WIRRAL

CABINET

27 JULY 2020

TREASURY MANAGEMENT ANNUAL REPORT 2019/20

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

“We have an excellent track record of investing public money to deliver a good return and using the profits to support the services our residents rely on. I am pleased to bring this report to Cabinet which demonstrates this trend continuing.

“An organisation the size of Wirral Council has a highly complex cashflow, with money coming in and out on a daily basis as services are provided and paid for. Our job is to manage those resources well, and make sure we maximise the interest we earn and the returns we can generate from sensible, targeted investments.”

REPORT SUMMARY

The Authority’s treasury management activity is underpinned by CIPFA’s Code of Practice on Treasury Management (“the Code”), which requires the Authority to approve treasury management semi-annual and annual reports.

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 savings of £0.9 million. These savings were on top of the £2 million worth of Treasury Management savings already built into the 2019/20 budget. The additional savings resulted due to a combination of increased investment income and securing lower cost loans.

The level of Capital Financing debt, including the Merseyside Residuary Body debt managed by the Council on behalf of the constituent authorities, was £173 million at 31 March 2020. This is a reduction of £91 million since 1 April 2012 and reflects policies to minimise and delay borrowing costs which adversely impact upon the revenue budget.

The Council has complied with the Prudential and Treasury Management Indicators as set out in the agreed Treasury Management Strategy for 2019/20.

This matter affects all Wards within the Borough.

The decisions in this report are key decisions.

RECOMMENDATION/S

Cabinet is recommended to

1 Agree the 2019/20 Treasury Management Annual Report

2 Note the saving of an additional £0.9 million above the budgeted savings target from treasury and capital financing activities in 2019/20.

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 annual review for 2019/20.

1.2 Under the Council's Financial Regulations any surplus resources, including any additional income, are returned to General Fund Balances and so used to support the delivery of other Council services.

2.0 OTHER OPTIONS CONSIDERED

2.1 There is a legal requirement to produce an Annual Report on Treasury Management activities so 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. During the year Cabinet receives a mid-year report on treasury management activities and at the end of each financial year and an Annual Report

ECONOMIC BACKGROUND

3.3 **Growth & Inflation**: The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.7% year on year in February, below the Bank of England's target of 2%. Labour market data remained positive. The International Labour Organisation unemployment rate was 3.9% in the three months to January 2020 while the employment rate hit a record high of 76.5%. The average annual growth rate for pay excluding bonuses was 3.1% in January 2020 and the same when bonuses were included, providing some evidence that a shortage of labour had been supporting wages.

3.4 GDP growth in Q4 2019 was reported as flat by the Office for National Statistics and service sector growth slowed and production and construction activity contracted on the back of what at the time were concerns over the impact of global trade tensions on economic activity. The annual rate of GDP growth remained below-trend at 1.1%.

3.5 The outbreak of COVID-19 swiftly changed everything. The virus, which had first appeared in China in December 2019, started spreading across the globe causing plummeting sentiment and falls in financial markets not seen since the Global

Financial Crisis as part of a flight to quality into sovereign debt and other perceived 'safe' assets.

3.6 In response to the spread of the virus and sharp increase in those infected, the government enforced lockdowns, central banks and governments around the world cut interest rates and introduced massive stimulus packages in an attempt to reduce some of the negative economic impact to domestic and global growth.

3.7 **Monetary Policy**: The Bank of England, which had held policy rates steady at 0.75% through most of 2019/20, moved in March to cut rates to 0.25% from 0.75% and then swiftly thereafter brought them down further to the record low of 0.1%. In conjunction with these cuts, the UK government introduced a number of measures to help businesses and households impacted by a series of ever-tightening social restrictions, culminating in pretty much the entire lockdown of the UK

3.8 **Market Reaction**: Financial markets sold off sharply as the impact from the coronavirus worsened. After starting positively in 2020, the FTSE 100 fell over 30% at its worst point with stock markets in other countries seeing similar huge falls. In March sterling touch its lowest level against the dollar since 1985. The measures implemented by central banks and governments helped restore some confidence and financial markets have rebounded in recent weeks but remain extremely volatile.

BORROWING AND DEBT MANAGEMENT

3.9 The Authority's underlying need to borrow as measured by the Capital Financing Requirement (CFR) at 31 March 2020 was £348.6 million.

