WEST OF ENGLAND Combined Authority

WEST OF ENGLAND COMBINED AUTHORITY COMMITTEE ITEM 17

25 June 2021

REPORT SUMMARY SHEET

TREASURY MANAGEMENT OUTTURN REPORT 2020-21

Purpose

To present the Treasury Management outturn report 2020-21.

Summary

This report includes the following key information:

- The CIPFA Code of Practice requires that the Combined Authority Committee considers the treasury management outturn report after the end of each financial year.
- Performance against the authority's key prudential indicators is shown in Appendix 1. All indicators are within target levels.
- The Authority's investment position as at 31st March 2021 is detailed in Appendix 2. This shows a change in Investment Balances to £279.4m at 31st March 2021 from £257.3m at 30th September 2020, which reflects a net increase.
- Appendix 3 details the investment performance, showing the average rate of interest earned over this period being 1.08%, which was 0.98% above the benchmark rate of average 7 day LIBID +0.05% (0.1%).
- 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 2021 the Authority held £20m of short-term loans, an increase of £5m from 31st March 2020. Outstanding loans on 31st March are summarised in Appendix 4.
- The Authority's treasury management advisors have provided an economic and market review for 2020/21 – attached at Appendix 5.

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:

- Paragraphs 2.10 and 2.11 of the report setting out the impact on pooled funds.
- Economic and Market Review in Appendix 5.

Recommendations

Members of the Combined Authority Committee are asked to:

a. Note the Treasury Management Outturn Report to 31st March 2021, prepared in accordance with the CIPFA Treasury Code of Practice.

b. Note the Treasury Management Indicators to 31st March 2021.

Contact officer: Malcolm Coe

Position: Director of Investment & Corporate Services

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

WEST OF ENGLAND Combined Authority

ITEM 17

REPORT TO: WECA COMMITTEE

DATE: 25th JUNE 2021

REPORT TITLE: TREASURY MANAGEMENT OUTTURN REPORT 2020/21

DIRECTOR: MALCOLM COE, DIRECTOR OF INVESTMENT AND CORPORATE SERVICES

AUTHOR: STEVE FINNEGAN, FINANCIAL ACCOUNTANT

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 2021.

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:

- Paragraphs 2.10 and 2.11 of the report sets out the impact on pooled funds;
- Economic and Market Review in Appendix 5.

Recommendations

The WECA Committee is required to:

a) Note the Treasury Management Outturn Report to 31st March 2021, prepared in accordance with the CIPFA Treasury Code of Practice.

b) Note the Treasury Management Indicators to 31st March 2021.

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 2020/21 was 1.08%, which is 0.98% above the benchmark rate.

2.2 The Authority's Prudential Indicators for 2020/21 were agreed by the Authority at its meeting on 29th January 2020 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 2021 is detailed in **Appendix 2**. This shows a change in Investment Balances to £279.4m at 31st March 2021 from £257.3m at 30th September 2020, which reflects a net increase.

2.4 The Authority is the Accountable Body for the West of England Revolving Investment Fund, (RIF). The balance at 31st March 2021 was £10.6m 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 2020/21 £34.2m of Local Growth Fund (LGF) grant was received from Central Government, along with the remaining sums, provided a balance at 31st March 2021 of £25m. 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 2020 to March 2021 was £2,790k. Interest earned for RIF and LGF is ringfenced to those funds, giving rise to an income outturn for WECA activities of £2,404k. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period being 1.08%, which was 0.98% above the benchmark rate of average 7 day LIBID +0.05% (0.1%).

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 2021 the Authority held £20m of short-term loans, an increase of £5m from 31st March 2020. Outstanding loans on 31st March are summarised in **Appendix 4.**

Strategic & Tactical Decisions

2.8 Both the CIPFA code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income

2.9 As shown in the charts at **Appendix 2**, the investment portfolio has been diversified across UK Banks and Local Authorities, which totalled £226.3m. The Authority also uses AAA rated Money Market funds to maintain very short-term liquidity with £19.1m invested in Money Market Funds as at 31st March 2021. The net return on Money Market Funds net of fees, which had fallen after Bank Rate was cut to 0.1% in March, are now at or very close to zero; fund management companies have temporarily lowered or waived fees to avoid negative net returns. With continued downward pressure on short dated cash rates, the possibility of net negative returns cannot be ruled out. Given the increasing risk and low returns from short term unsecured bank investments, the Authority has further diversified into higher yielding asset classes.

