WEST OF ENGLAND COMBINED AUTHORITY COMMITTEE

19 JULY 2019

REPORT SUMMARY SHEET

TREASURY MANAGEMENT OUTTURN REPORT 2018/19

Purpose

The Chartered Institute of Public Finance and Accountancy Treasury Management in the Public Services: Code of Practice requires the Authority to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year. This report provides a review of performance to 31st March 2019.

Summary

This report includes the following key information:

- The average rate of investment return for 2018/19 was 0.97%, which is 0.41% above the benchmark rate.
- The Authority's Prudential Indicators for 2018/19 were agreed by the Authority at its meeting on 2nd February 2018 and performance against the key indicators is shown in Appendix 1. All indicators are within target levels.

Recommendations

Members of the Combined Authority Committee are asked to:

1. Note the Treasury Management Report to 31st March 2019, prepared in accordance with the CIPFA Treasury Code of Practice.

2. Note the Treasury Management Indicators to 31st March 2019.

Contact officer: Malcolm Coe

Position: Director of Investment and Corporate Services

Email: Malcolm.Coe@westofengland-ca.gov.uk

REPORT TO: **WECA COMMITTEE**

DATE: **19 JULY 2019**

REPORT TITLE: **TREASURY MANAGEMENT OUTTURN REPORT 2018/19**

DIRECTOR: **MALCOLM COE, DIRECTOR OF INVESTMENT AND CORPORATE SERVICES**

AUTHOR: **MALCOLM COE**

Purpose of Report

1 The CIPFA Treasury Management in the Public Services: Code of Practice requires the Authority to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year. This report provides a review of performance to 31st March 2019.

Recommendations

The WECA Committee is required to:

a) Note the Treasury Management Report to 31st March 2019, prepared in accordance with the CIPFA Treasury Code of Practice.

b) Note the Treasury Management Indicators to 31st March 2019.

Background / Issues for Consideration

2 The CIPFA Code of Practice requires that the WECA Committee considers the treasury management outturn report after the end of each financial year.

Summary

2.1 The average rate of investment return for 2018/19 was 0.97%, which is 0.41% above the benchmark rate.

2.2 The Authority's Prudential Indicators for 2018/19 were agreed by the Authority at its meeting on 2nd February 2018 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

Summary of Returns

2.3 The Authority's investment position as at 31st March 2019 is detailed in **Appendix 2**. This shows a change in Investment Balances to £169.5m at 31st March 2019 from £198.2m at 30th September 2018, which reflects a net reduction due to project spend.

2.4 The Authority is the Accountable Body for the West of England Revolving Investment Fund, (RIF), a role previously undertaken by B&NES who received grant funding of £57 million at the end of the 2011/12 financial year. The balance at 31st March 2019 was £17.9m and this sum, prior to distribution, is being invested in line with the Authority's Treasury Management Strategy, with the interest earmarked to the RIF.

2.5 The Authority also acts as Accountable Body for the West of England Local Enterprise Partnership, (LEP). In 2018/19 £45.4m of Local Growth Fund (LGF) grant was received from Central Government, along with the remaining sums, provided a balance at 31st March 2019 of £60.3m. This sum, prior to distribution, is being invested in line with the Authority's Treasury Management Strategy with interest earmarked to fund associated operating and governance costs.

2.6 Gross interest earned on all investments for April to March 2018/19 was £1,852k. Interest earned for RIF and LGF is ringfenced to those funds, giving rise to an income outturn for WECA activities of £1,137k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period being 0.97%, which was 0.41% above the benchmark rate of average 7 day LIBID +0.05% (0.56%).

Summary of Borrowings

2.7 The Authority's currently has no external borrowing. Any future borrowing requirement would be subject to the Authority's decision making process and HM Treasury negotiations. For reference only, the Prudential Indicators that provide a framework for Borrowing is set out in **Appendix 1.**

Strategic & Tactical Decisions

2.8 As shown in the charts at **Appendix 2**, the investment portfolio has been diversified across UK Banks and Building Societies and Local Authorities, which totalled £136m. The Authority also uses AAA rated Money Market funds to maintain very short-term liquidity with £23.6m invested in Money Market Funds as at 31st March 2019.