Table 1 – Level of External Debt

	Balance at 01/04/19 £000	New Borrowing £000	Matured Debt £000	Balance at 31/03/20 £000
CFR	**345,788**			**348,556**
Outstanding Debt				
Short Term Capital Debt	5,233	6,191	(5,233)	6,191
Long Term Capital Debt	164,481	4,049	(6,191)	162,339
Total Capital Debt	**169,714**	**10,240**	**(11,424)**	**168,530**
Temporary Cashflow Loans	89,060	582,601	(531,060)	140,601
Other Long Term Liabilities	42,418	0	(2,860)	39,558
Total External Debt	**301,192**	**592,841**	**(545,344)**	**348,689**

3.10 The Authority pursued its strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low.

3.11 Affordability and the "cost of carry" remained important influences on the 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 have remained lower than long-term rates, it was more cost effective in the short-term to use internal resources instead.

3.12 The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose, the treasury management advisers, assist the Authority with this 'cost of carry' and breakeven analysis.

3.13 The chief objective when borrowing is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the long-term plans change, being a secondary objective.

3.14 Given the reductions in local government funding, the borrowing strategy continued to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

3.15 As a consequence of the decision to borrow internally, the Authority's level of external long-term borrowing has reduced significantly over recent years. Utilisation of the short-term borrowing market has aided the policy of internal borrowing, whilst enabling the Council to have enough liquidity at a lower cost compared to the longer-term loan market.

3.16 With external borrowing reducing, the annual cost of financing this debt has also fallen year on year, generating savings, as illustrated below. These cost reductions coupled with the deferral of further borrowing costs through internal borrowing provided substantial one-off savings.

Table 2 – Level of Capital Financing Loans

Year ending 31st March	Capital Financing Loans £m	Annual Interest Cost £m
2012	264.3	10.9
2013	247.2	10.5
2014	217.2	9.8
2015	204.2	9.4
2016	199.4	9.2
2017	190.9	9.1
2018	181.8	9.0
2019	173.9	8.9
2020	172.6	8.8

3.17 At 31 March 2020 the total external debt included £26.8 million for the Merseyside Residuary Body debt, which is repayable by other external organisations, which is administered by the Authority (£31.3 million at 31 March 2019).

3.18 The following table shows the capital financing loans repaid during the year.

Table 3 – Loan Maturities in 2019/20

Loans maturing in 2019/20	Principal £m	Fixed/ Variable	Rate %	Loan start date	Terms
PWLB	0.50	Fixed	3.04	February 2010	E I P
PWLB	0.50	Fixed	2.94	March 2010	E I P
PWLB	0.50	Fixed	1.89	October 2010	E I P
PWLB	0.50	Fixed	2.30	November 2011	E I P
PWLB	0.25	Fixed	2.16	February 2019	E I P
SALIX	0.70	Fixed	0.00	October 2015	E I P
Total Maturing Borrowing	**2.95**				

Note: Equal Instalments of Principal (EIP) loans are loans that are repaid in equal instalments spread over the duration of the loan. Maturity loans are repaid in full at the maturity date of the loan.

3.19 During 2019/20 the Council secured two further interest free loans from SALIX in respect of energy efficient lighting schemes. These loans totalled £1.74 million and mature in 2025/26.

3.20 The average rate of interest paid on long term borrowings as at 31 March 2019 was 5.85% (5.84% for 2018/19) and the average life is 28 years, (29 years in 2018/19). It should be noted that the average rate calculation excludes the benefit received from the policy of using internal borrowing to delay borrowing for capital financing purposes. This incurs a £nil borrowing cost at the expense of foregone investment income and if included would reduce the average rate.

3.21 Temporary, short dated loans, predominantly from other local authorities remain affordable and attractive for periods of low cash flow.

Other Long-Term Liabilities

3.22 Other Long-Term Liabilities relates to the schools Private Finance Initiative (PFI) scheme. Under the International Financial Reporting Standards (IFRS) these items are now shown on the Balance Sheet as a Financial Liability and therefore need to be considered within any Treasury Management decision making process.

3.23 As at 31 March 2020 the PFI liability was valued at £39.6 million to be repaid by 2031.

INVESTMENT ACTIVITY

3.24 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.

3.25 At 31 March 2019 the Council held investments of £41 million, this decreased to £34 million in June 2019 and maintaining similar levels at the end of September (£32 million) and through to December 2019 (£33 million).However in March 2020 the government started to issue financial assistance in the wake of the COVID-19 outbreak. The Council received an initial tranche of £25 million in cash, which temporarily increased investment levels coupled with further temporary borrowing from other Local Authorities to maintain sufficient cash liquidity to continue daily operations, hence the increase in investment levels seen in the table below to £88 million.

