City of Westminster

Decision Maker:	Audit and Performance Committee
Date:	5 February 2020
Classification:	General Release
Title:	Treasury Management Strategy Mid-Year Review 2019-20
Wards Affected:	All
Policy Context:	To manage the Council's finances prudently and efficiently
Cabinet Member	Cabinet Member for Finance, Property and Corporate Services
Financial Summary:	This report forms part of the monitoring of the treasury function as recommended in the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code of Practice. It reviews the implementation of the strategy to date and allows for any changes to be made depending on market conditions.
Report of:	Gerald Almeroth Executive Director for Finance and Resources

1. EXECUTIVE SUMMARY

1.1. The purpose of this report is to:

- update Members on the delivery of the 2019/20 Treasury Management Strategy approved by Council on 6th March 2019; and
- approve the recommendations in paragraph 2.1.

1.2. Treasury management comprises:

- managing the City Council's borrowing to ensure funding of the Council's future capital programme is at optimal cost;
- investing surplus cash balances arising from the day-to-day operations of the Council to obtain an optimal return while ensuring security of capital and liquidity.

1.3. This report complies with CIPFA's Code of Practice on Treasury Management, and covers the following:

- a six-monthly review of the Council's investment portfolio for 2019/20 to include the treasury position as at 30 September 2019;
- a review of the Council's borrowing strategy for 2019/20;
- a review of compliance with Treasury and Prudential Limits for the first six months of 2019/20;
- an economic update for the first part of the 2019/20 financial year.

1.4. The Council has complied with all elements of the Treasury Management Strategy Statement (TMSS) apart from one instance, which arose because of an exceptional banking receipt which was received too late in the day to be moved from the bank until the following day.

- £11.008m on 29th April 2019

2. RECOMMENDATIONS

3. The Committee is asked to note the annual treasury strategy mid year review 2019/20, noting the cases of non-compliance.

TREASURY POSITION AS AT 30 SEPTEMBER 2019

3.1. As at 30 September 2019, net cash invested was £675m, an increase of £169m on the position at 31 March 2019 as shown below:

	30 September 2019 (£m)	31 March 2019 (£m)
Total Borrowing	(221.2)	(223.2)
Total Cash Invested	895.9	729.0
Net Cash Invested	**674.7**	**505.8**

3.2. The significant increase of £169m reflects the forecast pattern of the Council's cashflows and largely relates to the timing of grants, council tax and business rates received.

Investments

3.3. The Council's Annual Investment Strategy which forms part of the annual Treasury Management Strategy Statement (TMSS) for 2019-20 was approved by the Council on 6 March 2019. The Council's policy objective is the prudent investment of balances to achieve optimum returns on investments, subject to maintaining adequate security of capital and a level of liquidity appropriate to the Council's projected need for funds over time.

3.4. The table below provides a breakdown of investments, together with comparisons for the previous financial year end.

	Investment Balance 30 September 2019 (£m)	Investment Balance 31 March 2019 (£m)	Movement
Money Market Funds	89	60	29
Notice Accounts	90	90	0
Term Deposits	508	465	43
Tradeable Securities	209	115	94
Total:	**896**	**729**	**167**

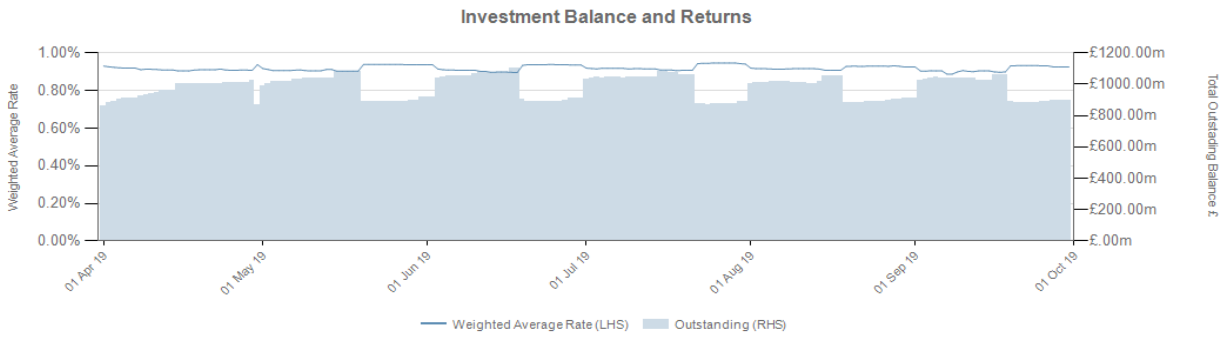
3.5. Liquid balances are managed through Money Market Funds providing same day liquidity. Cash has been invested in alternative and less liquid instruments, particularly term deposits and tradable securities. The average level of funds available for investment in the first six months of 2019-20 was £978m.

