve	1	1	2
Capital Grants Unapplied	16	27	30
	88	**99**	**103**
Internal Borrowing in lieu of External Borrowing	(46)	(64)	(71)
Reserves Invested	**42**	**35**	**32**

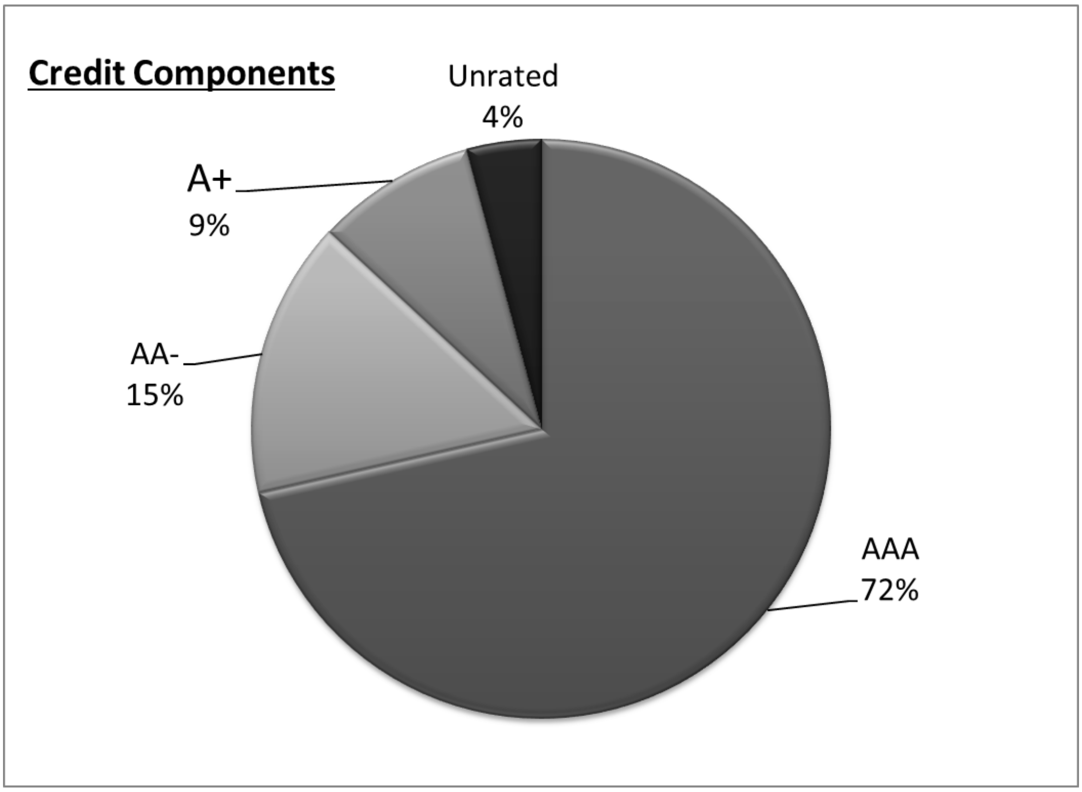
3.17 With short-term investment interest rates having remained at historic low levels, it is more cost effective, in the short-term, to use internal resources rather than undertake longer term external borrowing. By doing so, the Authority is able to reduce net borrowing costs despite foregone investment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

3.18 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 2019/20 which defined high credit quality organisations as those having a long-term credit rating of A- or higher.

3.19 Counterparty credit quality is assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for 2019/20 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.

3.20 The following chart shows the credit composition of the Council's investment portfolio as at 30th September 2019:

Chart 1: Investment Portfolio – Credit Components



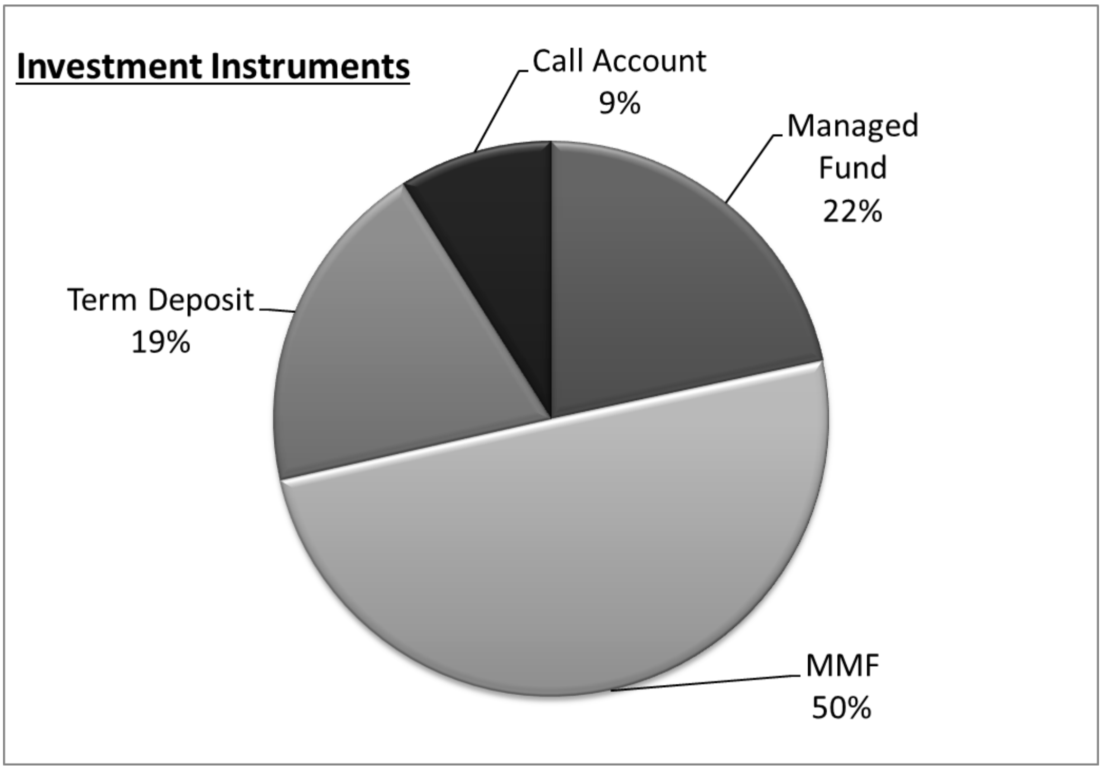
Note: *'Unrated' institutions are organisations that despite the absence of a formal rating, are deemed credit worthy due to analysis of their performance over a variety of credit metrics. These institutions are subject to a lower counterparty limit than those with formal credit ratings*

