Agenda item 9

Cabinet – 12 August 2020

Treasury Management Annual Report 2019/20

Portfolio:	Councillor Bird, Leader of the Council
Related portfolios:	N/A
Service:	Finance
Wards:	All
Key decision:	No
Forward plan:	Yes

1. Aim

1.1 The council is required through regulations issued under the Local Government Act 2003 to produce a year end position statement reviewing treasury management activities and prudential and treasury indicator performance. The Treasury Management year end position statement at Appendix A provides Cabinet with these details, and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 The council is required to note the TM Annual Report is presented to provide assurance that TM performance is in line with budgeted expectations and within the above regulations and Codes that the authority is required to comply with.

2. Summary

2.1 This report sets out the council's 2019/20 year end position for treasury management activities (Appendix A).

2.2 Despite difficult market conditions with low interest rates the council achieved an average interest rate across all investments of 1.50% compared to budget of 1.21%, realising an additional £0.704m of investment income. All of the target interest receivable rates set at Council on 28/02/19 were exceeded.

2.3 An overachievement of investment income was delivered of £0.704m as a result of the average rate achieved across all investments being higher than budgeted for in the 2019/20 budget setting exercise. This has taken considerable effort and negotiation from the treasury team to secure favourable rates when considering investment options, and through the review and identification of new opportunities for investment.

2.4 Capital expenditure was £69.780m of which £12.350m will be funded from approved borrowing (Table 2, Appendix A).

2.5 The actual debt position for the Council as at 31 March 2020 is £307.612m, which is within both the operational and authorised limits for external debt agreed at council on 28/02/19.

3. Recommendations

3.1 To note and forward to Council, for consideration and noting (in line with the requirements of the Treasury Management Code of Practice (2017)), the annual position statement for treasury management activities 2019/20 including prudential and local indicators (Appendix A).

4. Report detail - know

Context

4.1 The Treasury Management annual report at Appendix A provides Cabinet with these details, and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

The following key points of interest have been extracted from the report:

- The annual report meets the requirement of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

- Capital expenditure was £69.780m of which £12.350m will be funded from approved borrowing (Table 2, Appendix A).

- The banking environment has continued to be one of the low interest returns. The Bank of England base rate decreased from 0.75% to 0.25% on 11th March 2020 and then reduced further to 0.10% on 19th March, due to the onset of the global coronavirus crisis.

- Despite the situation of low interest returns throughout the financial year, the authority has continued to identify appropriate new areas of investment opportunity that has led to a significant impact on average investment performance, which increased from 1.32% in 2018/19 to 1.50% in 2019/20.

- To note within the local indicators (Table 9) that the net borrowing cost as a percentage of net council tax requirement 6.06% (3a) and the net borrowing cost as percentage of tax revenue 3.78% (3b) are both within their target upper limits of 20% and 12.50%.

- Debt as a percentage of the Capital Financing Requirement (Table 7). Due to the requirements of accounting standard IFRS9, the council has accrued £54.000m in this financial year in relation to pension borrowing which will be taken out in the next financial year. This has increased the Debt as % of CFR temporarily to 103%. If this accrual was removed the Debt as % of CFR would be 88%, which is a more representative figure.

Council Corporate Plan priorities

4.2 Sound financial management of the council's cash balances supports the delivery of council priorities within council's available resources.

Risk management

4.3 Treasury management activity takes place within a robust risk management environment, which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. It is recognised that the management of risk is as important as maximisation of performance and it is essential that the council has the right balance of risk and reward when making investment decisions. This is supported by treasury management policies which seek to manage the risk of adverse fluctuations in interest rates and safeguard the financial interests of the council.

4.4 Brexit continues to provide uncertainty for interest rates and within the financial markets and is expected to continue until at least the end of 2020. The Council has responded to this risk by reviewing counterparties for investments to minimise the risk to any one counter party or class of counter party.

Financial implications

4.5 Treasury management activity forms part of the council's financial framework and supports delivery of the medium term financial strategy. The review of treasury management performance and activity is reviewed through both the treasury management annual report and the mid-year performance review report.

Legal implications

4.6 The council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the council should comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original treasury management code in 1992 and further revisions to the Code in 2002, 2010 and 2017.

Procurement Implications/Social Value

4.7 None directly relating to this report.

Property implications

4.8 None directly relating to this report.

Health and wellbeing implications

4.9 None directly relating to this report.

Staffing implications

4.10 None directly relating to this report.

Reducing Inequalities

4.11 None directly relating to this report.

Consultation

4.12 The report has been approved by the finance treasury management panel, an internal governance arrangement comprising the S151 Officer, Head of Finance (Deputy S151 Officer) and Corporate Finance Manager.

5. Decide

5.1 In line with the Treasury Management Code of Practice (2017) there are a number of reports that are required to be produced and reported publicly each year. The Treasury Management Annual Report forms one of these requirements and as such is being reported to Cabinet for noting and forwarding onto Council for consideration.