2.10 The Authority retains units invested in the CCLA Property Fund of £9.9m and we have added a further £10m to our pooled fund's portfolio, with investments of £10m now with Investec, £7m with Kames, £3.5m with M & G and £3.5m with Columbia Threadneedle. The Authority has a total of £33.9m invested across the funds. These investments seek to enhance yields, provide diversification and are intended to be held for higher returns over a long period of time.

2.11 During the initial phase of the pandemic in March 2020, the sharp falls in corporate bond and equity markets had a negative impact on the value of the Council's pooled fund holdings which was reflected in the 31st March 2020 fund valuations with every fund registering negative capital returns over a 12 month period. Since March 2020 there has been improvement in market sentiment which is reflected in an increase in capital values of these strategic bond, equity and multi-asset income funds in the Authority's portfolio. The recovery in UK equities has lagged those of US and European markets. Similar to many other property funds, dealing (i.e. buying or selling units) in the CCLA Local Authorities' Property Fund was suspended in March 2020 and lifted in September. 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 2020-21 provided an average total return of 3.94%. In light of their performance over the medium-long term, investment in these funds have been maintained.

2.12 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.

2.13 Environmental, Social and Governance (ESG) and responsible investing has gained further momentum in 2021. Investors in physical and financial assets are increasingly being expected to be on the frontline of combating climate change and committing to sustainability goals. In its recent consultation on the Treasury Management Code of Practice, CIPFA has proposed a new Treasury Management Practice on ESG Risk

Management. The Authority will continue to work with its treasury advisors Arlingclose for support and advice through its ESG, and responsible investment service.

Future Strategic & Tactical Issues

2.14 The Authority's treasury management advisors have provided an economic and market review for 2020/21 – attached at **Appendix 5**.

2.15 Following the cut in Bank rate from 0.75% to 0.10% in March 2020, the Authority will expect to receive significantly lower income from its cash and short-dated money market investments, including money market funds in 2021/22, as rates on cash investments are close to zero percent. Income from most of the Authority's externally managed funds could also be lower than in 2020/21 and earlier years. The Authority has moved £400k from its investment income surplus for 2020-21 to an earmarked Treasury Management reserve to offset against future rate drops. Whilst the arrival and approval of vaccines against COVID-19 and the removal of Brexit uncertainty that had weighed on UK equities were encouraging developments, dividend and income distribution on pooled funds is dependent on company earnings in a very challenging and uncertain trading environment as well as enforced cuts or deferral required by regulatory authorities.

Other Options Considered

3 None.

Risk Management/Assessment

4 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

5 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.

5.1 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.

5.2 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:

6 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:

7 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 2021
Appendix 3 – Average monthly rate of return for 2020/21
Appendix 4 – The Authority's External Borrowing Position at 31 March 2021
Appendix 5 – Arlingclose's Economic & Market Review for 2020/21
Appendix 6 – Interest & Capital Financing Budget Monitoring 2020/21
Appendix 7 – Summary Guide to Credit Ratings

Background Papers: Treasury Management Strategy Statement & Investment Strategy 2020/21 – As reported to WECA Committee on 29th January 2020.

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 on 07436 600313; 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-	A+

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	£20m

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	£724k

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. Interest rates have fallen during 2020-21 and have had some impact on our investment accounts. There is a potential risk that interest rates will drop and reduce 2021/22 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 Target	2020/21 Actual	2021/22 Target	2021/22 Actual	2022/23 Target	2022/23 Actual
Limit on principal invested beyond year end	£100m	£100m	£75m	£55m	£50m	£49m

APPENDIX 2

The Authority's Investment position at 31st March 2021

The term of investments are as follows:

	Balance at 31st March 2021 £000s
Notice (instant access funds)	**25,300**
Up to 1 month	**0**
1 month to 3 months	**62,185**
4 to 6 months	**58,000**
6 to 12 months	**55,000**
More than 12 months	**45,000**
Pooled Funds	**33,957**
Total	**279,442**

The Authority had a total average net positive balance of £253.7m during the period April 2020 to March 2021

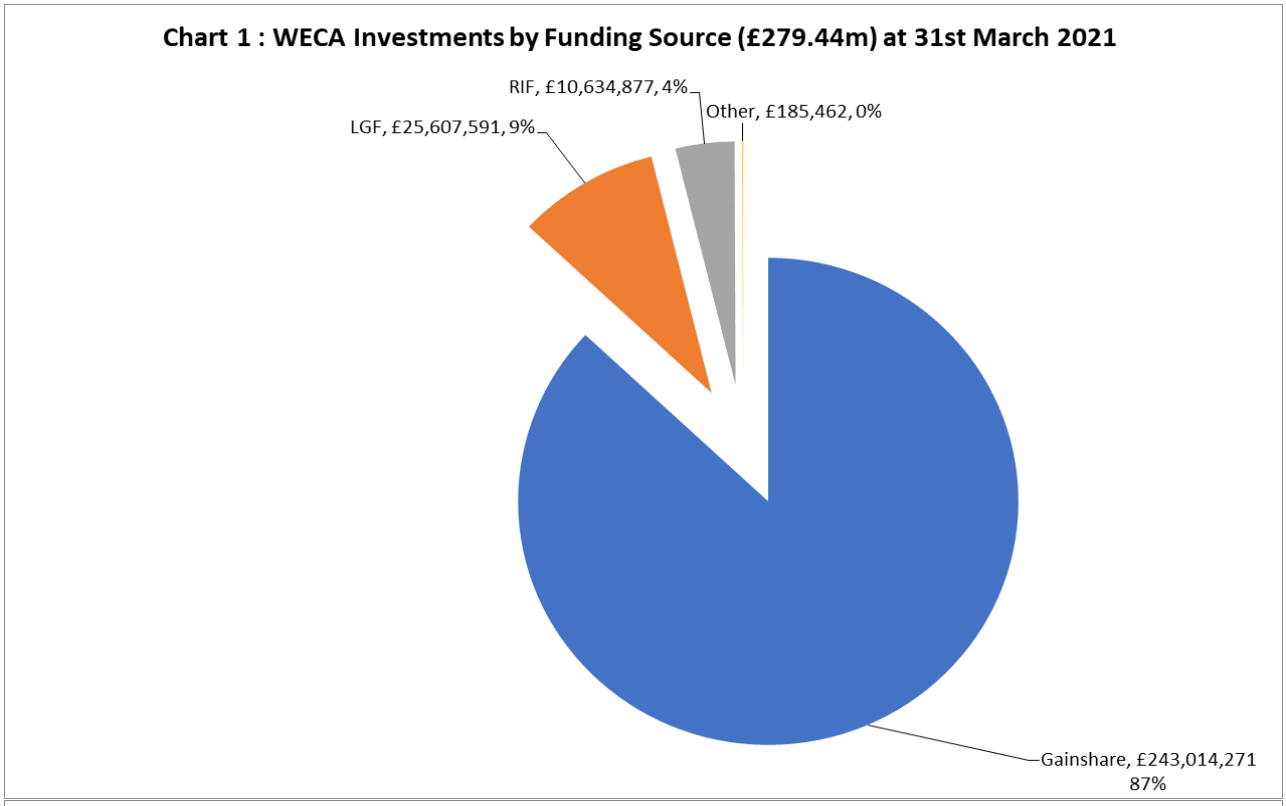


Chart 1 : WECA Investments by Funding Source (£279.44m) at 31st March 2021
RIF, £10,634,877, 4%
Other, £185,462, 0%
LGF, £25,607,591, 9%
Gainshare, £243,014,271
87%