2.9 The Authority retains units in the CCLA Property Fund with an investment of £9.9m. This investment seeks to enhance yields, provide diversification and is intended to be held for higher returns over a long period of time.

2.10 The Authority does not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates. The Authority's investment counterparty list does not currently include any banks from Portugal, Ireland, Greece, Spain and Italy.

Future Strategic & Tactical Issues

2.11 The Authority's treasury management advisors have provided an economic and market review for 2018/19 – attached at **Appendix 5**.

2.12 After rising to 0.6% in the third calendar quarter of the year, fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase the Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

Consultation

3 Consultation has been carried out with the Chief Executives, S151 Officers across the region and the Monitoring Officer.

Other Options Considered

4 None.

Risk Management/Assessment

5 The Authority's lending & borrowing list is regularly reviewed and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits, with approved institutions. Investment and Borrowing advice is provided by our Treasury Management consultants Arlingclose.

The CIPFA Treasury Management in the Public Services: Code of Practice requires the Authority nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. The WECA Audit Committee carries out this role.

Public Sector Equality Duties

6 The public sector equality duty created under the Equality Act 2010 means that public authorities must have due regard to the need to:

- Eliminate unlawful discrimination, harassment and victimization and other conduct prohibited by the Act.
- Advance equality of opportunity between people who share a protected characteristic and those who do not.
- Foster good relations between people who share a protected characteristic and those who do not.

6.1 The Act explains that having due regard for advancing equality involves:

- Removing or minimising disadvantages suffered by people due to their protected characteristics.
- Taking steps to meet the needs of people from protected groups where these are different from the needs of other people.
- Encouraging people from protected groups to participate in public life or in other

activities where their participation is disproportionately low.

6.2 The general equality duty therefore requires organisations to consider how they could positively contribute to the advancement of equality and good relations. It requires equality considerations to be reflected in the design of policies and the delivery of services, including policies, and for these issues to be kept under review.

Finance Implications, including economic impact assessment where appropriate:

7 A breakdown of the revenue budget that was set for interest income and the year-end outturn position is included in **Appendix 6**. There are no Economic Impacts arising as a result of this report.

Advice given by: Malcolm Coe, Director of Investment & Corporate Services

Legal Implications:

8 The Prudential Code and CIPFA's Code of Practice on Treasury Management requires regular monitoring and reporting of Treasury Management activities.

Advice given by: Shahzia Daya, Director of Legal Services

Appendices & Background papers:

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Authority's Investment Position at 31 March 2019
Appendix 3 – Average monthly rate of return for 2018/19
Appendix 4 – The Authority's External Borrowing Position at 31 March 2019
Appendix 5 – Arlingclose's Economic & Market Review for 2018/19
Appendix 6 – Interest & Capital Financing Budget Monitoring 2018/19
Appendix 7 – Summary Guide to Credit Ratings

Background Papers : Treasury Management Strategy Statement & Investment Strategy 2018/19 – As reported to WECA Committee on 2nd February 2018.

West of England Combined Authority Contact:
Any person seeking background information relating to this item should seek the assistance of the contact officer for the meeting who is Ian Hird / Tim Milgate on 0117 332 1486; or by writing to West of England Combined Authority, 3 Rivergate, Temple Way, Bristol BS1 6ER; email: democratic.services@westofengland-ca.gov.uk

APPENDIX 1

Performance against Treasury Management Indicators (as approved in the Treasury Management Strategy Statement)

1. Authorised limit for external debt

These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2018/19 Prudential Indicator	**Actual as at 31st March 2019**
	£'000	£'000
Borrowing	0	0
Other long term liabilities	0	0
Cumulative Total	**0**	**0**

2. Operational limit for external debt

The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2018/19 Prudential Indicator	**Actual as at 31st March 2019**
	£'000	£'000
Borrowing	0	0
Other long term liabilities	0	0
Cumulative Total	**0**	**0**

3. Upper limit for fixed interest rate exposure

This is the maximum amount of total ***borrowing*** which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2018/19 Prudential Indicator	**Actual as at 31st March 2019**
	%	%
Fixed interest rate exposure	**100**	**0**

4. Upper limit for variable interest rate exposure
While fixed rate ***borrowing*** contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping flexibility through the use of variable interest rates. This is the maximum amount of total borrowing which can be at variable interest rates.