6. Respond

6.1 This report is not seeking approval of a decision, in line with the Treasury Management Code of Practice (2017) it is required to be reported for noting and forwarding to Council for consideration.

7. Review

7.1 In line with Treasury Management Code of Practice (2017) this is a backward looking document looking at performance over the previous.

Background papers

Various financial working papers.

Mid-Year review of treasury management policy statement 2019/20 – Cabinet 18/12/19.

Corporate budget plan and treasury management and investment strategy 2019/20 – Council 28/02/19.

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4 August 2020

Councillor Bird
Leader of the Council

4 August 2020

Appendix A

Annual Treasury Management Report 2019/20

Walsall Council
June 2020

Annual Treasury Management Report 2019/20

Purpose

This council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicator performance. This document therefore reports this position for the 2019/20 financial year. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

During 2019/20 the following reports were produced:

- an annual treasury strategy in advance of the year (Council 28/02/2019)
- a mid-year (minimum) treasury update report (Cabinet 18/02/2019)
- an annual review of treasury management policies (Council 27/02/2020)
- an annual report following the year describing the activity compared to the strategy (this report to Audit Committee)

In addition, this council's treasury management panel has received regular treasury management update reports.

The regulatory environment places an onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the council's policies previously approved by members.

This council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to the full Council. In order to support members' scrutiny role member training on treasury management issues has been available to all members via the e-Learning platform throughout 2019/20.

Summary

During 2019/20, the council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Table 1 **Actual prudential and treasury indicators**	**2018/19 Actual £m**	**2019/20 Original £m**	**2019/20 Revised £m**	**2019/20 Actual £m**
Capital expenditure	57.075	73.483	132.669	69.780
Capital Financing Requirement:				
Including PFI and finance leases	357.673			357.159
Excluding PFI and finance leases	350.091			350.430
External Borrowing	302.753			361.612
Investments	179.860			214.485
Net borrowing	122.893			147.127

Other prudential and treasury indicators are to be found in the main body of this report. The Executive Director of Resources & Transformation (CFO) confirms that borrowing was only undertaken for capital purposes or to support required in year cash-flow requirements.

The challenging environment of low investment returns and uncertainty of counterparty risk has continued in 2019/20.

1. Introduction and background

To set the context of the treasury management environment it is first necessary to provide a review of the economy and interest rates.

In 2019/20 the challenging investment environment of previous years' continued, namely low investment returns, although levels of counterparty risk has continued to subside. The interest rate forecast at the start of the year was that the low interest rate environment would continue throughout 2019/20. An economic summary is given at the beginning of the borrowing and investment sections.

2. The Council's Capital Expenditure and Financing 2019/20

The council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc., which has no resultant impact on the council's borrowing need); or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed. The amount to be funded from borrowing for 2019/20 will be £12.350m. It shows an increase in capital expenditure funded from grants mainly due to Growth Fund Projects, for which Walsall is the accountable body for all the Black Country Districts.

Table 2	**2018/19 Actual £m**	**2019/20 Original £m**	**2019/20 Actual £m**
Total capital expenditure	**57.075**	**73.483**	**69.780**
Resourced by:			
• Capital receipts	1.977	1.790	2.781
• Capital grants	33.507	57.090	53.057
• Capital Reserves and Revenue	2.249	5.990	1.592
• Approved Borrowing	19.342	8.613	12.350
	57.075	**73.483**	**69.780**

3. The Council's Overall Borrowing Need

The council's underlying need to borrow for capital expenditure is termed the capital financing requirement (CFR). This figure is a gauge of the council's debt position. The CFR results from the capital activity of the council and which resources have been used to pay for the capital spend. It represents the 2019/20 capital expenditure funded by borrowing (see table 2), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the council.

Reducing the CFR – the council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The council is required to make an annual revenue charge, called the minimum revenue provision (MRP) to reduce the CFR. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a voluntary revenue provision (VRP).

In 2014/15 the MRP policy was reviewed, updated and approved by Council. Following a further review in 2015/16 Council on 26th February 2016 amended the implementation date of these changes from 1st April 2014 to 1st April 2008. The effect of this is a smoothing of the MRP charge. Rather than having a high MRP charge in initial years that reduces over time, the council will now pay a charge that is more consistent throughout a shorter time period. This will result in a lower MRP charge up to 2035/36 and then a higher MRP charge from 2036/37 to 2064/65. Overall the initial lower MRP charge is offset by the later higher MRP charge, although this increase will be lower in real terms because money loses value over time. The policy change supported the strategy of maintaining the level of current capital financing costs as a proportion of council tax revenue. A further outcome of the review of the MRP policy was a restatement of the Capital Financing Requirement (CFR) as at 31st March 2015. This was due to the review also highlighting the opportunity to apply consistently accounting practices from 2008 to 2015.