Table 4 – Level of Investment 2019/20

Investment Counterparty	Balance 01/04/19 £000	Investments Made £000	Maturities £000	Balance 31/03/20 £000	Credit Rating
Banks	-	23,619	-13,169	10,450	AA-
	7,278	35,335	-32,613	10,000	AA-
	5,000	184,060	-179,060	10,000	A+
Money Market Funds	20,827	323,723	-305,050	39,500	AAA
Corporate	1,550		-575	975	Unrated
Externally Managed Funds	7,000	10,000		17,000	AAA
Total	**41,655**	**576,737**	**-530,467**	**87,925**	

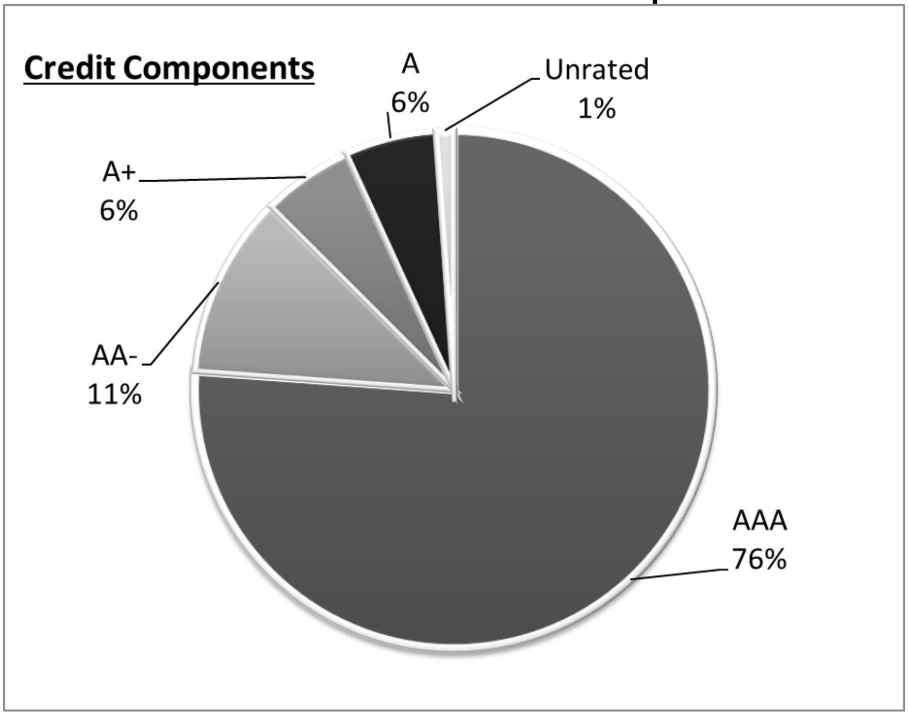
Note 1: Unrated Corporate investments are cash flow facilities backed by suitable financial guarantees.

3.26 Security of capital remained the main investment objective. This was 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 that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

3.27 Counterparty credit quality was assessed and monitored with reference to credit ratings (the Authority’s minimum long-term counterparty rating for 2019/20 was A- across rating agencies Fitch, S&P and Moody’s); credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

3.28 The following chart shows the credit composition of the Council’s investment portfolio as at 31 March 2020:

Chart 1: Investment Portfolio – Credit Components



Note: *'Unrated' components relate to Corporate investments that despite the absence of a formal rating, are either deemed credit worthy due to analysis of their performance over a variety of credit metrics or backed by suitable financial guarantees. These institutions are subject to a lower counterparty limit than those with formal credit ratings.*

3.29 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.

3.30 In a relatively short period since the onset of the COVID-19 pandemic, the global economic fallout was sharp and large. Market reaction was extreme with large falls in equities, corporate bond markets and, to some extent, real estate. lockdown-induced paralysis and the uncharted challenges for governments, businesses and individuals. Volatility measured by the VIX index was almost as high as during the global financial crisis of 2008/9.

