WEST OF ENGLAND Combined Authority

WEST OF ENGLAND COMBINED AUTHORITY COMMITTEE **ITEM 14**

19 JUNE 2020

REPORT SUMMARY SHEET

TREASURY MANAGEMENT OUTTURN REPORT 2019/20

Purpose

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 2020.

Summary

The Authority's investment position as at 31st March 2020 is detailed in **Appendix 2**. This shows a change in Investment Balances to £178.8m at 31st March 2020 from £212.8m at 30th September 2019, which reflects a net reduction due to project spend

Gross interest earned on all investments for April 2019 to March 2020 was £2,590k. Interest earned for RIF and LGF is ringfenced to those funds, giving rise to an income outturn for WECA activities of £2,060k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period being 1.24%, which was 0.72% above the benchmark rate.

Performance throughout the year was fully compliant with the prudential indicators as set, and approved, in the 2019/20 Treasury Management Strategy.

In order to assist West of England Unitary Authorities with cashflow challenges as a result of Covid, WECA will be implementing a 'short term loan facility', within the parameters of the approved Treasury Management Strategy, as detailed in **Appendix 8**.

Impact of Covid-19 pandemic

The Combined Authority has actively reviewed its key activities and work programme to reflect changing priorities as a result of the Covid-19 pandemic. Specific issues relating to the Covid-19 situation that impact on or are addressed through this report are as follows:

- Paragraph 2.10 of the report sets out the impact on pooled funds;
- Narrative in Appendix 4 explains impact on cashflow and borrowing;
- Economic and Market Review in Appendix 5.

Recommendations

Members of the Combined Authority Committee are asked to:

1. Note the Treasury Management Report to 31st March 2020, prepared in accordance with the CIPFA Treasury Code of Practice.

2. Note the Treasury Management Indicators to 31st March 2020.

3. Note that in order to assist West of England Unitary Authorities with cashflow challenges as a result of Covid-19, WECA will be implementing a 'short term loan facility', within the parameters of the approved Treasury Management Strategy, as detailed in Appendix 8.

Contact officer: Malcolm Coe

Position: Director of Investment and Corporate Services

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

WEST OF ENGLAND Combined Authority

ITEM 14

REPORT TO: WECA COMMITTEE

DATE: 19 JUNE 2020

REPORT TITLE: TREASURY MANAGEMENT OUTTURN REPORT 2019/20

DIRECTOR: MALCOLM COE, DIRECTOR OF INVESTMENT AND CORPORATE SERVICES

AUTHOR: MALCOLM COE

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c) Note that in order to assist West of England Unitary Authorities with cashflow challenges as a result of Covid-19, WECA will be implementing a 'short term loan facility', within the parameters of the approved Treasury Management Strategy, as detailed in Appendix 8.

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 2019/20 was 1.24%, which is 0.72% above the benchmark rate.

2.2 The Authority's Prudential Indicators for 2019/20 were agreed by the Authority at its meeting on 21st February 2019 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 2020 is detailed in **Appendix 2**. This shows a change in Investment Balances to £178.8m at 31st March 2020 from £212.8m at 30th September 2019, 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 2020 was £9.9m 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 2019/20 £14.1m of Local Growth Fund (LGF) grant was received from Central Government, along with the remaining sums, provided a balance at 31st March 2020 of £24m. This sum, prior to distribution, is being invested in line with the Authority's Treasury Management Strategy with interest being credited to the Local Enterprise Partnership revenue budget (as set out in the approved budget).

2.6 Gross interest earned on all investments for April to March 2019/20 was £2,590k. Interest earned for RIF and LGF is ringfenced to those funds, giving rise to an income outturn for WECA activities of £2,060k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period being 1.24%, which was 0.72% above the benchmark rate of average 7 day LIBID +0.05% (0.52%).

Summary of Borrowings

2.7 The Authority does not currently have any underlying need to borrow long term to fund capital expenditure. As part of its approach to liquidity management, the Authority may borrow short term loans to cover any unplanned cash flow shortages as they arrive. At 31st March 2020 the Authority held £15m of short-term loans, an increase of £15m from 31st March 2019. Outstanding loans on 31st March are summarised in **Appendix 4.**

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 £178.8m. The Authority also uses AAA rated Money Market funds to maintain very short-term liquidity with £6.8m invested in Money Market Funds as at 31st March 2020.