	2018/19 Prudential Indicator	**Actual as at 31st March 2019**
	%	%
Variable interest rate exposure	**10%**	**0%**

5. Upper limit for total principal sums invested for over 364 days
This is the maximum amount of total ***investments*** which can be over 364 days. The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments.

	2018/19 Prudential Indicator	**Actual as at 31st March 2019**
	%	%
Investments over 364 days	**30**	**25.4**

6. Maturity Structure of borrowing
This indicator is set to control the Authority's exposure to refinancing risk.

	Upper Limit	**Lower Limit**	**Actual as at 31st March 2019**
	%	%	%
Under 12 months	50	Nil	0
12 months and within 24 months	75	Nil	0
24 months and within 5 years	75	Nil	0
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	0

7. Average Credit Rating
The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. A summary guide to credit ratings is set out at **Appendix 7**. The figure excludes the Property Fund Investment.

	2018/19 Prudential Indicator	**Actual as at 31st March 2019**
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A-**	**AAA-**

APPENDIX 2

The Authority's Investment position at 31st March 2019.

The term of investments are as follows:

	Balance at 31st March 2019 £000s
Notice (instant access funds)	**23,620**
Up to 1 month	**0**
1 month to 3 months	**20,000**
4 to 6 months	**15,000**
6 to 12 months	**58,000**
More than 12 months	**43,000**
Property Fund	**9,957**
Total	**169,577**

The Authority had a total average net positive balance of £190.2m during the period April 2018 to March 2019 .