The council's CFR for the year 2019/20 is shown below in Table 3, and represents a key prudential indicator (PrI4). It includes Private Finance Initiative (PFI) and leasing schemes from the balance sheet which increase the council's borrowing need – although no borrowing is normally required against these schemes as a borrowing facility is included in the contract (if applicable). It shows that in 2019/20 the council's CFR has reduced by £0.514m from £357.673m to £357.159m.

Table 3 CFR (£m)	31 March 2019 Actual £m	31 March 2020 Actual £m
Opening balance	**351.592**	**357.673**
Add capital expenditure funded from approved borrowing (as above)	19.342	12.350
Add adjustment to CFR	-2.000	0.000
Less MRP	-11.261	-12.864
Closing balance	**357.673**	**357.159**

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term the council's external borrowing, net of investments, must only be for a capital purpose, or to fund expected in year cash-flow requirements. This essentially means that the council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR. Table 4 below highlights the council's net borrowing position (£147.127m) against the CFR excluding PFIs and Finance leases (£350.430m) because the debt liability for these are not in the net borrowing position of the council. The council has complied with this prudential indicator.

Table 4 Gross borrowing and the CFR (£m)	31 March 2019 Actual £m	31 March 2020 Actual £m
Gross Borrowing	**308.034**	**366.329**
Net borrowing position	**122.893**	**147.127**
CFR – excluding PFIs and Finance Leases	**350.091**	**350.430**
Long term Assets	**595.727**	**584.001**
Net Borrowing % of Long term Assets	**20.63%**	**25.19%**

Another measure of prudency is the proportion of net to fixed assets. Table 4 shows that the net borrowing position of the council as at 31/03/20 is £147.127m which represents 25% of the value of the council's long term assets which are valued on the council's balance sheet at that date (by comparison, the average position for our statistical neighbours was 28% at 31/03/19 – this data is not currently available for 31st March 2020).

Other key Prudential Indicators are shown in Table 5 below:

Table 5 Prudential and Borrowing Limits	31 March 2019 Actual £m	31 March 2020 Actual £m
1. Authorised limit	**442.096**	**458.391**
2. Maximum gross borrowing in year	**349.318**	**307.568**
3. Operational boundary	**401.905**	**416.719**
4. Average gross borrowing	**316.573**	**337.182**
5. Financing costs as proportion of net revenue stream	**4.46%**	**4.31%**

1. **The authorised limit** - the authorised limit is the "affordable borrowing limit" set by the council as required by section 3 of the Local Government Act 2003. The council does not have the power to borrow above this level without the prior approval of full Council. Table 5 demonstrates that during 2019/20 the council's maximum gross borrowing was within its authorised limit.

2. **Maximum Gross borrowing** – is the peak level of borrowing in year.

3. **The operational boundary** – the operational boundary is the expected borrowing position of the council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached. In 2019/20 the council's average borrowing position was less than the operational boundary.

4. **Average Gross Borrowing** – is an estimate of the borrowing level in the year see Table 7 for analysis of Borrowing.

5. **Actual financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. Net revenue stream is defined as Net Council Tax Requirement + Standard Spending Assessment (previously Formula Grant).

4. Prudential Indicators

The following tables show performance against statutorily required prudential and local indicators.

Table 6 – Prudential Indicators		Actual 2018-19	Target 2019-20	Position 31-Mar-20	Variance to target	
		£m	£m	£m	£m	%
PrI 1	Capital Expenditure	57.073	132.669	69.780	(62.889)	(47%)
PrI 2	Ratio of financing costs to net revenue stream	4.46%	4.32%	4.31%	0.01%	0%
PrI 3	Estimates of the incremental impact of new capital investment decisions on Council Tax	£24.14	£15.36	£15.36	0.00	0%
PrI 4	Capital Financing Requirement	357.672	381.564	381.564	0.00	0%
PrI 5	Authorised Limit for external debt	442.096	458.391	458.391	0.00	0%
PrI 6	Operational Limit for external debt	401.905	416.719	416.719	0.00	0%

Ref	Prudential Indicator	Actual 2018-19 £m	Target 2019-20 £m	Position 31-Mar-20 £m
PrI 7	Gross Borrowing exceeds capital financing requirement	No	No	No
PrI 8	Authority has adopted CIPFA Code of Practice for Treasury Management	Yes	Yes	Yes
PrI 9	Total principle sums invested for longer than 365 days must not exceed	15.0	25.0	14.0

Ref	Prudential Indicator	Upper Limit	Lower Limit	Actual 2018/19	Position 31-Mar-20
PrI 10	Fixed Interest Rate Exposure	95%	40%	**95%**	**94%**
PrI 11	Variable Interest Rate Exposure	45%	0%	**6%**	**6%**
PrI 12	***Maturity Structure of Borrowing:***				
	Under 12 months	25%	0%	**13%**	**13%**
	12 months and within 24 months	25%	0%	**5%**	**5%**
	24 months and within 5 years	40%	0%	**26%**	**26%**
	5 years and within 10 years	50%	5%	**8%**	**8%**
	10 years and above	85%	30%	**48%**	**48%**

PRL 5 (authorised limit for external debt) and PRL 6 (operational limit for external debt) were approved by Council on the 28 February 2019 and the CIPFA Code of Practice only allows these limits to be changed by Council and therefore the actual limit and the target remain the same. The actual debt position for the Council as at 31 March 2020 is £307.612m.