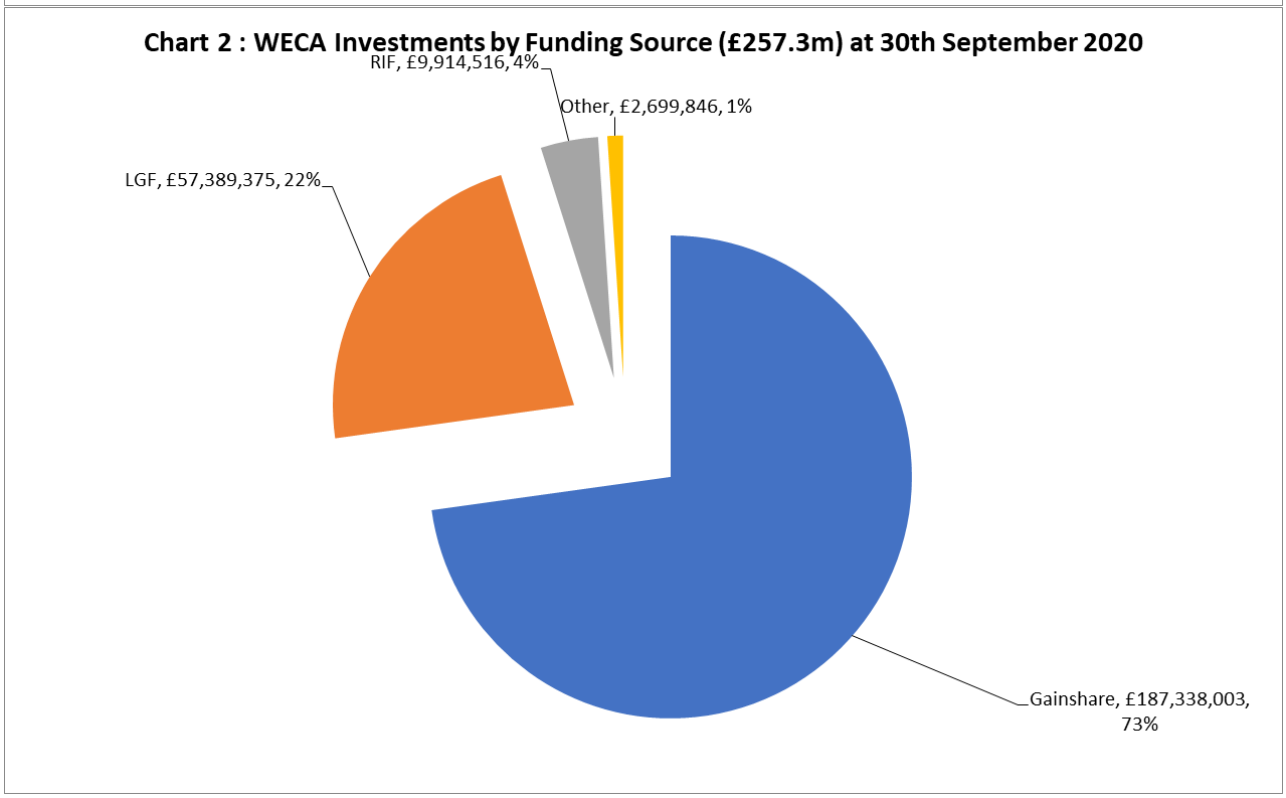


Chart 2 : WECA Investments by Funding Source (£257.3m) at 30th September 2020
RIF, £9,914,516, 4%
Other, £2,699,846, 1%
LGF, £57,389,375, 22%
Gainshare, £187,338,003,
73%