2.9 The Authority retains units invested in the CCLA Property Fund of £9.9m and have added to our pooled fund's portfolio, with an investment of £7m with Investec and £7m with Kames. These investments seek to enhance yields, provide diversification and is intended to be held for higher returns over a long period of time.

2.10 Since the outbreak of the COVID-19 pandemic, the global economic fallout was sharp and large. Market reaction was extreme with large falls in equities, corporate bonds and real estate. The falls in the capital values of the Authorities pooled funds were reflected in the 31st March fund valuations, with every fund registering negative capital returns, with unrealised losses of 11.1%. 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. These investments are made in the knowledge that capital values will move both up and down on months and quarters, but with the confidence that over a three to five-year period, total returns will exceed interest rates. They provide regular revenue income and in 2019-20 provided an average total return of 3.56%. In light of their performance over the medium-long term, investment in these funds have been maintained.

2.11 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.

2.12 The Authority is in the process of opening a Green Deposit account with Barclays where deposits will be earmarked against projects including energy efficiency, green transport, greenhouse gas emission reduction, agriculture and forestry. The Authority has also registered interest to its treasury advisors for the 'Environmental Social and Governance', (ESG), and responsible investment service.

Future Strategic & Tactical Issues

2.13 The Authority's treasury management advisors have provided an economic and market review for 2019/20 – attached at **Appendix 5**.

2.14 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.

2.15 The West of England Unitary Authorities, like many others across the country, are facing significant financial challenges and short term issues with cashflow over the coming months as a result of Covid. In order to assist, WECA will be implementing a 'short term loan facility', within the parameters of the approved Treasury Management Strategy, as detailed in **Appendix 8**.

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 2020
Appendix 3 – Average monthly rate of return for 2019/20
Appendix 4 – The Authority's External Borrowing Position at 31 March 2020
Appendix 5 – Arlingclose's Economic & Market Review for 2019/20
Appendix 6 – Interest & Capital Financing Budget Monitoring 2019/20
Appendix 7 – Summary Guide to Credit Ratings
Appendix 8 – Short term loan facility for West of England Unitary Authorities

Background Papers : Treasury Management Strategy Statement & Investment Strategy 2019/20

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 07436 600313; or by writing to West of England Combined Authority, 3 Rivergate, Temple Quay, Bristol BS1 6EW; email: democratic.services@westofengland-ca.gov.uk

APPENDIX 1

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

The Authority measures and manages its exposure to treasury management risks using the following 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.

Credit risk indicator	Target	Actual
Minimum portfolio average credit rating	A-	AAA-

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	Actual
Total sum borrowed in past 3 months without prior notice	£30m	£15m

3. Interest Rate Exposure
This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit	Actual
Upper limit on one-year revenue impact of a 1% fall in interest rates	£900k	£2k

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The interest rate fall at the end of March 2020 had little impact on our investment accounts. However, there is a potential risk that this interest rate drop will reduce 2020/21 income returns. We will keep this risk under regular review and diversify our investments, where feasible, accordingly.

4. Principal sums invested for periods longer than a year:
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. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2020/21	Actual	2021/22	Actual
Limit on principal invested beyond year end	£100m	£23.9m	£75m	£23.9m

APPENDIX 2

The Authority's Investment position at 31st March 2020.

The term of investments are as follows:

	Balance at 31st March 2020 £000s
Notice (instant access funds)	**6,840**
Up to 1 month	**0**
1 month to 3 months	**50,000**
4 to 6 months	**45,000**
6 to 12 months	**53,000**
More than 12 months	**0**
Pooled Funds	**23,957**
Total	**178,797**

The Authority had a total average net positive balance of £205.7m during the period April 2019 to March 2020

