WIRRAL

POLICY AND RESOURCES COMMITTEE

Wednesday, 11 November 2020

REPORT TITLE:	**TREASURY MANAGEMENT MID-YEAR REPORT 2020/21**
REPORT OF:	**DIRECTOR OF RESOURCES**

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 an annual 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.

Whilst in past years Treasury Management has generated savings against budget the COVID situation has contributed to the current forecast being -

- A projected overspend of £2.3 million on Treasury activities is presented at the mid-year point, which is attributable to 2020/21 budget savings that are considered to be of a high risk of not being achieved due to implementation delays emanating from COVID response activity and significant changes in interest rates on investments.

This matter affects all Wards within the Borough.

The decisions in this report are key decisions.

RECOMMENDATION

That the Treasury Management Mid-Year Report for 2020/21 be noted.

SUPPORTING INFORMATION

1.0 REASON/S FOR RECOMMENDATION

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 2020/21.

2.0 OTHER OPTIONS CONSIDERED

2.1 The mid-year report is in accordance with CIPFA's code of Treasury Management which recommends reporting on Treasury Management at least twice yearly. Alternative options would be to report at more frequent intervals.

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 The Treasury Management Strategy must be agreed by members before 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, Members receive 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 The spread of the coronavirus dominated during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus while easing lockdown measures and getting their populations and economies working again. After a relatively quiet few months of Brexit news it was back in the headlines towards the end of the period as agreement between the UK and EU on a trade deal was looking difficult.

3.4 GDP growth contracted by a massive 19.8% (revised from first estimate -20.4%) in Q2 2020 (Apr-Jun) according to the Office for National Statistics, pushing the annual growth rate down to -21.5% (first estimate -21.7%). Recent monthly estimates of GDP have shown growth recovering, with the latest rise of almost 7% in July, but even with the two previous monthly gains this still only makes up half of the lost output.

3.5 The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year/year in August, further below the Bank of England's 2% target.

3.6 In the three months to July, labour market data showed the unemployment rate increased from 3.9% to 4.1% while wages fell 1% for total pay in nominal terms (0.2% regular pay) and was down 1.8% in real terms (-0.7% regular pay). Despite only a modest rise in unemployment over the period, the rate is expected to pick up sharply in the coming months as the furlough scheme ends in October. On the back of this, the Bank of England has forecast unemployment could hit a peak of between 8% and 9%.

Monetary Policy

3.7 The Bank of England (BoE) maintained Bank Rate at 0.1% and its Quantitative Easing programme at £745 billion.

Market Reaction

3.8 Equity markets continued their recovery, with the Dow Jones climbing to not far off its pre-crisis peak, albeit that performance being driven by a handful of technology stocks including Apple and Microsoft, with the former up 75% in 2020. The FTSE 100 and 250 have made up around half of their losses at the height of the pandemic in March. Central bank and government stimulus packages continue to support asset prices, but volatility remains.

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 Ultra-low interest rates and the flight to quality continued, keeping gilts yields low but volatile over the period with the yield on some short-dated UK government bonds remaining negative. The 5-year UK benchmark gilt yield started and ended the June–September period at -0.06% (with much volatility in between). The 10-year gilt yield also bounced around, starting at 0.21% and ending at 0.23% over the same period, while the 20-year rose from 0.56% to 0.74%.

3.11 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

3.12 The table shows how the position has changed since 31 March 2020.

Table 1: Summary of Treasury Position

	Balance 31 Mar 20 £m	Maturities £m	Additions £m	Balance 30 Sep 20 £m
Investments	88	(824)	781	45
Borrowings	(313)	261	(182)	(234)
Other Long-Term Liabilites	(40)	1	0	(39)
Net Debt	(265)	(562)	599	(228)

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. During the latter part of March, the Council received upfront funding from Central Government in relation to the response to the COVID-19 outbreak. These funds were invested in short term instruments until such time that the cash was required and consequently the level of investment at 31 March 2020 increased to £88 million. As this funding has been utilised, the level of investments has reduced.

3.13 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

3.14 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.

3.15 At 30 September 2020 the Council held investments of £45 million. Table 2 below shows the level of investment decreasing to £50 million at 30 June 2020 (from £88 million as 31 March 2020) due to temporary loans being repaid and the utilisation of the COVID response funding being utilised.