Chart 3: WECA Investments by Type (279.44m) as at 31st March 2021

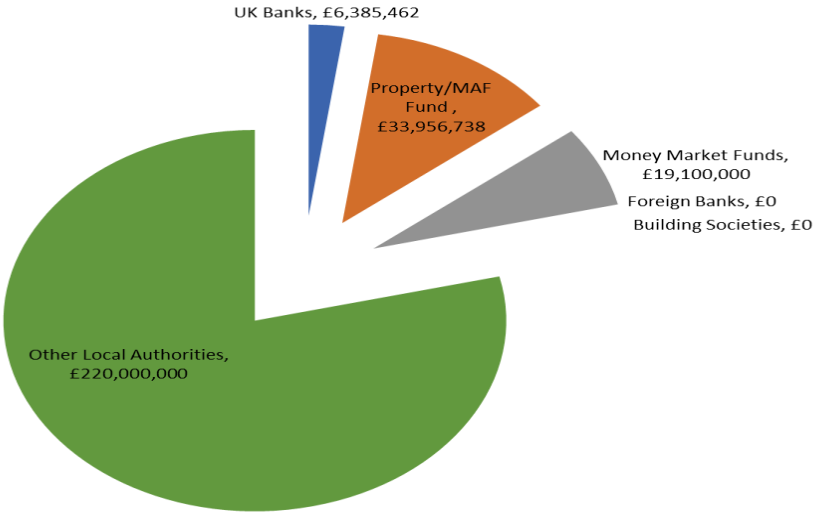


Chart 4: WECA Investments by Type (257.3m) as at 30th September2020

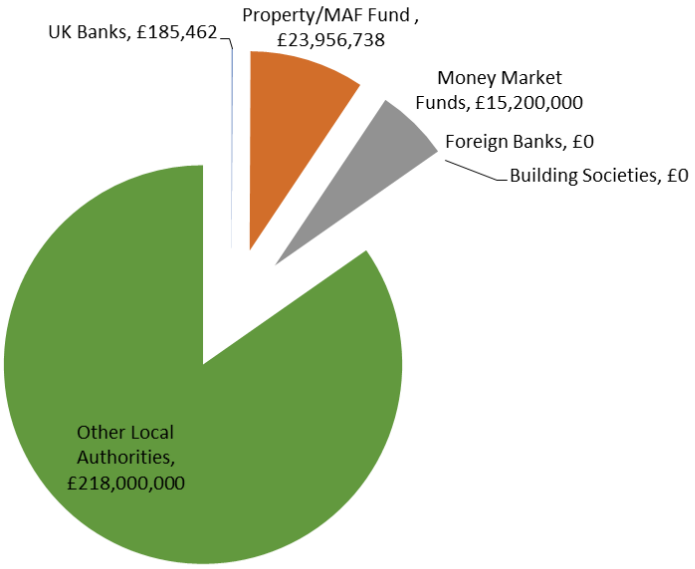


Chart 5: WECA Investments per lowest equivalent Long Term credit rating (£279.44m) at 31st March 2021

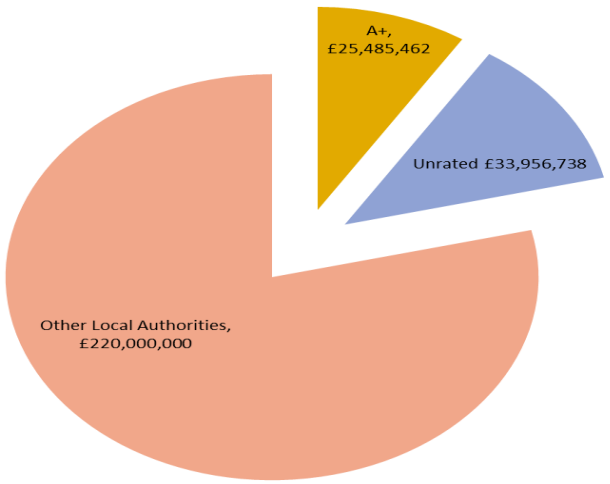
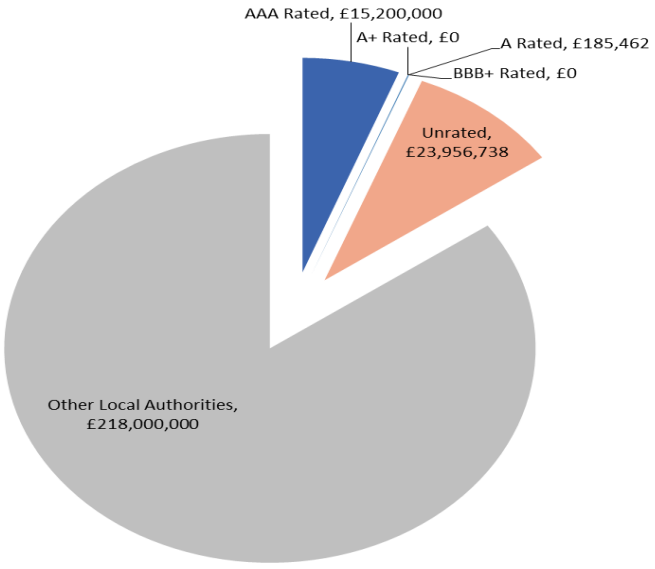