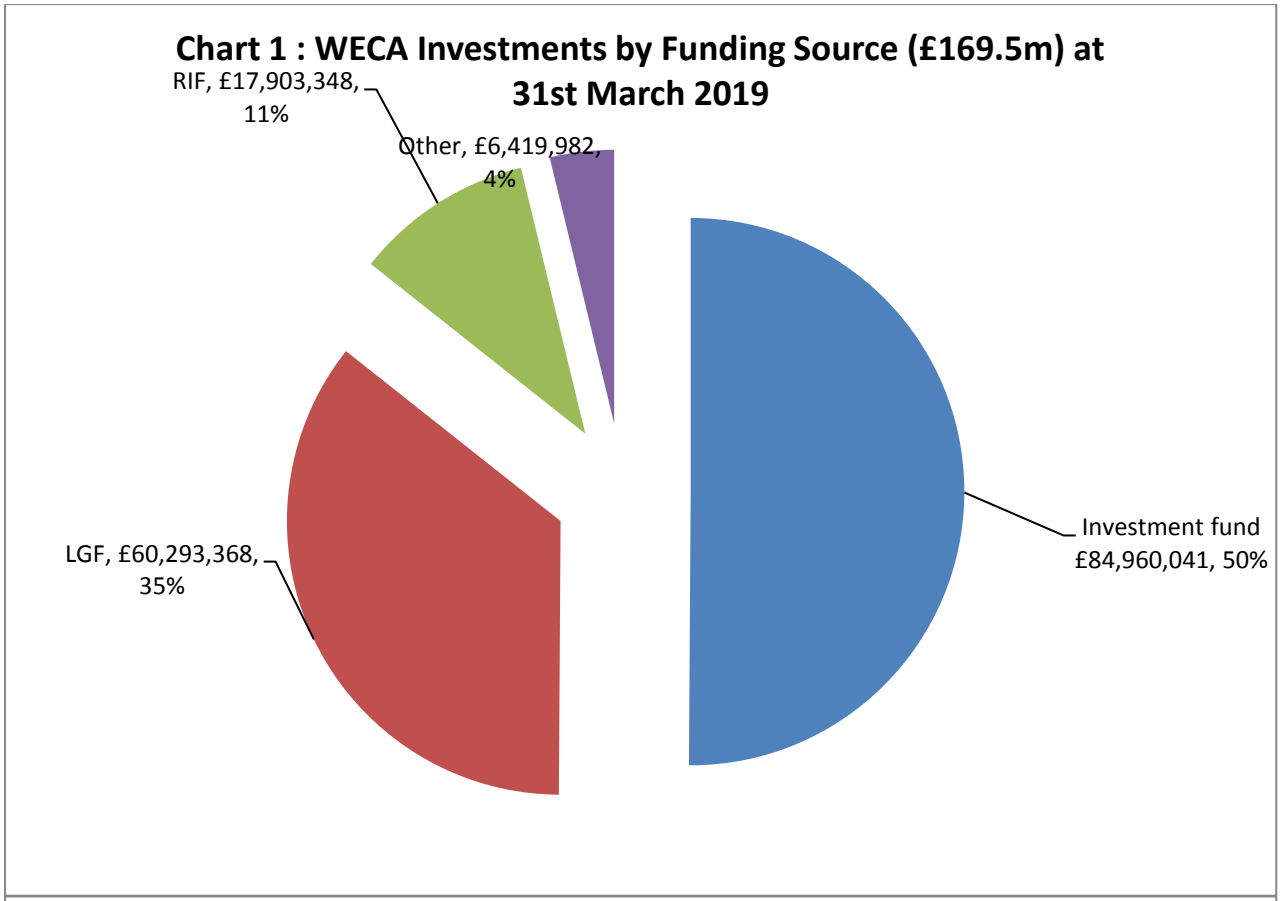


Chart 1 : WECA Investments by Funding Source (£169.5m) at 31st March 2019
RIF, £17,903,348, 11%
Other, £6,419,982, 4%
Investment fund £84,960,041, 50%
LGF, £60,293,368, 35%