3.16 **Table 2: Investment Profile**

Investments with:	31 Mar 20 £m	30 Jun 20 £m	30 Sep 20 £m
UK Banks	15	-	5
Non-UK Banks	5	7	-
Central Government	10	-	-
Money Market Funds	40	25	22
Community Interest Companies	1	1	1

Other Pooled Funds:			
- Property Funds	1	1	1
- Strategic Bond Funds	1	1	1
- Public Sector Social Investment Fund	10	10	10
- Cash Plus Funds	5	5	5
TOTAL	**88**	**50**	**45**

3.17 **Table 3: Investment Sources**

Usable Reserves	**31 Mar 20 £m**	**30 Jun 20 £m**	**30 Sep 20 £m**
General Fund	11	11	11
Earmarked Reserves	67	67	67
Capital Receipts Reserve	1	1	1
Capital Grants Unapplied	19	28	31
	97	**107**	**110**
Internal Borrowing in lieu of External Borrowing	(9)	(57)	(65)
Reserves Invested	**88**	**50**	**45**

3.18 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.

3.19 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 2020/21 which defined high credit quality organisations as those having a long-term credit rating of A- or higher.

3.20 Counterparty credit quality is assessed and monitored with reference to credit ratings (the Authority's minimum long-term counterparty rating for 2020/21 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.

3.21 The following table shows the credit composition of the Council's investment portfolio as at 30th September 2020:

Table 4: Credit Composition of Investment Portfolio

Credit Rating	Proportion of Portfolio %
AAA	64
A	11
Unrated	25
Total	**100**

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.*

3.22 Investments with banks are 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.

3.23 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.

3.24 For diversification purposes the Council can invest in a variety of counterparties and financial instruments to help mitigate counterparty and liquidity risks. A summary of the instruments invested in follows:

Table 5: Investment Portfolio – Financial Instruments

Investment Instrument	Proportion of Portfolio %
Money Market Fund	49
Externally Managed Fund	38
Call Account	11
Term Deposit	2
Total	**100**

3.25 £17m 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 generate an income return which is used to support services in year.

3.26 As these funds have no defined maturity date, but most 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 fiveyear 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.

3.27 The budget for investment income is £2.1 million but achievable income will be in the region of £0.3 million. This reduction in investment income is attributable to these key factors:

a) Low interest rates offered for investments
b) The economic impact of COVID-19
c) 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 savings in interest incurred.

3.28 The UK Bank Rate remained at 0.1% throughout the first half of the year. The average income return on investments at the end of September was 0.3%, with the portfolio invested in secure counterparties with a good level of liquidity. However, this does not reflect the savings of an estimated 2.0% on delayed borrowing for amounts internally borrowed.

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 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, is helping to reduce borrowing costs in 2020/21. The level of cost reduction 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 reduce costs.

3.33 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 6: 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
2019/20	172.7	0.9

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 £59 million borrowed via such loans running at an average rate of 0.04%. These temporary, short dated loans, from other local authorities remain affordable and attractive for periods of low cash flow, with rates available of around 0.05% for up to three-month periods.

3.35 On 9th October 2019 the PWLB raised the cost of certainty rate borrowing to 1.8% above UK gilt yields making it relatively expensive. Market alternatives are available; however, the financial strength of individual authorities will be scrutinised by investors and commercial lenders. The Chancellor’s March 2020 Budget statement included significant changes to Public Works Loan Board (PWLB) policy and launched a wide-ranging consultation on the PWLB’s future direction.

3.36 The consultation titled “Future Lending Terms” allows stakeholders to contribute to developing a system whereby PWLB loans can be made available at improved margins to support qualifying projects. It contains proposals to recommend authorities that are not involved in “debt for yield” activity to borrow at lower rates as well as stopping local authorities using PWLB loans to buy commercial assets primarily for yield. The consultation also broaches the possibility of slowing, or stopping, individual authorities from borrowing large sums in specific circumstances. The consultation closed on 31st July 2020 with the announcement and implementation of the revised lending terms expected in the latter part of this calendar year or early next year.

3.37 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.

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

3.39 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.