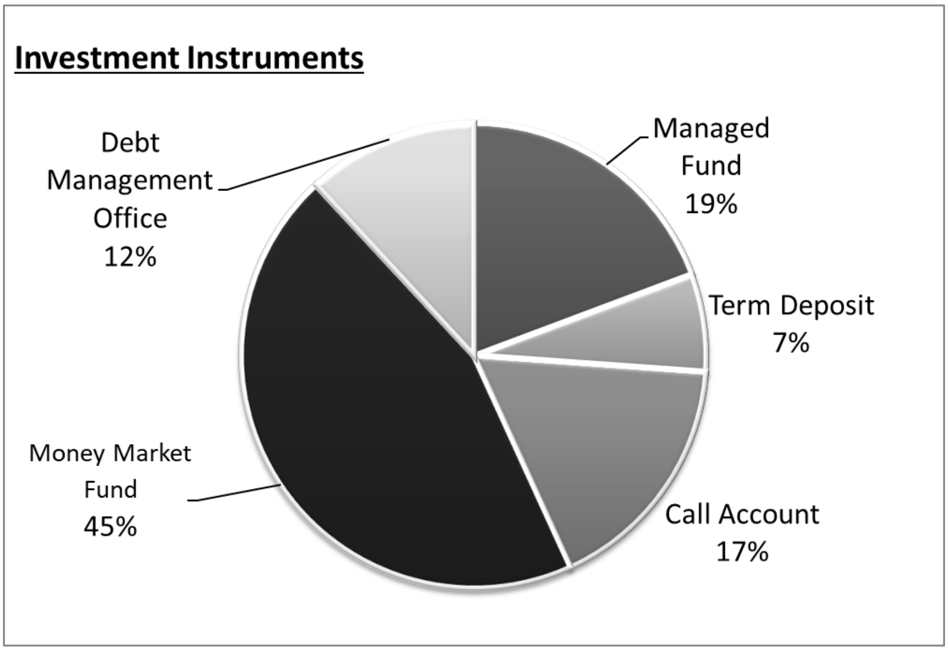
3.31 The Authority also has investments in externally managed cash plus funds, a strategic bond fund and a pooled property fund, which allow the Authority to diversify into asset classes other than cash with the need to own and manage the underlying investments. The funds which are operated on a variable net asset value (VNAV) basis offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short-term. The Authority's pooled fund investments are in the respective fund's 'distributing' share class which pay out the income generated. The falls in the capital values of the underlying assets were reflected in the 31st March fund valuations with every fund registering negative capital returns over 12 months to March.

3.32 These unrealised capital losses will not have an impact on the General Fund as the Authority has either, depending on the fund, elected to present changes in the funds' fair values in other comprehensive income (FVOCI) or is using the alternative fair value through profit and loss (FVPL) accounting and must defer the funds' fair value losses to the Pooled Investment Fund Adjustment Account until 2023/24.

3.33 Because 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 is 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. Their performance and suitability in meeting the Authority's investment objectives are monitored regularly and discussed with Arlingclose.

3.34 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



3.35 As stated in the Revenue Monitoring reports the budgeted investment income for the year estimated at £0.56 million was unlikely to be achieved. The final income for the year was £0.37 million (£0.38 million in 2019/20) with the reduction due to: -

a) The continuing policy of achieving larger savings by relying on internal borrowing to temporarily fund and thereby delay borrowing for the Capital Programme, which also reduces balances available to put into investments.
b) Low interest rates offered for investments.

3.36 The level of investment income does not reflect the savings of an estimated 2.0% on delayed borrowing for amounts internally borrowed. Throughout 20/19 the Bank of England Base Rate was set at 0.75% until the COVID-19 pandemic prompted two rate reductions in quick succession to the current level of 0.10%. Interest rates have remained at historically low levels. The return on investments, along with our policy of internally borrowing, reflects prevailing market conditions and the objective of optimising returns commensurate with the principles of security and liquidity.

Credit Rating Developments

3.37 In Q4 2019 Fitch affirmed the UK's AA sovereign rating, removed it from Rating Watch Negative (RWN) and assigned a negative outlook. Fitch then affirmed UK banks' long-term ratings, removed the RWN and assigned a stable outlook. Standard & Poor's also affirmed the UK sovereign AA rating and revised the outlook to stable from negative. The Bank of England announced its latest stress tests results for the main seven UK banking groups. All seven passed on both a common equity Tier 1 (CET1) ratio and a leverage ratio basis. Under the test scenario the banks' aggregate level of CET1 capital would remain twice their level before the 2008 financial crisis.

3.38 Credit Default Swaps (CDS) can be used as a measure of the financial markets view of the financial health of a banking institution, the higher the CDS the higher the uncertainty level. Credit Default Swap spreads rose sharply in March as the potential impact of the coronavirus on bank balance sheets gave cause for concern.

3.39 While the UK and Non-UK banks on the Arlingclose counterparty list remain in a strong and well-capitalised position, the duration advice on all these banks was cut to 35 days in mid-March.

