City of Westminster

Cabinet

Decision Maker	Cabinet
Date:	10 February 2020
Status:	General Release
Title:	Treasury Management Strategy Statement for 2020/21 to 2024/25
Wards Affected:	All
Policy Context:	To manage the Council's finances prudently and efficiently.
Cabinet Member	Cabinet Member for Finance, Property and Regeneration
Financial Summary:	The Annual Treasury Management Strategy Statement sets out the Council's strategy for ensuring that: a. its capital investment plans are prudent, affordable and sustainable; b. the financing of the Council's capital programme and ensuring that cash flow is properly planned; c. cash balances are appropriately invested to generate optimum returns having regard to security and liquidity of capital.
Report of:	Gerald Almeroth Executive Director – Finance & Resources galmeroth@westminster.gov.uk 020 7641 2904

1. EXECUTIVE SUMMARY

1.1 The Local Government Act 2003 and the Regulations made under the Act require the Council to have regard to the Prudential Code for Capital Finance in Local Authorities 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.

1.2 The Act also requires the Council to set out a statement of its treasury management strategy for borrowing and to prepare an Annual Investment Strategy (as shown in Appendix 1). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. The Treasury Management Strategy Statement and Annual Investment Strategy must both have regard to guidance issued by the Ministry for Housing, Communities and Local Government (MHCLG) and must be agreed by the Full Council.

1.3 This report sets out the Council's proposed Treasury Management Strategy Statement (TMSS) for the period 2020/21 to 2024/25, and Annual Investment Strategy (AIS) for the year ended 31 March 2021, together with supporting information.

1.4 The TMSS and AIS form part of the Council's overall budget setting and financial framework.

2. RECOMMENDATIONS

2.1 The Cabinet recommend to the Full Council the approval of:

- the Treasury Management Strategy Statement;
- the borrowing strategy and borrowing limits for 2020/21 to 2024/25 set out in sections 5 to 7;
- the prudential Indicators set out in section 8;
- the Annual Investment Strategy and approved investments set out in Appendix 1;
- the Minimum Revenue Provision Policy set out in Appendix 2.

3. REASONS FOR DECISIONS

3.1 To comply with the Local Government Act 2003, other regulations and guidance and to ensure that the Council's borrowing and investment plans are prudent, affordable and sustainable and comply with statutory requirements.

4. BACKGROUND INFORMATION

4.1 The Council is required to operate a balanced budget, which broadly means that monies received during the year will meet payments expenditure. The function of treasury management is to ensure that the Council's capital programme and corporate investment plans are adequatly funded, and the cashflow is adequately planned, with cash being available when it is needed to discharge the Council's legal obligations and deliver Council services. Surplus monies are invested to obtain an optimal return, while ensuring security of capital and liquidity.

4.2 CIPFA defines treasury management as “the management of the local authority’s borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

4.3 The Council has formally adopted CIPFA’s Code of Practice on Treasury Management and follows the key requirements of the Code as set out in Appendix 3.

4.4 The TMSS covers three main areas summarised below:

Capital spending

- Capital spending plans
- Other investment opportunities
- Capital Finance Requirement (CFR)
- Affordability
- The Minimum Revenue Provision (MRP) policy (see Appendix 2)

Borrowing

- Overall borrowing strategy
- Prospects for interest rates
- Post PWLB interest rate increase borrowing strategy
- Limits on external borrowing
- Maturity structure of borrowing
- Policy on borrowing in advance of need
- Forward borrowing
- Debt rescheduling

Managing cash balances

- The current cash position and cash flow forecast
- Prospects for investment returns
- Council policy on investing and managing risk
- Balancing short and long term investments
- Improving investment returns

4.5 The Annual Investment Strategy (AIS) at Appendix 1 provides more detail on how the Council’s surplus cash investments are to be managed in 2020/21. Approved schedules of specified and non-specified investments will be updated following consideration by Members and finalisation of 2020/21 budget plans.

TREASURY MANAGEMENT STRATEGY STATEMENT

5. SECTION 1 - CAPITAL SPENDING

Capital spending plans

5.1 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

5.2 Table 1 summarises the Council's capital expenditure plans, both in terms of those projects agreed previously, and those forming part of the current budget cycle. The table sets out the Council's current expectations reference the revenue or capital financing.