3.40 The Council has not entered into any new lease agreements during 2020/21.

3.41 The table below shows Council debt as at 30 September 2020:

Table 7: Council Debt as at 30 September 2020

Debt	Balance 31 Mar 20 £m	Maturities £m	Additions £m	Balance 30 Sep 20 £m
Borrowings				
PWLB	(19)	1	0	(18)
Market Loans (Fixed Rate)	(44)	3	0	(41)
Market Loans (LOBO)	(108)	0	0	(108)
Interest Free Loans	(2)	0	0	(2)
Total Capital Finance Loans	**(173)**	**4**	**0**	**(169)**
Other Long Term Liabilities	(40)	1	0	(39)
Temporary Cashflow Loans	(141)	266	(184)	(59)
TOTAL	**(354)**	**271**	**(184)**	**(267)**

The reduction in total debt is due to a combination of factors:

- *Repayment of temporary cashflow loans that were required over the latter part of 2019/20. These loans were taken out to finance cashflow requirements and provide additional liquidity as the COVID outbreak caused uncertainty within loan markets.*
- *The repayment of longer term PWLB loans, through the use of internal resources rather than arranging new loans to replace the maturing debt.*

3.42 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. Discussions are taking place to investigate the possibility of replacing some LOBOs with alternative loan arrangements. A saving option was included in the 20/21 budget for this refinancing, however the COVID situation resulted in officer time being redirected to response activities and caused issues with access to documentation as buildings were closed, which delayed this review.

COMPLIANCE WITH TREASURY INDICATORS

3.43 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

3.44 Our treasury advisor Arlingclose expects Bank Rate to remain at the current 0.10% level for some time and additional monetary loosening in the future most likely through further financial asset purchases (QE). While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

3.45 Gilt yields are expected to remain very low in the medium term. Shorter-term gilt yields are currently negative and will remain around zero or below until either the Bank of England expressly rules out negative Bank Rate or growth/inflation prospects improve.

3.46 Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.

Table 8: Arlingclose Bank of England Interest Rate Forecast

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Upside Risk	0.00	0.00	0.00	0.15	0.15	0.15
Arlingclose Central Case	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**	**0.10**
Downside Risk	0.50	0.50	0.50	0.50	0.50	0.50

4.0 FINANCIAL IMPLICATIONS

4.1 Capital debt finance has reduced annually over recent years, despite additional annual Capital commitments. This has 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.

4.4 Savings of £2.5 million were incorporated into the 2020/21 budget in respect of treasury/investment activity. The budget for interest payable was reduced by £1 million and £1.5 million was added to the interest receivable budget. The Bank of England Base Rate has been significantly reduced by from 0.75% to 0.1% as a response to the COVID pandemic. Opportunities for investments have been curtailed whilst the rate of increase for yields has slowed, however work is being carried out with Arlingclose to try and enhance the rate of return on the investment portfolio. With regards to reducing the interest costs associated with the Council's loans, work is taking place to renegotiate borrowing terms with lenders but is behind schedule due to other demands on financial institutions and other involved parties.

4.5 Consequently, these issues mentioned above are resulting in a forecast overspend of £2.3 million on Treasury activities for 2020/21.

5.0 LEGAL IMPLICATIONS

5.1 The Council 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: 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.

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 CO_2.

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APPENDICES

Appendix 1 Treasury Indicators 2020/21

BACKGROUND PAPERS

CIPFA Code of Practice on Treasury Management

SUBJECT HISTORY

Meeting	Date
Treasury Management Strategy Statement 2020-21	17^{th} February 2020
Treasury Management Annual Report 2019-20	27th July 2020

APPENDIX 1

TREASURY MANAGEMENT INDICATORS 2020/2021

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 30.09.20
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 30.09.20
Total sum borrowed in past 3 months without prior notice	£15m	£100m

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 2020/21 %	Upper Limit 2020/21 %	Actual Maturity 30.09.20 %
Under 12 Months	0	90	66.5
12 Months and within 24 months	0	75	1.6
24 Months and within 5 years	0	75	4.1
5 years and within 10 years	0	75	0.6
10 years and over	0	100	27.2
		Total	**100.00**

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	2020/21	As At 30.09.20
Limit on principal invested beyond year end	£30m	£10m