3.6. The shaded area in the chart below shows the daily investment balance from 1 April 2019 to 30 September 2019. The line shows the weighted average return of the investment portfolio, which has remained stable during the first half of the 2019-20 financial year. The daily investment balance is shown by the grey shaded area. The daily investment balance rises and then falls each month and follows a monthly fluctuating cycle.

3.7. Daily investment balances have steadily increased from £729.0m at 1 April 2019 to £895.9m at 30 September 2019.

3.8. The Bank of England reduced the Base Rate in August 2016 to 0.25%. However, since the latter half of 2017, rates have steadily improved. This is due to the November 2017 and August 2018 Bank of England base rate increases to the current level of 0.75%.

3.9. Whilst surplus cash for investment has increased, cash has been invested with higher interest rate paying counterparties. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.



3.10. The table below shows the forecast investment income to be achieved in the year: budget versus actual and the variance. The Council's budgeted investment return for 2019/20 is £9.810m, and performance for the year is expected to be £1.286 above budget. The total portfolio weighted average performance for the first half of 2019/20 to 30 September 2019 was 0.94%

	Budget £000	Actual £000	Variance £000
Investment Income	9,810	11,096	1,286

3.11. Appendix 1 provides a full list of the Council's limits and exposures as at 30 September 2019.

Borrowing

3.12. At £221m, the Council's borrowing was well within the Prudential Indicator for external borrowing, namely, that borrowing should not exceed the estimated capital financing requirement (CFR) for 2019/20 of £893m.

3.13. Therefore the Council is effectively "under borrowed" by £672m because it has used its own internal funding resources to fund the gap between the borrowing level and the CFR.

3.14. The table below shows the details around the Council's external borrowing as at 30 September 2019, split between the General Fund and HRA.

Total Borrowing	30 September 2019 (£m)	31 March 2019 (£m)
HRA	196.0	196.0
General Fund	25.2	27.2
Total Borrowing	**221.2**	**223.2**

3.15. An analysis of the existing loans is shown below:

Borrowing Type	Loan Balance 30 September 2019 (£m)	Loan Balance 31 March 2019 (£m)	Movement
PWLB	151.0	151.0	0.0
LOBO	70.0	70.0	0.0
Mortgage Annuity	0.2	0.2	0.0
Greater London Authority	0.0	2.0	2.0
Total:	**221.2**	**223.2**	**2.0**

3.16. No new borrowing was taken in the first half of 2019/20. The general fund external borrowing reduced by £2.03m. This is due to the repayment of principal of two annuity loans and a £2m advance loan repayment from the Greater London Authority.

3.17. On 9 October 2019 HM Treasury and PWLB announced an increase in the margin over gilt yields by 1% for new borrowing from the PWLB, thus taking the total cost of a PWLB loan to gilt yield plus 2% (or 1.8% as the Council qualifies for the certainty rate). There was no prior warning that this would happen and it now means that every local authority has to fundamentally reassess how to finance their external borrowing needs and the financial viability of capital projects in their capital programme due to this unexpected increase in the cost of borrowing. Representations are going to be made to HM Treasury to suggest that areas of capital expenditure that the Government are keen to see move forward, e.g., housing, should not be subject to this increase in borrowing.

Forward Borrowing

3.18. As anticipated in the 2019/20 TMSS, the Council has undertaken no new borrowing for this financial year due to the high level of cash holdings. Officers are monitoring market conditions and reviewing the need to borrow at current low rates if a requirement is identified for either the General Fund or Housing Revenue Account (HRA).

3.19. Due to the overall financial position and the underlying need to borrow for capital purposes, it is prudent for the Council to lock in affordability by placing some forward borrowing for the amounts it can be relatively certain it will need, whilst maintaining some forward flexibility as projects may or may not proceed within the expected timeframes.