Key variances are because of the following reasons:-

Prl 1 Total capital expenditure - variation of £62.889m

The £132.669m target for 2019/20 is based on the figure for the 2019/20 capital programme reported in the budget report presented to full Council on the 28th February 2019. The actual spend for 2019/20 is lower than the target due to amendments to the original capital programme agreed during the year, mainly in relation to the Growth Deal and Basic Need projects, of which spend will now be incurred in 2020/21.

Prl 12 Maturity Structure of Borrowing

For the purpose of the maturity profile indicator the next call date on a LOBO loan is assumed; as it is the right of the lender to require repayment. However due to the low interest rate environment it is unlikely that in the medium term that any of the LOBO's will be called.

5. Treasury Position at 31st March 2020

The council's debt and investment position is organised by the treasury management team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the council's treasury management practices. At the beginning and the end of 2019/20 the council's treasury position was as shown below in **Table 7**:

Table 7 Loans and Investments	Opening Balance £m	Average Rate At 31/03/19 %	Movement in Year £m	Closing Balance £m	Average Rate At 31/03/20 %
PWLB loans	175.530	3.48%	20.041	195.571	3.38%
Market Loans	95.000	4.38%	0.000	95.000	4.49%
Bonds	0.002	1.97%	-0.002	0.000	0.00%
Total Borrowing over 12 months excluding WMCC debt	**270.532**	**3.80%**	**20.039**	**290.571**	**3.74%**
Temporary Loans	20.961	0.87%	40.000	60.961	0.87%
Total borrowing excluding WMCC debt	**291.493**	**3.59%**	**60.039**	**351.532**	**3.25%**
WMCC Debt	16.541	5.62%	-1.743	14.798	6.50%
Gross Borrowing	**308.034**	**3.69%**	**58.295**	**366.329**	**3.38%**
Waste Disposal & Cannock Chase Debtor	-5.281	5.62%	0.563	-4.718	6.50%
Borrowing	**302.753**	**3.66%**	**58.859**	**361.612**	**3.34%**
CFR less PFI finance & leases	350.091		0.339	350.430	
Under Borrowing	47.338		59.198	-11.182	
Debt as % of CFR	**86%**			**103%**	
Call Accounts	24.360	0.55%	22.125	46.485	0.63%
Short Term Investments	120.500	1.09%	3.500	124.000	1.24%
Long Term Investments	35.000	1.37%	9.000	44.000	1.65%
Total Investments	**179.860**	**1.32%**	34.625	**214.485**	**1.50%**
Net Borrowing Position	**122.893**		24.234	**147.127**	

The under borrowing position the council has represents additional external borrowing the council could choose to take if required, however this has currently been financed by internal borrowing – utilising the Council's accumulated cash reserves rather than taking out new external borrowing. This position will continue to be monitored and additional external borrowing may be undertaken if required for cash flow purposes.

6. The Borrowing Strategy for 2019/20 and Economic Context

During 2019-20, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2019/20 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

7. Borrowing Outturn for 2019/20

PWLB rates are based on, and are determined by, gilt (UK Government bonds) yields through H.M. Treasury determining a specified margin to add to gilt yields. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020, and a general background of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued; these conditions were conducive to very low bond yields.

While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. We have therefore seen, over the last year, many bond yields up to 10 years in the Eurozone turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields were on a generally falling trend during the last year up until the coronavirus crisis hit western economies. Since then, gilt yields have fallen sharply to unprecedented lows as investors have panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks also started quantitative easing purchases of government bonds which will act to maintain downward pressure on government bond yields at a time when there is going to be a huge and quick expansion of government expenditure financed by issuing government bonds; (this would normally cause bond yields to rise). At the close of the day on 31 March, all gilt yields from 1 to 5 years were between 0.12 – 0.20% while even 25-year yields were at only 0.83%.