Chart 1 : WECA Investments by Funding Source (£178.8m) at 31st March 2020

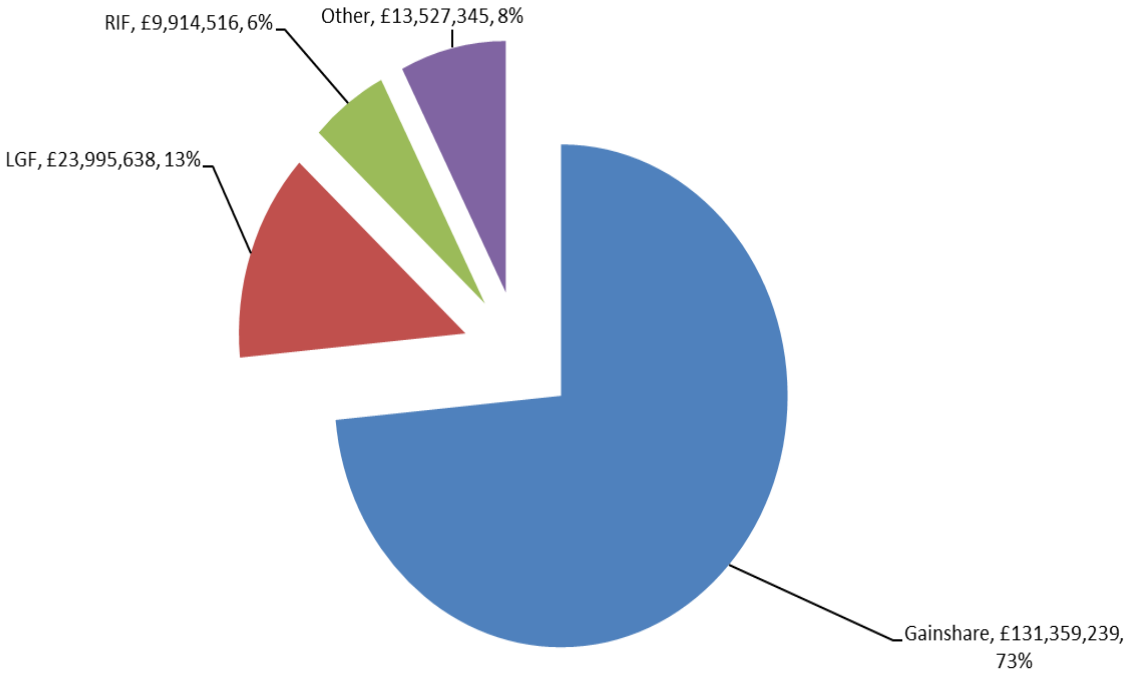


Chart 2 : WECA Investments by Funding Source (£212.8m) at 30th September 2019

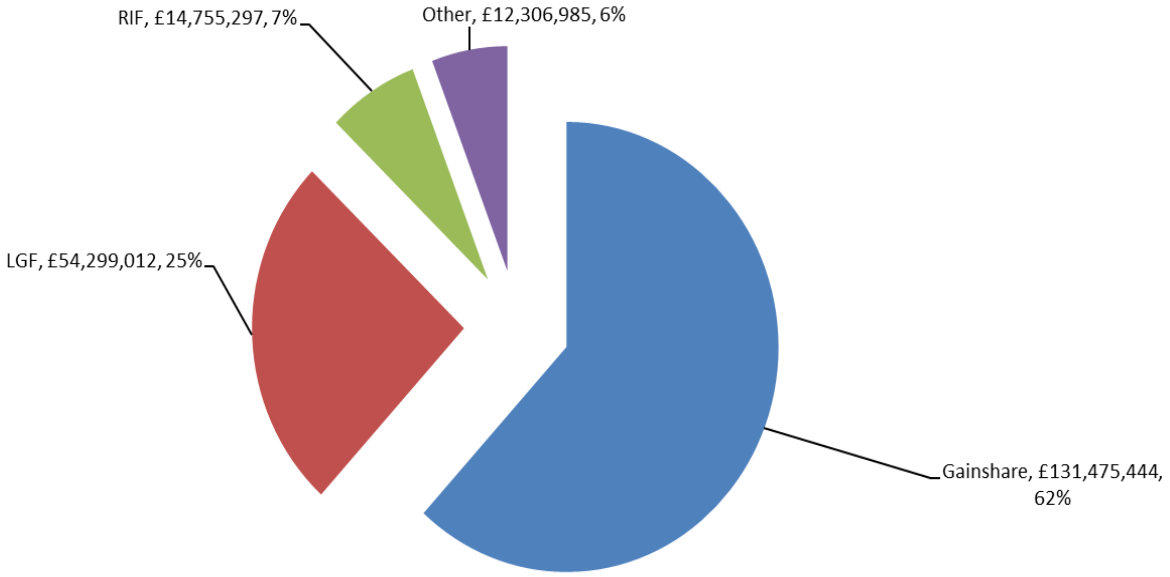


Chart 3: WECA Investments by Type (178.8m) as at 31st March 2020