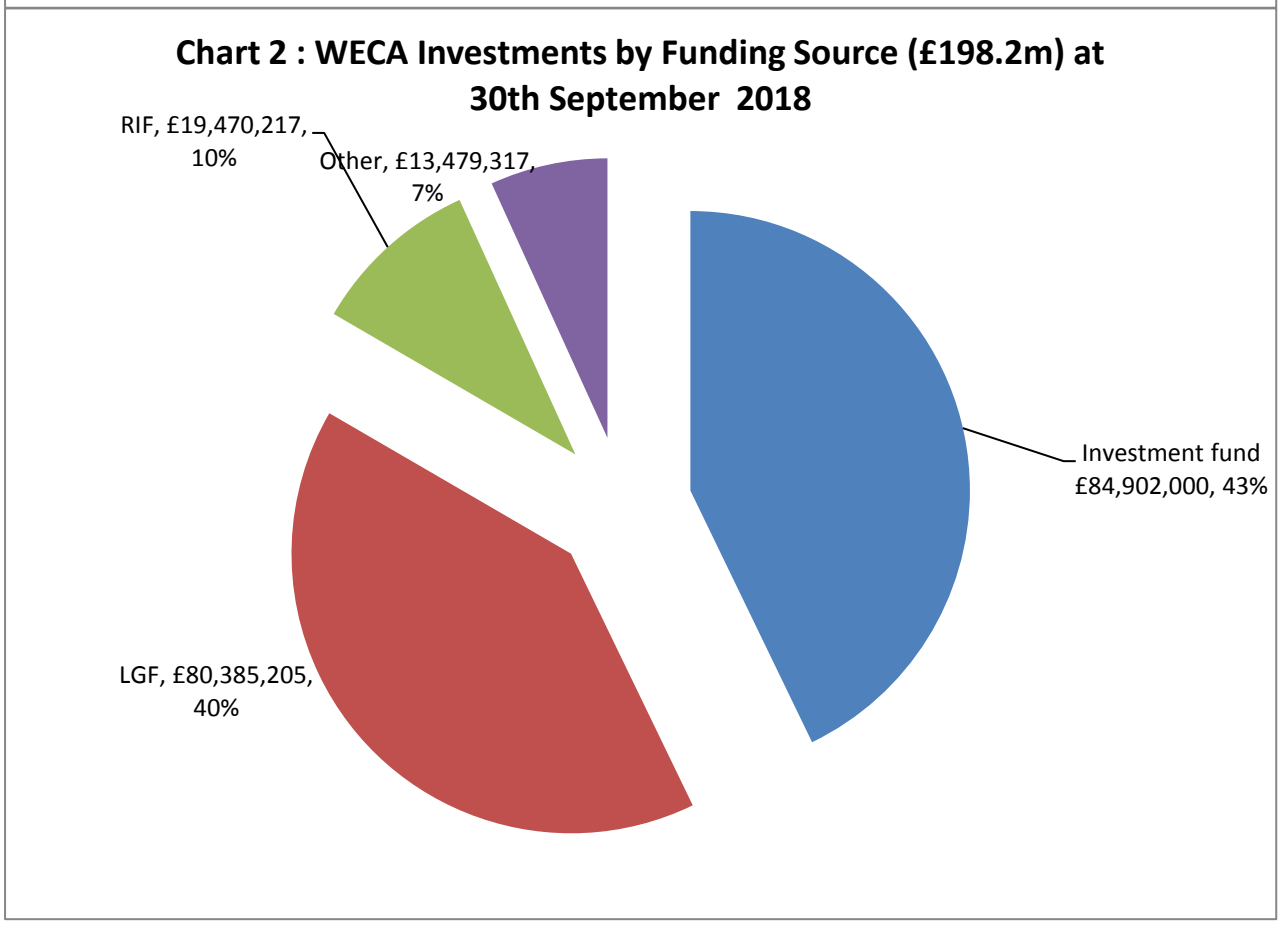


Chart 2 : WECA Investments by Funding Source (£198.2m) at 30th September 2018
RIF, £19,470,217, 10%
Other, £13,479,317, 7%
Investment fund £84,902,000, 43%
LGF, £80,385,205, 40%

Chart 3: WECA Investments by Type (£169.5m) as at 31st March 2019

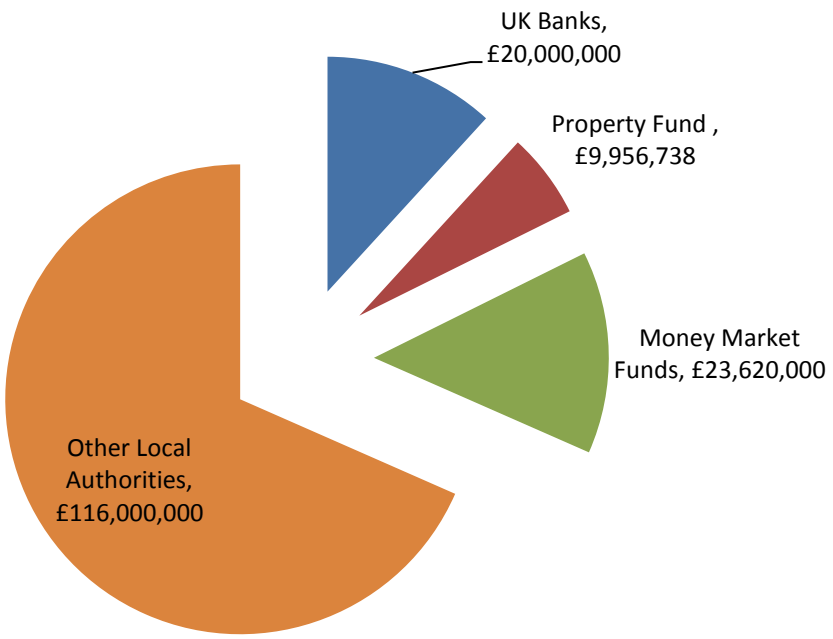


Chart 4: WECA Investments by Type (£198.2m) as at 30th September 2018

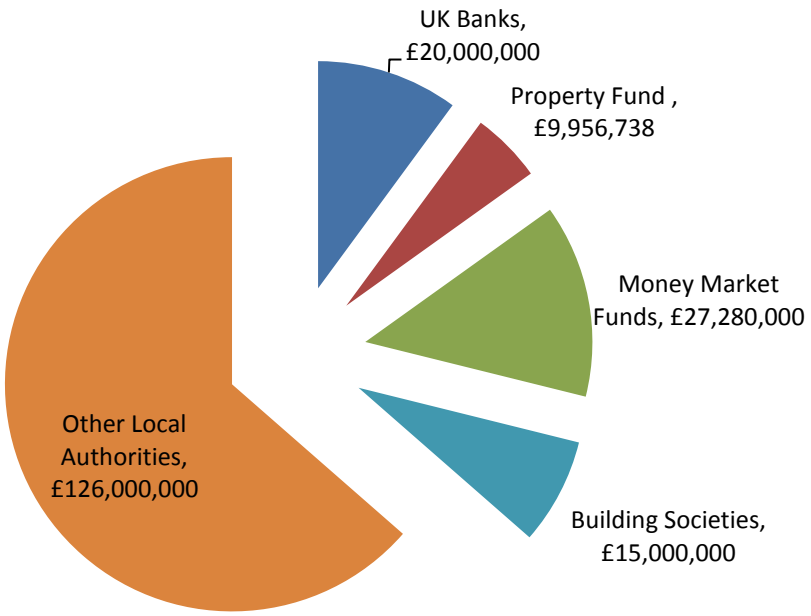


Chart 5: WECA Investments per lowest equivalent Long Term credit rating (£169.5m) at 31st March 2019