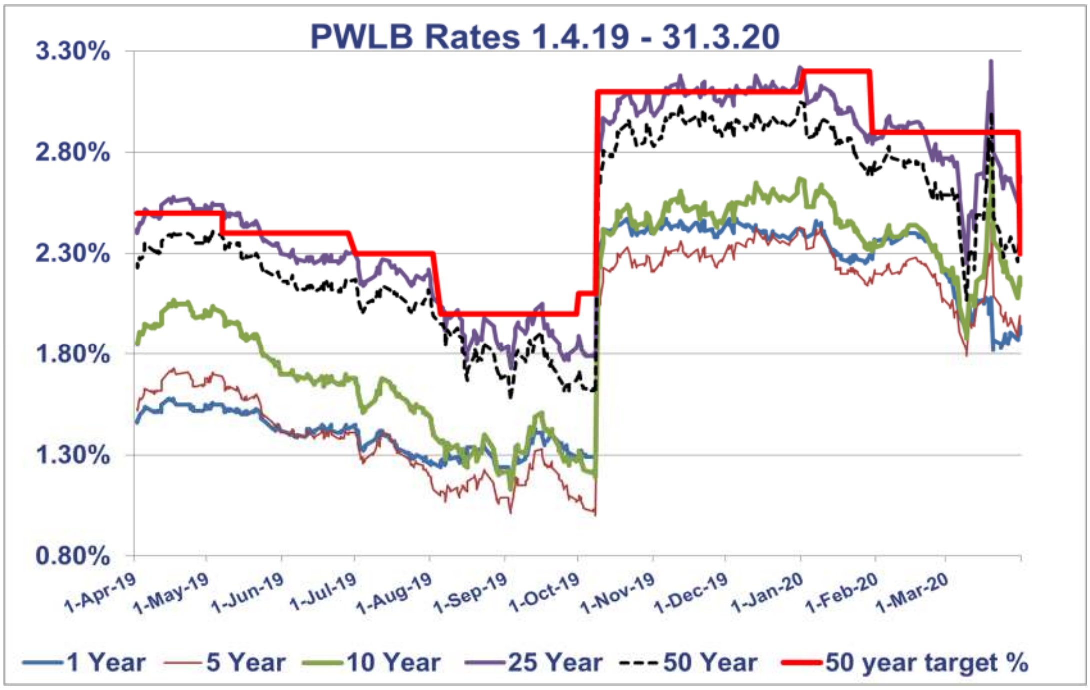
However, HM Treasury has imposed **two changes in the margins over gilt yields for PWLB rates** in 2019-20 without any prior warning; the first on 9 October 2019, added an additional 1% margin over gilts to all PWLB rates. That increase was then partially reversed for some forms of borrowing on 11 March 2020, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this ends on 4 June. It is clear that the Treasury intends to put a stop to local authorities borrowing money from the PWLB to purchase commercial property if the aim is solely to generate an income stream.

Following the changes on 11 March 2020 in margins over gilt yields, the current situation is as follows: -

- **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
- **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
-

There is likely to be little upward movement in PWLB rates over the next two years as it will take national economies a prolonged period to recover all the momentum they will lose in the sharp recession that will be caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020-21.

The graphs and tables for PWLB rates show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



The council's long term borrowing (over 12 months in length) has increased in the year from £271m to £291m, to support the capital programme and unwind the authorities under borrowed position.

8. Investments in 2019/20 and Economic Context

Investment returns remained low during 2019/20. The expectation for interest rates within the treasury management strategy for 2019/20 was that Bank Rate would stay at 0.75% during 2019/20 as it was not expected that the MPC would be able to deliver on an increase in Bank Rate until the Brexit issue was finally settled. However, there was an expectation that Bank Rate would rise after that issue was settled, but would only rise to 1.0% during 2020.

Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the coronavirus outbreak hit the UK in February/March, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