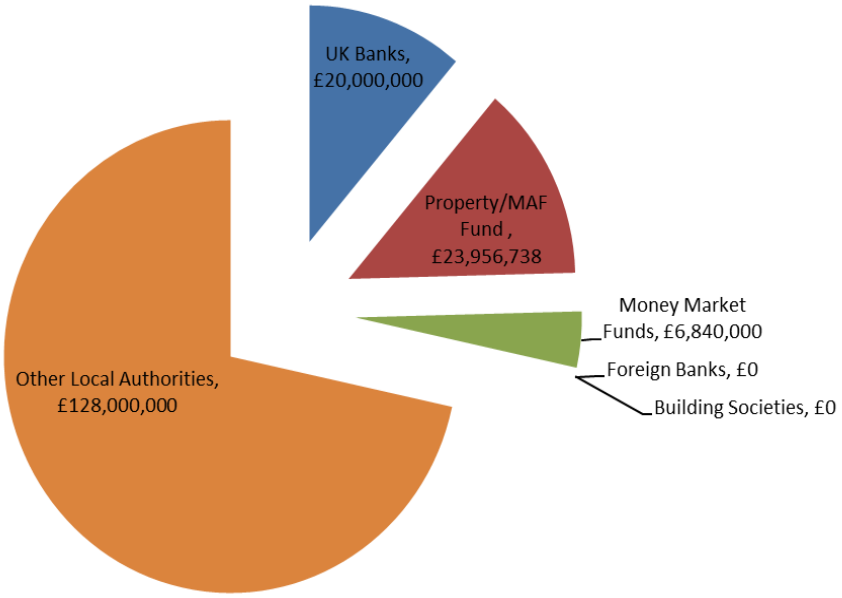


Chart 4: WECA Investments by Type (212.8m) as at 30th September 2019

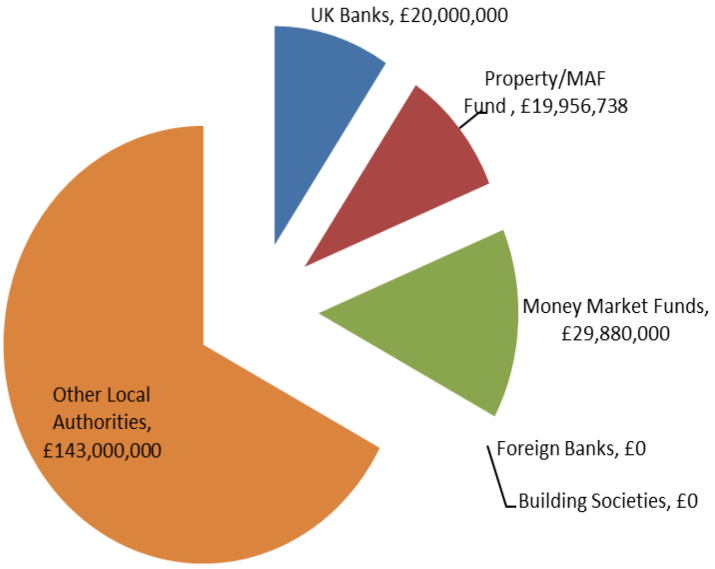


Chart 5: WECA Investments per lowest equivalent Long Term credit rating (£178.8m) at 31st March 2020