Chart 6: WECA Investments per lowest equivalent Long Term credit rating (£257.3m) at 30th September 2020



APPENDIX 3

Average Rate of Return on Investments for 2020/21

	Apr %	May %	Jun %	Jul	Aug	Sep
Average rate of interest earned	1.04	1.04	1.14	1.11	1.10	1.09
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.145	0.118	0.113	0.112	0.1058	0.096
Difference from Benchmark %	+0.895	+0.922	+1.027	+0.998	+0.992	+0.994

	Oct %	Nov %	Dec %	Jan	Feb	Mar	Average %
Average rate of interest earned	1.08	1.07	1.08	1.09	1.06	1.07	1.08
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.094	0.086	0.075	0.084	0.085	0.092	0.10
Difference from Benchmark %	+0.986	+0.984	+1.005	+1.006	+0.975	+0.978	+0.98

APPENDIX 4

Authorities External Borrowing at 31st March 2021

	Balance at 31st March 2021 £000s
Public Works Loan Board	**0**
Banks (LOBO)	**0**
Banks (Fixed Term)	**0**
Local Authorities (Long Term)	**0**
Local Authorities (Short Term)	**20,000**
Total	**20,000**

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.

APPENDIX 5

Economic and Market Review for 2020/21

Economic background: The coronavirus pandemic dominated 2020/21, leading to almost the entire planet being in some form of lockdown during the year. The start of the financial year saw many central banks cutting interest rates as lockdowns caused economic activity to grind to a halt. The Bank of England cut Bank Rate to 0.1% and the UK government provided a range of fiscal stimulus measures, the size of which has not been seen in peacetime.

Some good news came in December 2020 as two COVID-19 vaccines were given approval by the UK Medicines and Healthcare products Regulatory Agency (MHRA). The UK vaccine rollout started in earnest; over 31 million people had received their first dose by 31st March.

A Brexit trade deal was agreed with only days to spare before the 11pm 31st December 2020 deadline having been agreed with the European Union on Christmas Eve.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the year but extended its Quantitative Easing programme by £150 billion to £895 billion at its November 2020 meeting. In its March 2021 interest rate announcement, the BoE noted that while GDP would remain low in the near-term due to COVID-19 lockdown restrictions, the easing of these measures means growth is expected to recover strongly later in the year. Inflation is forecast to increase in the near-term and while the economic outlook has improved there are downside risks to the forecast, including from unemployment which is still predicted to rise when the furlough scheme is eventually withdrawn.

Government initiatives supported the economy and the Chancellor announced in the 2021 Budget a further extension to the furlough (Coronavirus Job Retention) scheme until September 2021. Access to support grants was also widened, enabling more self-employed people to be eligible for government help. Since March 2020, the government schemes have help protect more than 11 million jobs.

Despite the furlough scheme, unemployment still rose. Labour market data showed that in the three months to January 2021 the unemployment rate was 5.0%, in contrast to 3.9% recorded for the same period 12 months ago. Wages rose 4.8% for total pay in nominal terms (4.2% for regular pay) and was up 3.9% in real terms (3.4% for regular pay). Unemployment is still expected to increase once the various government job support schemes come to an end.

Inflation has remained low over the 12 month period. Latest figures showed the annual headline rate of UK Consumer Price Inflation (CPI) fell to 0.4% year/year in February, below expectations (0.8%) and still well below the Bank of England's 2% target. The ONS' preferred measure of CPIH which includes owner-occupied housing was 0.7% year/year (1.0% expected).