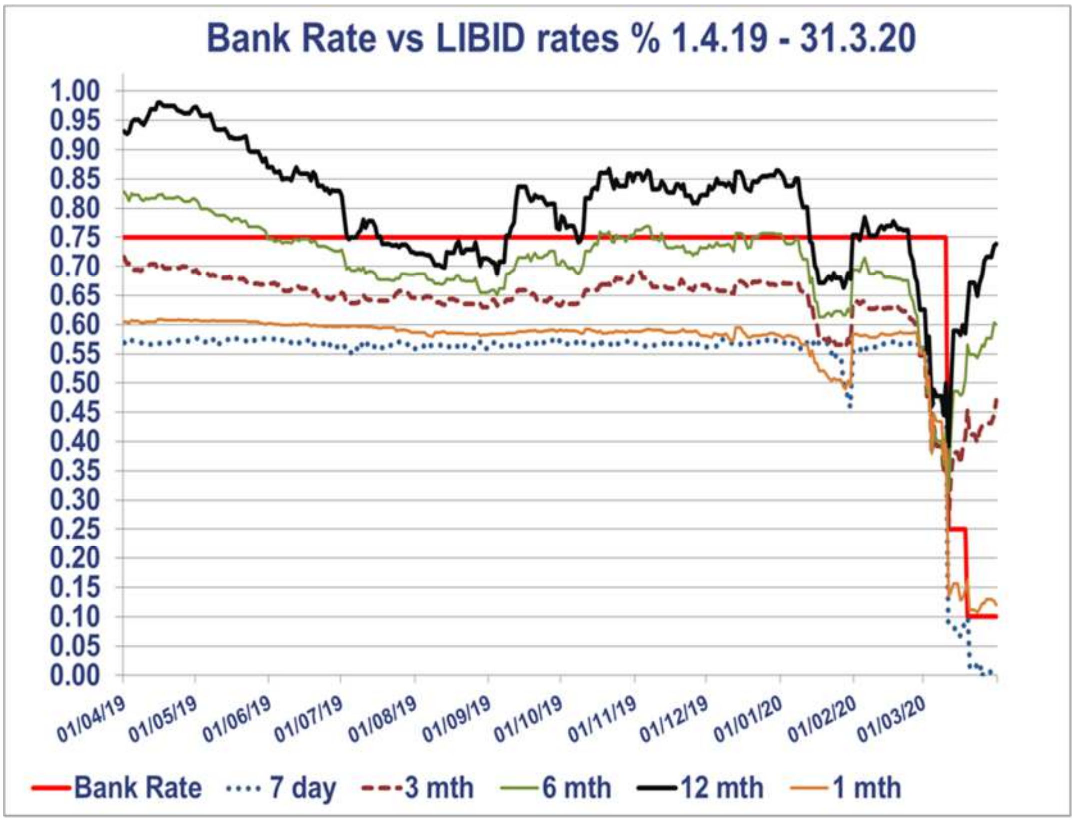


Table 9 within the report details the authority's investments by call, short and long term. The 7 day rate above (average of 0.57% across the year) is a fair comparator for at-call and the 12 month LIBID (average of 0.80% across the year) for short term investments.

Resources – the council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations.

Investment Policy – the council's investment policy is governed by central Government guidance, which was implemented in the Annual Investment Strategy approved by Council on 28th February 2019. This policy set out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by KPMG survey of Building Societies and an analysis of Common Equity Tier (CET1) levels. The investment activity during the year conformed to the approved Strategy, and the council had no liquidity difficulties.

At the end of 2019/20 Walsall's investment balance was £34.625m higher than that at the start of the year. **Table 8** below shows an age profile of the investments.

Table 8: Changes in Investments during 2019/20	Opening Balance £m	Closing Balance £m	Movement in Year £m
At Call accounts	24.360	46.485	22.125
Between 31 days and 365 days	120.500	124.000	3.500
Over 365 days	35.000	44.000	9.000
Total	**179.860**	**214.485**	**34.625**

Investments held by the council - the council maintained an average balance of £197m of internally managed funds. The internally managed funds earned an average rate of return of 1.50%.

Recognising the continuation of the stresses on the world banking system, enhanced priority has continued to be given to security and liquidity. To reduce counterparty risk to the maximum possible extent the investment portfolio was spread across a range of appropriately credit rated / analysed institutions. **Table 9** shows the outturn on investment income in 2019/20.

Table 9 Investments Interest – Gross Income	2019/20 Approved Cash Limit £m	Outturn at 31 March 2020 £m	Over /(under) achieved cash limit £m	% Target Rate	% Average Rate achieved
Call Account investments	0.090	0.208	0.118	0.60%	0.63%
Short Term Investments	1.284	1.760	0.476	1.10%	1.24%
Long Term Investments	1.037	1.147	0.110	1.40%	1.65%
Total	**2.411**	**3.115**	**0.704**	**1.21%**	**1.50%**

9. Performance Measurement

One of the key requirements in the CIPFA Code of Practice on Treasury Management is the formal introduction of performance measurements relating to investments, debt and capital financing activities. **Table 10** below shows that Walsall has consistently achieved a higher average return on it's investments and has reduced it's average rate it pays for its borrowing. The figures for 2011/12 to 2014/15 are derived from the the CIPFA treasury management benchmarking club. For 2015/16 onwards, as a number of authorities no longer participate in this benchmarking exercise, the figures set out are based on a review of reports issued by the authorities statistical neighbours. Comparative figures for 2019/20 are not yet available.

Table 10 Comparison of Walsall with other councils Average Interest Rates	Walsall Rate Received %	Average Rate Received %	Walsall Rate Paid %	Average Rate Paid %
2011/12	1.80	1.20	4.53	4.53
2012/13	2.14	1.11	4.47	4.52
2013/14	1.29	0.85	4.51	4.26
2014/15	1.09	0.77	4.61	4.14
2015/16	1.08	0.76	4.54	4.18
2016/17	0.86	0.76	3.99	4.34
2017/18	1.32	0.73	3.42	4.06
2018/19	1.37	1.10	3.83	4.15
2019/20	1.50		3.34	

Council approved the following local performance indicators, the majority of which were complied with during the year, **Table 11** provides the indicators for March 2019.