5.3 Compared with the forecast in the original 2019/20 TMSS, General Fund capital spend has slipped back by around £44m in the 2019/20 revised budget and there remains an element of further slippage in future years.

The risks are that:

- ➢ continued slippage in new starts will push borrowing requirements to later years when interest rates are forecast to be higher than currently;
- ➢ slippage in the programme of capital receipts may increase the need to borrow in the short to medium term.

Table 1 Capital spending and funding plans

2018/19		2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	Total
Actual		Forecast	Estimate	Estimate	Estimate	Estimate	Estimate	
£m		£m	£m	£m	£m	£m	£m	£m
	Expenditure							
223	General Fund	**229**	**244**	**402**	**399**	**219**	**97**	**1,590**
102	HRA	**158**	**187**	**247**	**197**	**126**	**139**	**1,054**
325		**387**	**431**	**649**	**596**	**345**	**236**	**2,644**
	Funding							
	General Fund							
98	Grants & Contributions	**79**	**73**	**61**	**36**	**20**	**17**	**286**
17	Capital Receipts Applied	**0**	**31**	**8**	**63**	**9**	**64**	**175**
	HRA							
14	Grants & Contributions	**80**	**88**	**91**	**54**	**38**	**21**	**372**
29	Capital Receipts Applied	**45**	**52**	**99**	**49**	**46**	**63**	**354**
24	Major Repairs Allowance	**24**	**25**	**24**	**24**	**25**	**25**	**147**
22	Revenue Financing	**0**	**8**	**10**	**10**	**10**	**9**	**47**
204		**228**	**277**	**293**	**236**	**148**	**199**	**1,381**
121	**Net financing need for the year**	**159**	**154**	**356**	**360**	**197**	**37**	**1,263**

Other investment opportunities

5.4 As well as investing in assets owned by the Council and used in the delivery of services, the Council can also invest, where appropriate, in:

- infrastructure projects, such as green energy;
- loans to third parties;
- shareholdings, and loans to limited companies and joint ventures.

5.5 Such investments are treated as expenditure for treasury management and prudential borrowing purposes even though they do not create physical assets in the Council's accounts. Appropriate budgets in respect of these activities are agreed as part of the Council's budget setting and ongoing monitoring processes and considered as part of the Annual Investment Strategy.

5.6 In addition, the Council has a substantial commercial investment property portfolio which forms part of the investment strategy. In previous years, the Council has invested in traditional asset classes of offices, retail and industrial/logistics, which meet the Council's requirements for the income to be secure and reliable and the investments low risk.

5.7 Following a Cabinet decision in late 2015, the Council allocated funds to invest in a commercial property partnership portfolio that commenced in 2016/17 (£50m) and 2017/18 (£50m). The aim is to diversify the property portfolio into sectors that have historically been considered alternatives but are increasingly being viewed as mainstream. The strategy focuses on increasing the income generated by the Council from its property holdings, while also meeting statutory service requirements and improving the quality of the Council's current portfolio. A further amount will be included in the 2020/21 capital budget, increasing this to £120m.

5.8 The Council has also invested £30m within the overall context of the Council's annual investment strategy in a residential housing partnership with LB Lambeth and LB Croydon.

Capital Financing Requirement (CFR)

5.9 The CFR measures the extent to which capital expenditure has not yet been financed from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

5.10 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

5.11 Table 2 shows that the CFR will increase over the medium term. Consequently, the capital financing charge to revenue will increase, reflecting the capital spending plans.

Table 2 Capital Financing Requirement forecast

2018/19 Actual £m		2019/20 Forecast £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
	CFR as at 31 March						
473	General Fund	**623**	**763**	**1,096**	**1,396**	**1,586**	**1,602**
273	HRA	**282**	**296**	**319**	**379**	**386**	**407**
746		**905**	**1,059**	**1,415**	**1,775**	**1,972**	**2,009**
	Annual Charge						
108	General Fund	**150**	**140**	**333**	**300**	**190**	**16**
13	HRA	**9**	**14**	**23**	**60**	**7**	**21**
121		**159**	**154**	**356**	**360**	**197**	**37**
	Reason for Change						
130	Net financing	**171**	**169**	**375**	**389**	**233**	**81**
(9)	Less MRP	**(12)**	**(15)**	**(19)**	**(29)**	**(36)**	**(44)**
121		**159**	**154**	**356**	**360**	**197**	**37**

5.12 Table 3 below confirms that the Council's gross debt does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for current year and the following financial years. This allows some flexibility for limited early borrowing for future years and ensures that borrowing is not undertaken for revenue purposes.