3.40 Fitch downgraded the UK sovereign rating to AA- in March which was followed by a number of actions on UK and Non-UK banks. This included revising the outlook on all banks on the counterparty list to negative, with the exception of Barclays Bank, Rabobank, Handelsbanken and Nordea Bank which were placed on Rating Watch Negative, as well as cutting Close Brothers long-term rating to A-. Having revised their outlooks to negative, Fitch upgraded the long-term ratings on Canadian and German banks but downgraded the long-term ratings for Australian banks. HSBC Bank and HSBC UK Bank, however, had their long-term ratings increased by Fitch to AA-.

Environmental, Social & Governance (ESG) Issues

3.41 Over 250 UK local authorities, including Wirral, have declared a climate emergency to tackle the drivers and impact of climate change, adapting now for sustainability in future years. Whilst there are no universally agreed metrics to assess these issues, the Council is undertaking a review of its investment portfolio to consider the instruments currently invested in and any associated issues. The results of this review will be reported once complete.

Non-Treasury Investments

3.42 The Treasury Management Code definition of 'investments' has been widened to include financial assets as well as non-financial assets held primarily for financial returns such as investment property. These, along with other investments made for non-treasury management purposes such as loans supporting service outcomes and investments in subsidiaries, must be discussed in the Capital Strategy or Investment Strategy. Additional risks of such investments are to be set out clearly and the impact on financial sustainability is to be identified and reported.

COMPLIANCE WITH TREASURY INDICATORS

3.43 The Authority confirms that it has complied with its Treasury Management Indicators for 2019/20, which were approved on 18 February 2019 as part of the Treasury Management Strategy Statement. Details can be found in the Appendix.

3.44 In compliance with the requirements of the CIPFA Code of Practice this report provides Members with a summary report of the treasury management activity during 2019/20. None of the indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

OTHER MATTERS

3.45 **IFRS 16 - Leases accounting standard**: Due to the effects of the COVID-19 pandemic, CIPFA/LASAAC has proposed delaying the implementation of the new IFRS 16 Leases accounting standard for a further year to 2021/22**.**

4.0 FINANCIAL IMPLICATIONS

4.1 In the financial year 2019/20 proactive treasury management activities produced a one-off saving of £0.9 million. This was in addition to the £2 million of savings built into the 2019/20 treasury management budget.

4.2 Capital financing debt has reduced to £173 million, a decrease of £91 million since 2012, despite additional annual capital expenditure commitments. This has also contributed to the generation of substantial savings.

4.3 Investment income has also helped to generate resources for service delivery

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.

5.2 This report also 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.

6.0 RESOURCE IMPLICATIONS: STAFFING, ICT 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

7.2 The Council has a range of control measures in place to ensure that the risks identified above are managed and mitigated. These include:

- Dedicated team experienced and suitably qualified in Treasury Management
- Engagement of external advisors who provide regular updated credit risk, counterparty assessments and updates on technical and legislative issues
- Maintained and regularly reviewed counterparty approval lists
- Operation of daily updated cashbook and rolling12 month projected cashflow forecasting
- Regular review of loan maturity profiles
- Approved treasury management policies and procedures which are subject to as a minimum annual review

8.0 ENGAGEMENT/CONSULTATION

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

9.0 EQUALITY IMPLICATIONS

9.1 Wirral Council has a legal requirement to make sure its policies, and the way it carries out its work, do not discriminate against anyone. An Equality Impact Assessment is a tool to help council services identify steps they can take to ensure equality for anyone who might be affected by a particular policy, decision or activity.

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 Prudential & Treasury Indicators 2019/20

BACKGROUND PAPERS

CIPFA Code of Practice on Treasury Management

SUBJECT HISTORY

Council Meeting	**Date**
Treasury Management Annual Report 2018/19	22 July 2019
Treasury Management Strategy Statement 2019/20	18 February 2019
Treasury Management Mid-Year Report 2019/20	25 November 2019

APPENDIX 1

TREASURY MANAGEMENT INDICATORS

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	31.3.20 Actual	Complied?
Portfolio average credit rating	A-	AA-	Yes

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	31.3.20 Actual	Complied?
Total sum borrowed in past 3 months without prior notice	**£15m**	**£186m**	**Yes**

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 %	Actual 31.03.20 %	Complied?
Under 12 Months	0	90	76	YES
12 Months and within 24 months	0	50	0	YES
24 Months and within 5 years	0	50	3	YES
5 years and within 10 years	0	50	1	YES
10 years and over	0	100	20	YES

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.

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.

	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£30m	£30m	£30m
Actual principal invested beyond year end	£10m	£10m	£10m
Complied?	Yes	Yes	Yes