Table 11 - Local Indicators		Actual 2018/19	Target 2019/20	Position 31-Mar-20	Variance to target	
		£m	£m	£m	value	%
L1	Full compliance with Prudential Code.	YES	YES	YES	N/A	N/A
L2	Average length of debt. (Years)	18.37	Lower Limit 15 Years, Upper Limit 25 Years	19.05	N/A	N/A
L3a	Net borrowing costs as % of net council tax requirement.	6.54%	20.00%	6.06%	(13.94%)	(69.69%)
3b	Net borrowing costs as % of Tax Revenue.	4.06%	12.50%	3.78%	(8.72%)	(69.78%)
L4	Net actual debt vs. operational debt.	75.20%	85.00%	73.82%	(11.18%)	(13.16%)
L5	Average interest rate of external debt outstanding excluding OLA.	3.69%	3.69%	3.74%	0.05%	1.44%
	Average interest rate of external debt outstanding including OLA.	3.83%	3.93%	3.86%	(0.06%)	(1.63%)
L7	Gearing effect of 1% increase in interest rate.	3.89%	5.00%	3.92%	(1.08%)	(21.60%)
L8	Average interest rate received on STI vs. 7 day LIBID rate.	0.77%	0.75%	1.24%	0.49%	65.62%

L9	Average interest rate received:					
L9a	At Call investments.	0.55%	0.60%	0.63%	0.03%	5.00%
L9b	Short Term Investments.	1.09%	1.10%	1.24%	0.14%	12.73%
L9c	Long Term Investments.	1.85%	1.05%	1.37%	0.32%	30.48%
L9d	Property Fund Investments	4.17%	4.14%	4.16%	0.02%	0.48%
L10	Average interest rate on all ST investments (ST and At Call).	0.98%	1.04%	1.11%	0.07%	6.73%
L11a	Average rate on all investments (excluding property fund)	1.05%	1.08%	1.20%	0.12%	11.11%
L11b	Average Rate on all investments (including property fund)	1.37%	1.45%	1.50%	0.05%	3.45%
L12	% daily bank balances within target range.	100%	99%	100%	1.00%	1.01%

Key variances are because of the following reasons:-

L3a - Net borrowing costs as % of net council tax requirement (variance of -69.69%). The target figure of 20.00% represents an upper limit of affordable net borrowing costs as a percentage of the net council tax requirement for the authority. The actual level of net borrowing costs is currently less than the upper limit, which in the main is linked to the work undertaken by the service to seek to secure favourable rates on investments and reduced costs on borrowing, thus reducing the overall net borrowing costs.

L3b - Net borrowing costs as % of Tax Revenue (variance of -69.78%). The target figure of 12.50% represents an upper limit of affordable net borrowing costs as a percentage of tax revenues for the authority. The actual level of net borrowing costs is currently less than the upper limit, which in the main is linked to the work undertaken by the service to seek to secure favourable rates on investments and reduced costs on borrowing, thus reducing the overall net borrowing costs.

L8, L9, L10 & L11 – Interest Rates received – all 8 of the indicators within L8, L9, L10 and L11 are currently being exceeded. This is in the main due to the ongoing negotiations being undertaken by the service to secure favourable rates when considering investment options, and through the review and identification of new and appropriate opportunities for investment.

10. The Economy and Interest Rates

UK. Brexit. The main issue in 2019 was the repeated battles in the House of Commons to agree on one way forward for the UK over the issue of Brexit. This resulted in the resignation of Teresa May as the leader of the Conservative minority Government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. The House of Commons duly frustrated that renewed effort and so a general election in December settled the matter once and for all by a decisive victory for the Conservative Party: that then enabled the UK to leave the EU on 31 January 2020.

However, this still leaves much uncertainty as to whether there will be a reasonable trade deal achieved by the target deadline of the end of 2020. It is also unclear as to whether the coronavirus outbreak may yet impact on this deadline; however, the second and third rounds of negotiations have already had to be cancelled due to the virus.

Economic growth in 2019 has been very volatile with quarter 1 unexpectedly strong at 0.5%, quarter 2 dire at -0.2%, quarter 3 bouncing back up to +0.5% and quarter 4 flat at 0.0%, +1.1% y/y. 2020 started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election in December settled the Brexit issue. However, the three monthly GDP statistics in January were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the **coronavirus outbreak**. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least 15% in quarter two. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lock down period, when the end of the lock down will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and then how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, Brexit uncertainty caused the MPC to sit on its hands and to do nothing until March 2020; at this point it was abundantly clear that the coronavirus outbreak posed a huge threat to the economy of the UK. Two emergency cuts in Bank Rate from 0.75% occurred in March, first to 0.25% and then to 0.10%. These cuts were accompanied by an increase in **quantitative easing (QE),** essentially the purchases of gilts (mainly) by the Bank of England of £200bn. The Government and the Bank were also very concerned to stop people losing their jobs during this lock down period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms may have little or no income. However, at the time of writing, this leaves open a question as to whether some firms will be solvent, even if they take out such loans, and some may also choose to close as there is, and will be, insufficient demand for their services. At the time of writing, this is a rapidly evolving situation so there may be further measures to come from the Bank and the Government in April and beyond. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2%, to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Budget in March, the Government also announced a large increase in spending on infrastructure; this will also help the economy to recover once the lock down is ended. Provided the coronavirus outbreak is brought under control relatively swiftly, and the lock down is eased, then it is hoped that there would be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