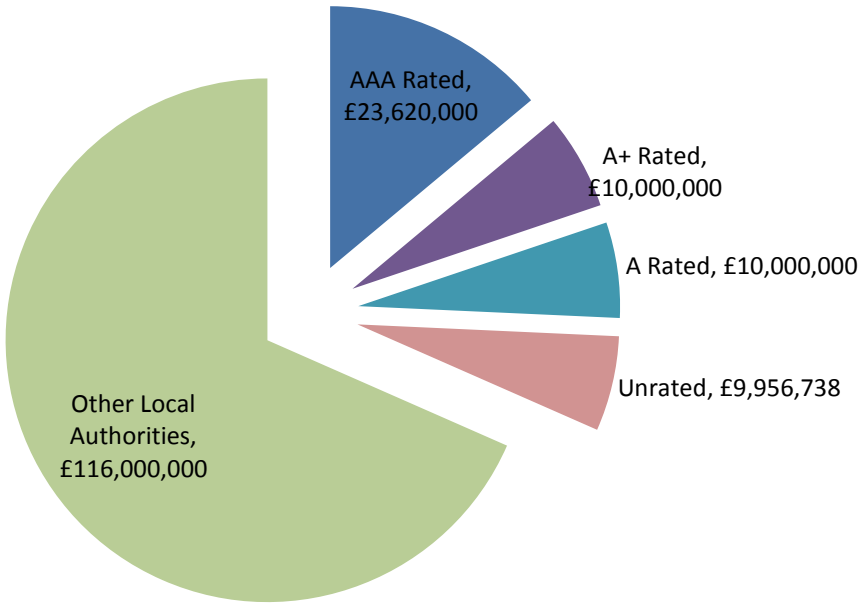
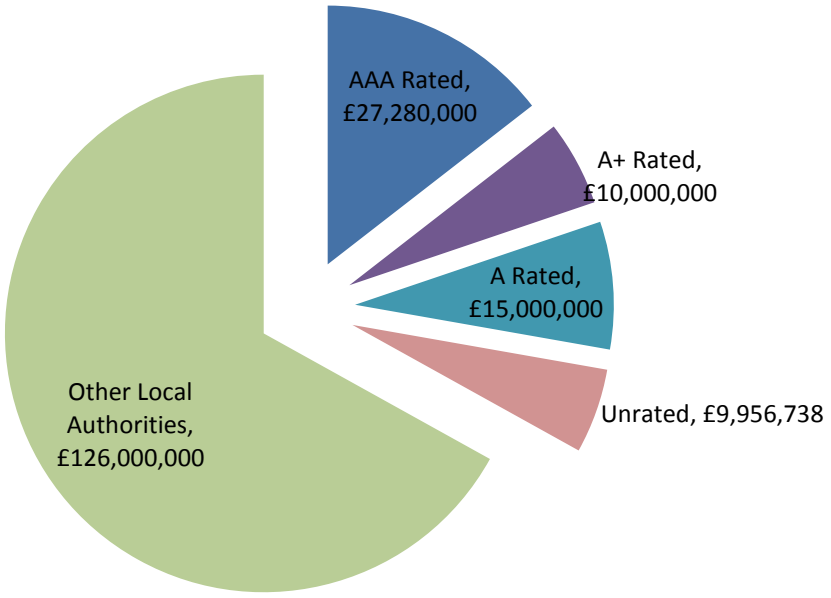


Chart 6: WECA Investments per lowest equivalent Long Term credit rating (£198.2m) at 30th September 2018