3.21 Investments with banks 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.

3.22 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.

3.23 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



3.24 £7m of the Authority's investments are held in externally managed strategic pooled bond, property and cash plus funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an average total return of 4.95%, comprising of income return which is used to support services in year, and capital growth.

3.25 As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates. In light of their performance over the medium to long-term and the Authority's latest cash flow forecasts, investment in these funds has been maintained.

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 remained at 0.75% throughout the first half of the year. The average income return on investments at the end of September was 0.96%, 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 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

3.29 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.

3.30 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.

3.31 The decision to continue to use internal resources in lieu of borrowing for capital purposes, thereby reducing borrowing costs will generate savings in 2019/20. 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.

3.32 With external longer-term borrowing reducing, the Council has used the Local Authority loan market to delay entering into more costly debt, generating savings as illustrated below. The deferral of further borrowing costs through internal borrowing and policy amendments have provided substantial one-off savings to the Council:

Table 4: Debt Levels and Savings Achieved

Year	Capital Financing Loans £m	Contribution to General Fund £m
2015/16	199.4	4.0
2016/17	190.9	9.4
2017/18	181.8	6.8
2018/19	173.9	2.1

3.33 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 £79.5 million borrowed via such loans running at an average rate of 0.66%. These temporary, short dated loans, from other local authorities remain affordable and attractive for periods of low cash flow, with rates available between 0.75% and 0.90% for one and three month periods.

3.34 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.

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

3.36 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.

3.37 The Council has not entered into any new lease agreements during 2019/20.

3.38 The table shows Council debt at 30 September 2019:

Table 5: Council Debt at 30 September 2019

Debt	Balance 31 Mar 19 £m	Maturities £m	Additions £m	Balance 30 Sep 19 £m
Borrowings				
PWLB	(21)	1	0	(20)
Market Loans (Fixed Rate)	(44)	0	0	(44)
Market Loans (LOBO)	(108)	0	0	(108)
Interest Free Loans	(1)	0	0	(1)
Total Capital Finance Loans	**(174)**	**1**	**0**	**(173)**
Other Long Term Liabilities	(42)	1	0	(41)
Temporary Cashflow Loans	(89)	297	(287)	(79)

The reduction in total debt is due to a combination of repaying temporary cashflow loans that were required over the latter part of 2018/19 and the repayment of longer term PWLB loans, through the use of internal resources rather than arranging new loans to replace the maturing debt.

3.39 LOBO loans: The Authority continues to hold £108m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. No banks have exercised their option during the first half of the year.

COMPLIANCE WITH TREASURY INDICATORS

3.40 The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in Appendix 1 below.

INTEREST RATE FORECAST

3.41 Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future and judge the risks to be weighted to the downside and that volatility will continue to offer longer-term borrowing opportunities

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Cas	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

4.0 FINANCIAL IMPLICATIONS

4.1 Capital debt finance has reduced to £174 million (Table 5), a decrease of £90 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 Performance 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

10.0 ENVIRONMENT AND CLIMATE IMPLICATIONS

10.1 The content and/or recommendations contained within this report are expected to have no impact on emissions of CO2.

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APPENDICES

Appendix 1 Treasury Indicators 2019/20

BACKGROUND PAPERS

CIPFA Code of Practice on Treasury Management

SUBJECT HISTORY

Meeting	Date
Treasury Management Strategy Statement 2019-20	**18th February 2019**
Treasury Management Annual Report 2018-19	**22nd July 2019**

APPENDIX 1

TREASURY MANAGEMENT INDICATORS 2019/2020

Background

Treasury management indicators are not in the 2017 edition of the CIPFA Treasury Management Code itself but in the separate Treasury Management Code guidance notes for local authorities, which was last published in 2011. The Authority measures and manages its exposures to treasury management risks using the following indicators.

Treasury Management Indicators

1. Security

The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	**Target**	**As at 30.09.19**
Portfolio average credit rating	A-	AA-

2. Liquidity

The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

Liquidity risk indicator	**Target**	**As at 30.09.19**
Total sum borrowed in past 3 months without prior notice	£15m	£139m

3. Maturity Structure of Borrowing

This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Maturity Structure of Borrowing	**Lower Limit 2019/20 %**	**Upper Limit 2019/20 %**
Under 12 Months	0	90
12 Months and within 24 months	0	50
24 Months and within 5 years	0	50
5 years and within 10 years	0	50
10 years and over	0	100

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment, including LOBO loans, many of which have repayment options every six months. The Authority complied with this indicator in the first half of the year.

4. Principal Sums Invested For Periods Longer Than a Year

The Council has placed an upper limit for principal sums invested for periods longer than a year. This limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

Price risk indicator	2019/20	As At 30.09.19
Limit on principal invested beyond year end	£30m	£0m