Inflation has posed little concern for the MPC during the last year, being mainly between 1.5 – 2.0%. It is also not going to be an issue for the near future as the world economy will be heading into a recession which is already causing a glut in the supply of oil which has fallen sharply in price. Other prices will also be under downward pressure while wage inflation has also been on a downward path over the last half year and is likely to continue that trend in the current environment. While inflation could even turn negative in the Eurozone, this is currently not likely in the UK.

Employment had been growing healthily through the last year but it is obviously heading for a big hit in March – April 2020. The good news over the last year is that wage inflation has been significantly higher than CPI inflation which means that consumer real spending power had been increasing and so will have provided support to GDP growth. However, while people cannot leave their homes to do non-food shopping, retail sales will also take a big hit.

USA. Growth in quarter 1 of 2019 was strong at 3.1% but growth fell back to 2.0% in quarter 2 and 2.1% in quarters 3 and 4. The slowdown in economic growth resulted in the Fed cutting rates from 2.25-2.50% by 0.25% in each of July, September and October. Once coronavirus started to impact the US in a big way, the Fed took decisive action by cutting rates twice by 0.50%, and then 1.00%, in March, all the way down to 0.00 – 0.25%. Near the end of March, Congress agreed a $2trn stimulus package (worth about 10% of GDP) and new lending facilities announced by the Fed which could channel up to $6trn in temporary financing to consumers and firms over the coming months. Nearly half of the first figure is made up of permanent fiscal transfers to households and firms, including cash payments of $1,200 to individuals.

The loans for small businesses, which convert into grants if firms use them to maintain their payroll, will cost $367bn and 100% of the cost of lost wages for four months will also be covered. In addition there will be $500bn of funding from the Treasury's Exchange Stabilization Fund which will provide loans for hard-hit industries, including $50bn for airlines.

However, all this will not stop the US falling into a sharp recession in quarter 2 of 2020; some estimates are that growth could fall by as much as 40%. The first two weeks in March of initial jobless claims have already hit a total of 10 million and look headed for a total of 15 million by the end of March.

EUROZONE. The annual rate of GDP growth has been steadily falling, from 1.8% in 2018 to only 0.9% y/y in quarter 4 in 2019. The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in EZ growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting it announced a third round of TLTROs; this provided banks with cheap two year maturity borrowing every three months from September 2019 until March 2021. However, since then, the downturn in EZ and world growth has gathered momentum so at its meeting in September 2019, it cut its deposit rate further into negative territory, from -0.4% to -0.5% and announced a resumption of quantitative easing purchases of debt to start in November at €20bn per month, a relatively small amount, plus more TLTRO measures. Once coronavirus started having a major impact in Europe, the ECB took action in March 2020 to expand its QE operations and other measures to help promote expansion of credit and economic growth. What is currently missing is a coordinated EU response of fiscal action by all national governments to protect jobs, support businesses directly and promote economic growth by expanding government expenditure on e.g. infrastructure; action is therefore likely to be patchy.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium-term risks have also been increasing. The major feature of 2019 was the trade war with the US. However, this has been eclipsed by being the first country to be hit by the coronavirus outbreak; this resulted in a lock down of the country and a major contraction of economic activity in February-March 2020. While it appears that China has put a lid on the virus by the end of March, these are still early days to be confident and it is clear that the economy is going to take some time to recover its previous rate of growth. Ongoing economic issues remain, in needing to make major progress to eliminate excess industrial capacity and to switch investment from property construction and infrastructure to consumer goods production. It also needs to address the level of non-performing loans in the banking and credit systems.

JAPAN has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It appears to have missed much of the domestic impact from coronavirus in 2019-20 but the virus is at an early stage there.

WORLD GROWTH. The trade war between the US and China on tariffs was a major concern to financial markets and was depressing worldwide growth during 2019, as any downturn in China would spill over into impacting countries supplying raw materials to China. Concerns were particularly focused on the synchronised general weakening of growth in the major economies of the world. These concerns resulted in government bond yields in the developed world falling significantly during 2019. In 2020, coronavirus is the big issue which is going to sweep around the world and have a major impact in causing a world recession in growth in 2020.