After contracting sharply in Q2 (Apr-Jun) 2020 by 19.8% q/q, growth in Q3 and Q4 bounced back by 15.5% and 1.3% respectively. The easing of some lockdown measures in the last quarter of the calendar year enabled construction output to continue, albeit at a much slower

pace than the 41.7% rise in the prior quarter. When released, figures for Q1 (Jan-Mar) 2021 are expected to show a decline given the national lockdown.

After collapsing at an annualised rate of 31.4% in Q2, the US economy rebounded by 33.4% in Q3 and then a further 4.1% in Q4. The US recovery has been fuelled by three major pandemic relief stimulus packages totalling over $5 trillion. The Federal Reserve cut its main interest rate to between 0% and 0.25% in March 2020 in response to the pandemic and it has remained at the same level since. Joe Biden became the 46th US president after defeating Donald Trump.

The European Central Bank maintained its base rate at 0% and deposit rate at -0.5% but in December 2020 increased the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

Financial markets: Monetary and fiscal stimulus helped provide support for equity markets which rose over the period, with the Dow Jones beating its pre-crisis peak on the back of outperformance by a small number of technology stocks. The FTSE indices performed reasonably well during the period April to November, before being buoyed in December by both the vaccine approval and Brexit deal, which helped give a boost to both the more internationally focused FTSE 100 and the more UK-focused FTSE 250, however they remain lower than their pre-pandemic levels.

Ultra-low interest rates prevailed throughout most of the period, with yields generally falling between April and December 2020. From early in 2021 the improved economic outlook due to the new various stimulus packages (particularly in the US), together with the approval and successful rollout of vaccines, caused government bonds to sell off sharply on the back of expected higher inflation and increased uncertainty, pushing yields higher more quickly than had been anticipated.

The 5-year UK benchmark gilt yield began the financial year at 0.18% before declining to -0.03% at the end of 2020 and then rising strongly to 0.39% by the end of the financial year. Over the same period the 10-year gilt yield fell from 0.31% to 0.19% before rising to 0.84%. The 20-year declined slightly from 0.70% to 0.68% before increasing to 1.36%.

1-month, 3-month and 12-month SONIA bid rates averaged 0.01%, 0.10% and 0.23% respectively over the financial year.

The yield on 2-year US treasuries was 0.16% at the end of the period, up from 0.12% at the beginning of January but down from 0.21% at the start of the financial year. For 10-year treasuries the end of period yield was 1.75%, up from both the beginning of 2021 (0.91%) and the start of the financial year (0.58%).

German bund yields continue to remain negative across most maturities.

Credit review: After spiking in March 2020, credit default swap spreads declined over the remaining period of the year to broadly pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, albeit Santander UK is still an outlier compared to the other ringfenced/retail banks. At the end of the period Santander UK was trading the highest at 57bps and Standard Chartered the lowest at 32bps. The other

ringfenced banks were trading around 33 and 34bps while Nationwide Building Society was 43bps.

Credit rating actions to the period ending September 2020 have been covered in previous outturn reports. Subsequent credit developments include Moody's downgrading the UK sovereign rating to Aa3 with a stable outlook which then impacted a number of other UK institutions, banks and local government. In the last quarter of the financial year S&P upgraded Clydesdale Bank to A- and revised Barclay's outlook to stable (from negative) while Moody's downgraded HSBC's Baseline Credit Assessment to baa3 whilst affirming the long-term rating at A1.

The vaccine approval and subsequent rollout programme are both credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. The institutions and durations on the Authority's counterparty list recommended by treasury management advisors Arlingclose remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

APPENDIX 6

Interest & Capital Financing Costs – Outturn Position for 2020/21

April 2020 to March 2021	Year End Position Budgeted Income £'000	Outturn Income £'000	Outturn over or under spend £'000	Adv/Fav
Interest & Capital Financing				
- Debit Costs (Borrowing)	0	-166	-166	Adv
- Interest on Balances				
WECA	1,020	2,404	1,384	Fav
RIF	0	68	68	Fav
LEP	200	317	117	Fav
Total - Interest & Capital Financing	**1,220**	**2,623**	**1,403**	**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.