3.20. During 2019/20, the Council has arranged forward borrowing loans totalling £400m. These loans have enabled the Council to agree competitive rates in advance of need which eliminates the “cost of carry”, that is the difference between loan interest cost and the rate of return on cash investments. An analysis of the deals arranged is shown below;

Counterparty	Amount (£m)	Start Date	Maturity Date	Rate (%)	Profile
Phoenix Group	37.5	15 March 2022	15 March 2062	2.706	Annuity
Barings LLC	150.0	15 August 2022	15 August 2052	1.970	Maturity
Phoenix Group	12.5	15 March 2023	15 March 2063	2.751	Annuity
Rothesay Life Plc	200.0	08 May 2023	08 May 2069	2.887	Equal Installment of Principal
Weighted average interest rate				**2.579**	

4. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

4.1. During the financial year to 30 September 2019, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS approved by Council on 6 March 2019 as set out below.

PI Ref		2019/20 Indicator	2019/20 Forecast	Indicator Met?
1	Capital expenditure	£423m	£383m	Met
2	Capital Financing Requirement (CFR)	£908m	£893m	Met
3	Net debt vs CFR	£687m underborrowing	£672m underborrowing	Met
4	Ratio of financing costs to revenue stream	GF (1.86)% HRA 28.68%	GF (3.59)% HRA 28.68%	Met
5a	Authorised limit for external debt	£908m	£893m	Met
5b	Operational debt boundary	£273m	£252m	Met
6	Working Capital Balance	£0m	£0m	Met
7a	Upper limit for variable interest rate borrowing	£0m	£0m	Met
7b	Upper limit for fixed interest rate borrowing	£908m	£893m	Met
7c	Limit on surplus funds invested for more than 364 days (i.e. non specified investments)	£450m	£25m	Met
8	Maturity structure of borrowing	Upper limit under 12 months: 40% Forecast: 0% Lower limit 10 years and above: 35% Forecast: 75%	Upper limit under 12 months: 40% Forecast: 0% Lower limit 10 years and above: 35% Forecast: 67%	Met

Capital expenditure and borrowing limits

4.2. The capital expenditure forecast to 31 March 2020 totalled £383m for the General Fund and the HRA against a forecast for the whole year of £423m. This relates to a number of large development projects and related acquisitions. The forecast for development projects are contingent on progress by developers which is anticipated will improve over the remainder of the year. Acquisitions are reactive and depend on properties becoming available on the market and as such the forecast can be volatile but will continue to be monitored by officers.

4.3. External borrowing was well within the Capital Financing Requirement, Authorised Borrowing Limit and the Operational Boundary as shown in the table above:

- The Authorised Limit is a level for which the external borrowing cannot be exceeded without reporting back to Full Council. It therefore provides sufficient headroom such that in the event that the planned capital programme required new borrowing to be raised over the medium term, if interest rates were deemed favourable and a thorough risk analysis determined, the cost of carry was

appropriate, this borrowing could be raised ahead of when the spend took place.

- The Operational Boundary is set at a lower level and should take account of the most likely level of external borrowing. Operationally, in accordance with CIPFA best practice for Treasury Risk Management, a liability benchmark is used to determine the point at which any new external borrowing should take place.

4.4. The purpose of the maturity structure of borrowing indicator is to highlight any potential refinancing risk that the Council may be facing if, in any one particular period there was a disproportionate level of loans maturing. The table below shows that the maturity structure of the Council's borrowing as at 30 September 2019 was within the limits set and does not highlight any significant issues.

Actual Maturity at 30 September 2019	Duration	Upper Limit	Lower Limit
0	Under 12 Months	40	0
9	12 Months and within 24 Months	35	0
9	24 Months and within 5 Years	35	0
15	5 Years and within 10 Years	50	0
67	10 Years and Above	100	35

4.5. The Council is not subject to any adverse movement in interest rates in its current loans portfolio as it only holds fixed interest borrowing.

4.6. The average rate on the fixed interest borrowing is 4.24% with an average redemption period of 19 years. This reflects the historical legacy of borrowing taken out some years ago which is now higher than PWLB interest rates for comparable loans if they were taken out now. Officers have considered loan re-financing but premiums for premature redemption are prohibitively expensive making this option poor value for money.

4.7. The Council's borrowing portfolio contains £70m of Lender Option Borrower Option loans (LOBOs). These are long-term loans of up to 60 years, which are subject to periodic rate re-pricing. The rates are comparable with loans for similar durations provided by the PWLB. There is some refinancing risk associated with these loans because of the lender option to increase interest rates. Some banks are offering premature repayment or loan conversion for LOBOs to fixed term loans and officers will remain alert to such opportunities as they arise.