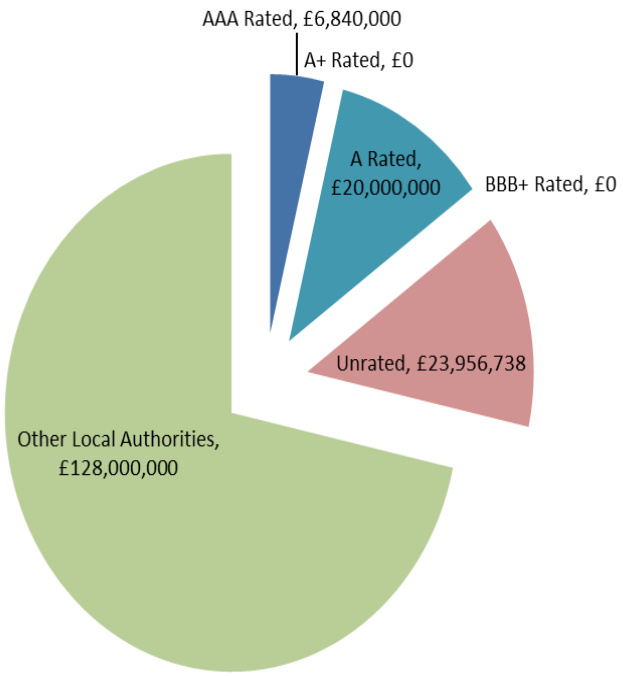
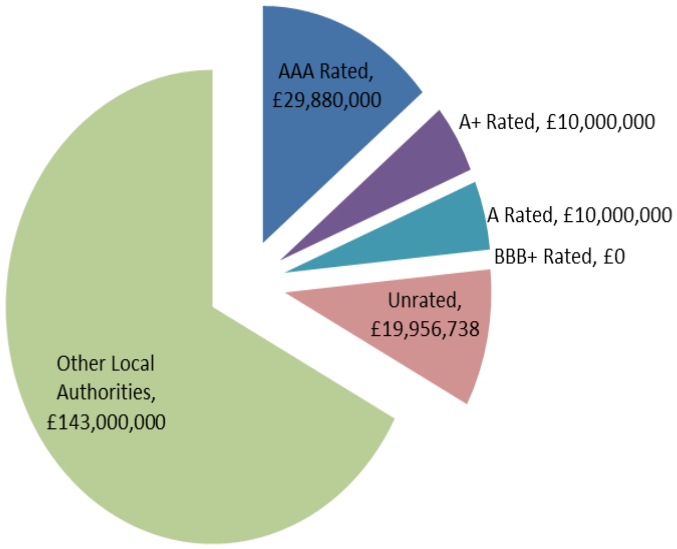


Chart 6: WECA Investments per lowest equivalent Long Term credit rating (£212.8m) at 30th September 2019



APPENDIX 3

Average rate of return on investments for 2019/20

	Apr %	May %	Jun %	Jul	Aug	Sep
Average rate of interest earned	0.90	1.03	1.08	1.24	1.26	1.29
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.63	0.63	0.61	0.61	0.61	0.62
Difference from Benchmark %	+0.27	+0.40	+0.47	+0.63	+0.65	+0.67

	Oct %	Nov %	Dec %	Jan	Feb	Mar	Average %
Average rate of interest earned	1.31	1.36	1.39	1.37	1.41	1.40	1.24
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.61	0.61	0.62	0.61	0.61	0.06	0.52
Difference from Benchmark %	+0.70	+0.75	+0.77	+0.73	+0.80	+1.34	+0.72

APPENDIX 4

Authorities External Borrowing at 31st March 2020

	Balance at 31st March 2020 £000s
Public Works Loan Board	**0**
Banks (LOBO)	**0**
Banks (Fixed Term)	**0**
Local Authorities (Long Term)	**0**
Local Authorities (Short Term)	**15,000**
Total	**15,000**

As part of its approach to liquidity management, the Authority may borrow short term loans to cover any unplanned cash flow shortages as they arrive.

Covid-19 has had a detrimental effect on cashflow like any other Local Authority in the country and, together with receipt of funding from Government being difficult to forecast, this has led the Authority to approach the short term LA loan market at the end of March 2020. Rates in this market were exceptionally high at the time and above 2%, due to both the high volume of Local Authorities needing to borrow and very few willing to lend with short-term liquidity needing to be retained during the Coronavirus pandemic.

The market has now settled, and we are seeing rates at a more normal level, at or under 1%.

APPENDIX 5

Economic and Market Review for 2019/20

Economic background: The UK's exit from the European Union and future trading arrangements, had remained one of major influences on the UK economy and sentiment during 2019/20. The 29th March 2019 Brexit deadline was extended to 12th April, then to 31st October and finally to 31st January 2020. Politics played a major role in financial markets over the period as the UK's tenuous progress negotiating its exit from the European Union together with its future trading arrangements drove volatility, particularly in foreign exchange markets. The outcome of December's General Election removed a lot of the uncertainty and looked set to provide a 'bounce' to confidence and activity.

The headline rate of UK Consumer Price Inflation UK Consumer Price Inflation fell to 1.7% y/y in February, below the Bank of England's target of 2%. Labour market data remained positive. The ILO 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.

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%.

Then coronavirus swiftly changed everything. COVID-19, 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.

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.

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.