APPENDIX 3

Average rate of return on investments for 2018/19

	Apr %	May %	Jun %	Jul	Aug	Sep
Average rate of interest earned	0.79	0.84	0.85	0.88	0.90	0.97
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.41	0.41	0.41	0.41	0.63	0.64
Difference from Benchmark %	+0.38	+0.43	+0.44	+0.47	+0.27	+0.33

	Oct %	Nov %	Dec %	Jan	Feb	Mar	Average %
Average rate of interest earned	0.99	1.02	1.06	1.07	1.17	1.18	0.97
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.63	0.64	0.63	0.63	0.62	0.62	0.56
Difference from Benchmark %	+0.36	+0.38	+0.43	+0.44	+0.55	+0.56	+0.41

APPENDIX 4

Authorities External Borrowing at 31st March 2019

*There is no current borrowing.

APPENDIX 5

Economic and Market Review for 2018/19

Economic background: After spiking at over $85/barrel in October 2018, oil prices fell back sharply by the end of the year, declining to just over $50 in late December before steadily climbing toward $70 in April 2019. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year/year, just above the consensus forecast but broadly in line with the Bank of England's February Inflation Report. The most recent labour market data for the three months to January 2019 showed the unemployment rate fell to a new low 3.9% while the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%.

After rising to 0.6% in the third calendar quarter from 0.4% in the second, fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in December. However, a recent softening in US data caused the Fed to signal a pause in hiking interest rates at the last Federal Open Market Committee (FOMC) meeting in March.

While the domestic focus has been on Brexit's potential impact on the UK economy, globally the first quarter of 2019 has been overshadowed by a gathering level of broader based economic uncertainty. The US continues to be set on a path of protectionist trade policies and tensions with China in particular, but with the potential for this to spill over into wider trade relationships, most notably with EU. The EU itself appeared to be show signs of a rapid slowdown in economic growth with the major engines of its economy, Germany and France, both suffering misfires from downturns in manufacturing alongside continued domestic/populist unrest in France. The International Monetary Fund downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.

Financial markets: December was a month to forget in terms of performance of riskier asset classes, most notably equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of 2018.

Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising in October, gilts regained their safe-haven status throughout December and into the new year - the 5-year benchmark gilt yield fell as low as 0.80% and there were similar falls

in the 10-year and 20-year gilts over the same period dropping from 1.73% to 1.08% and from 1.90% to 1.55%. The increase in Bank Rate pushed up money markets rates over the year and 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.53%, 0.67% and 0.94% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth is not just a UK phenomenon but a global risk. During March the US yield curve inverted (10-year Treasury yields were lower than US 3 month money market rates) and German 10-year Bund yields turned negative. The drivers are a significant shift in global economic growth prospects and subsequent official interest rate expectations given its impact on inflation expectations. Further to this is world trade growth which collapsed at the end of 2018 falling by 1.8% year-on-year. A large proportion of this downturn in trade can be ascribed to the ongoing trade tensions between the US and China which despite some moderation in January does suggest that the International Monetary Fund's (IMF) and Organisation for Economic Co-Operation & Development's (OECD) forecasts for global growth in 2019 of 3.5% might need to be revised downwards.

Credit background: Credit Default Swap (CDS) spreads drifted up towards the end of 2018 on the back of Brexit uncertainty before declining again in 2019 and continuing to remain low in historical terms. After hitting around 129 basis points in December 2018, the spread on non-ringfenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc) transferred their business lines into retail (ringfenced) and investment banking (non-ringfenced) entities.

In February, Fitch put the UK AA sovereign long-term rating on Rating Watch Negative as a result of Brexit uncertainty, following this move with the same treatment for UK banks and a number of government-related entities.

There were minimal other credit rating changes during the period. Moody's revised the outlook on Santander UK to positive from stable to reflect the bank's expected issuance plans which will provide additional protection for the its senior unsecured debt and deposits.

APPENDIX 6

Interest & Capital Financing Costs – Outturn Position for 2018/19

April 2018 to March 2019	YEAR END FORECAST			ADV/FAV
	Budgeted (Income) £'000	Outturn (Income) £'000	Forecast over or (under) spend £'000	
Interest & Capital Financing				
- Debt Costs	0	0	0	
- Interest on Balances	(520)	(1,137)	(617)	FAV
Sub Total - Capital Financing	**(520)**	**(1,137)**	**(617)**	**FAV**

APPENDIX 7

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.