Investment limits

4.8. Investment in non-specified investments at £25m is well within the limit of £450m for such investments. This reflects the fact that 97% of the Council's investments have a life of less than 12 months. The highest level of non-specified investments during the year was £25m.

4.9. Whilst the short duration is within approved limits, there is scope within the Investment Strategy to extend the duration of investments for up to five years. Using longer duration investments and marginally lower credit ratings is likely to increase the yield the Council earns from its investments.

5. THE ECONOMY AND INTEREST RATES

5.1. This first half year has been a time of upheaval and uncertainty on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October 2019, with or without a deal. There was no majority of MPs for any one option to move forward on enabling Brexit to be implemented.

5.2. A certain outcome of the General Election on 12 December 2019 has led to the likelihood of a UK exit from the EU on 31 January 2020. In such circumstances, any interest rate forecasts are subject to material change as the situation evolves. At present, if the UK does leave with a suitable deal struck with the EU, then it is possible that UK growth could recover quickly.

5.3. The MPC could then need to address the issue of whether to raise Bank Rate when there is very little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation.

5.4. On the other hand, if there is a significant level of disruption to the economy, then growth could falter and the MPC would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by way of tax cuts and / or expenditure on infrastructure projects, to boost the economy.

5.5. However, infrastructure projects generally take a long time to plan and to start up, and so to feed through into impacting the economy; tax cuts would be much quicker in impacting the level of consumption in the economy.

5.6. The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August 2019, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. This mirrored investor confidence around the world which is now expecting a significant downturn or possibly even a recession in some developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit.

5.7. As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, (CPI for November 2019 is 1.5%), and is likely to shift only a little upwards over the rest of 2019/20. It does not therefore pose any immediate concern to the MPC at the current time.

5.8. With the General Election outcome known, monetary policy could tighten. Conversely, a weak international backdrop could provide further support for low yielding government gilts.

6. BACKGROUND

6.1. The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. These are contained within this report.

7. FINANCIAL IMPLICATIONS

7.1. Financial implications contained in the body of this report.

8. LEGAL IMPLICATIONS

8.1. The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. This report assists the Council in fulfilling its statutory obligation under the Local Government Act 2003 to monitor its borrowing and investment activities.

8.2. Legal implications were verified by Michael Carson, Principal Solicitor Employment, Criminal and Commercial Litigation.

9. BACKGROUND PAPERS

Full Council Report

Treasury Management – Annual Strategy for 2019/20, including Prudential Indicators and Statutory Borrowing Determinations – 6 March 2019.

If you have any queries about this Report or wish to inspect any of the Background Papers, please contact:

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Limits and exposures as at 30th September 2019 Appendix 1

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)
UK Government (Gilts/ T-Bills/ Repos)	Unlimited	Unlimited	Treasury Bills	189.4
UK Local Authorities	£100m per local authority; £500m in aggregate	3 years	Blackpool Borough Council	18.0
			Cambridgeshire County Council	20.0
			Doncaster Borough Council	15.0
			Isle of Wight Council	10.0
			Leeds City Council	10.0
			London Borough of Barnet	20.0
			London Borough of Croydon	30.0
			London Borough of Enfield	20.0
			London Borough of Hackney	15.0
			London Borough of Southwark	10.0
			Plymouth City Council	20.0
			Redcar & Cleveland Borough Council	30.0
			Rotherham Council	15.0
			South Ayrshire Council	10.0
Money Market Funds	£70m per fund. £300m in aggregate.	Three day notice	Aberdeen Sterling Liquidity Fund	1.0
			Deutsche Managed Sterling Fund	1.0
			Federated Sterling Liquidity Fund	28.8
			JP Morgan Sterling Liquidity Fund	57.0
			Morgan Stanley Sterling Liquidity Fund	1.0
UK Banks (AA-/Aa3/ AA-)	£75m	5 years	HSBC	49.2
UK Banks (A-/A3/A)	£50m	3 years	Goldman Sachs International	45.0
			Lloyds Bank	30.0
			Santander UK Plc	50.0
			Standard Chartered Bank	50.0
Non-UK Banks (AA-/ Aa2/ AA-)	£50m	5 years	Svenska Handelsbanken	40.5
			Toronto Dominion Bank	20.0
Non-UK Banks (A/A2/ A)	£35m	3 years	Australia & New Zealand Banking Group	20.0
			Commonwealth Bank of Australia	35.0
			Helaba	35.0
TOTAL				**895.9**