The US economy grew at an annualised rate of 2.1% in Q4 2019. After escalating trade wars and a protracted standoff, the signing of Phase 1 of the trade agreement between the US and China in January was initially positive for both economies, but COVID-19 severely impacted sentiment and production in both countries. Against a

slowing economic outlook, the US Federal Reserve began cutting rates in August. Following a series of five cuts, the largest of which were in March 2020, the Fed Funds rate fell from of 2.5% to range of 0% - 0.25%. The US government also unleashed a raft of COVID-19 related measures and support for its economy including a $2 trillion fiscal stimulus package. With interest rates already on (or below) the floor, the European Central Bank held its base rate at 0% and deposit rate at -0.5%.

Financial markets: 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. The flight to quality caused gilts yields to fall substantially. The 5-year benchmark falling from 0.75% in April 2019 to 0.26% on 31st March. The 10-year benchmark yield fell from 1% to 0.4%, the 20-year benchmark yield from 1.47% to 0.76% over the same period. 1-month, 3-month and 12-month bid rates averaged 0.61%, 0.72% and 0.88% respectively over the period.

Since the start of the calendar 2020, the yield on 2-year US treasuries had fallen from 1.573% to 0.20% and from 1.877% to 0.61% for 10-year treasuries. German bund yields remain negative.

Credit background: 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.

After remaining flat in January and February and between a range of 30-55bps, Credit Default Swap spreads rose sharply in March as the potential impact of the coronavirus on bank balance sheets gave cause for concern. Spreads declined in late March and through to mid-April but remain above their initial 2020 levels. NatWest Markets Plc (non-ringfenced) remains the highest at 128bps and National Westminster Bank Plc (ringfenced) still the lowest at 56bps. The other main UK banks are between 65bps and 123bps, with the latter being the thinly traded and volatile Santander UK CDS.

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.

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-.

APPENDIX 6

Interest & Capital Financing Costs – Outturn Position for 2019/20

April 2019 to March 2020	YEAR END FORECAST			ADV/FAV
	Budgeted (Income) £'000	Outturn (Income) £'000	Forecast over or (under) spend £'000	
Interest & Capital Financing				
- Debt Costs	0	-4	-4	ADV
- Interest on Balances				
WECA	820	2,060	1,240	FAV
RIF	109	115	6	FAV
LEP	400	415	15	FAV
Total - Interest & Capital Financing	**1,329**	**2,586**	**1,257**	**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.

APPENDIX 8

WEST OF ENGLAND Combined Authority

WECA – Short term loan facility for West of England Unitary Authorities

Purpose

To outline a proposition where WECA, consistent with their Treasury Management Strategy, can offer short term loans to assist BANES, Bristol and South Gloucestershire Unitary Authorities where required.

Proposal

In unprecedented financial times for public sector finances, the West of England Unitary Authorities, (like all others across the country), will undoubtably face cashflow challenges over the coming months. The need to continue spending on organisational staffing and front line services will not always correlate with the receipt of emergency government funding to cover identified budget shortfalls.

WECA will offer short term loans to assist in the cashflow of the region's UA's, where feasible. Any loans offered will be dependent on WECA's own cashflow availability, be consistent with its Treasury Management Strategy and be pragmatic in terms of administrative processing.

- **Period of Application**

WECA will consider short term borrowing requests from the West of England Unitary Authorities on a monthly basis commencing on 1st July 2020 running to 1st December 2020 initially. In order to manage overall cashflow needs across the region, the window of application will be for one week, from the first of the relevant month.

- **Duration of Loan**

WECA will be flexible in offering loans for periods ranging from 2 weeks to 3 months where cashflow allows with the start and end dates being mutually agreed by both WECA and the relevant Unitary Authority.

- **Borrowing Limit**

Remaining within its approved Treasury Management Strategy, currently the maximum that will be lent to any one organisation, at any given time, will be £10m with any extension to this limit to be reviewed by the WECA audit committee.

- **Interest Rates**

Interest rates will be linked to the Local Authority loan market and will be determined based on the rates available at the point of borrowing. The loan period, and set interest rate, will be agreed, in advance, by the WECA Section 73 Officer and the UA Section 151 Officer. As a guide, based on prices as at 1st June 2020, any approved loans of up to three months would be at a rate of below 0.5%

- **Repayment arrangements**

The Unitary Authority, in negotiation with WECA, will have the option to extend any loan upon maturity for, up to, a further three month period subject to: (a) availability of WECA cashflow and (b) not exceeding an overall loan limit of £10m with WECA.

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