5.13 The Council's full MRP policy is shown at Appendix 2. However, a change in MRP policy for 2020/21 has been introduced to reflect where cash flows adopts an annuity structure for a specific asset. In this instance the MRP profile should match accordingly with principal repayments matching the associated MRP charge. In practice this means that the ratio of interest expense to MRP payments in the earlier years for the asset would be higher, as principal loan repayments represent a smaller element of the overall cash flows.

Table 3 Borrowing compared to the Capital Financing Requirement

2018/19 Actual £m		2019/20 Forecast £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
223	Gross Projected Debt	**221**	**206**	**238**	**400**	**587**	**572**
746	Capital Financing Requirement	**905**	**1,059**	**1,415**	**1,775**	**1,972**	**2,009**
523	**Under / (over) borrowing**	**684**	**853**	**1,177**	**1,375**	**1,385**	**1,437**

Affordability

5.14 The objective of the affordability indicator is to ensure that the level of investment in capital assets proposed remains within sustainable limits and, in particular, the impact on the Council's "bottom line". The estimates of financing costs include current commitments and the proposals in the Council's budget report. Table 4 below sets out the expected ratio of capital financing costs to income for both General Fund and HRA activities:

Table 4 Ratio of capital financing costs to income

2018/19		2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
Actual		Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
%		%	%	%	%	%	%
(4.06)	General Fund	**1.69**	**(1.95)**	**(2.90)**	**(0.80)**	**5.54**	**6.33**
33.61	HRA	**34.22**	**24.07**	**20.20**	**27.97**	**25.98**	**30.98**

5.15 For the next three years, gross capital financing charges (loan interest, MRP and finance and PFI payments) for the General Fund capital programme are largely outweighed or balanced by income from investments and the commercial property portfolio.

However, in future years the Council will begin to incur increasing capital financing charges in line with the forecast increase in the General Fund CFR in Table 2.

5.16 The capital financing charges arising from the HRA capital programme increase in line with the forecast increase income, hence, capital charges as a proportion of the HRA net revenue stream remain relatively steady.

6. SECTION 2 - BORROWING

Overall borrowing strategy

6.1 One of the main functions of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

6.2 The Council's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required. Given the significant cuts to public expenditure and, in particular, to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the long-term stability of the debt portfolio.

The key factors influencing the 2020/21 strategy are:

- forecast borrowing requirements,
- the current economic and market environment, and
- interest rate forecasts.

6.3 The Council is currently maintaining an under-borrowed position. This means that capital expenditure has not been fully funded from loan debt as other funding streams (such as government grants and third party contributions, use of Council reserves and cash balances and capital receipts) have been employed where available. This policy has served the Council well over the last few years while investment returns have been low and counterparty risk has been relatively high.

Prospects for Interest Rates

6.4 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

6.5 The borrowing position needs to be kept under review to avoid incurring higher borrowing costs in future years when the Council may not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt.

6.6 While GDP growth is likely to be subdued in 2020/21 due to all the uncertainties around the UK's exit from the European Union depressing consumer and business confidence, a UK/EU agreement is likely to lead to a boost to the rate of growth in subsequent years which could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in the Bank Rate. Just how fast, and how far those increases will occur and rise to will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

6.7 In the event of a disorderly no-agreement exit, it is likely that the Bank of England would take action to cut the Bank Rate from 0.75% in order to help the economy deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.

6.8 If there was a disorderly exit from the European Union, then any cut in the Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus. However, there would appear to be a majority consensus in the House of Commons against any form of non-agreement exit so the chance of this occurring has diminished.

6.9 Against this background and the risks within the economic forecast, caution will be adopted in 2020/21 and beyond with regard to treasury borrowing decisions. The Executive Director for Finance and Resouces and Treasury team will continue to monitor interest rates, financial markets and adopt a pragmatic approach to changing circumstances (within the approved remit).

6.10 PWLB borrowing interest rates were on a major falling trend during the first half of 2019/20 but then, with a unannounced policy change, rose by 100 bps on 9 October 2019. The strategy of avoiding new borrowing by utilising spare cash balances has served the Council well over the last few years. However, the unexpected increase of 100 basis points in the PWLB rates places a new perspective on the local authority treasury management strategy and risk management.

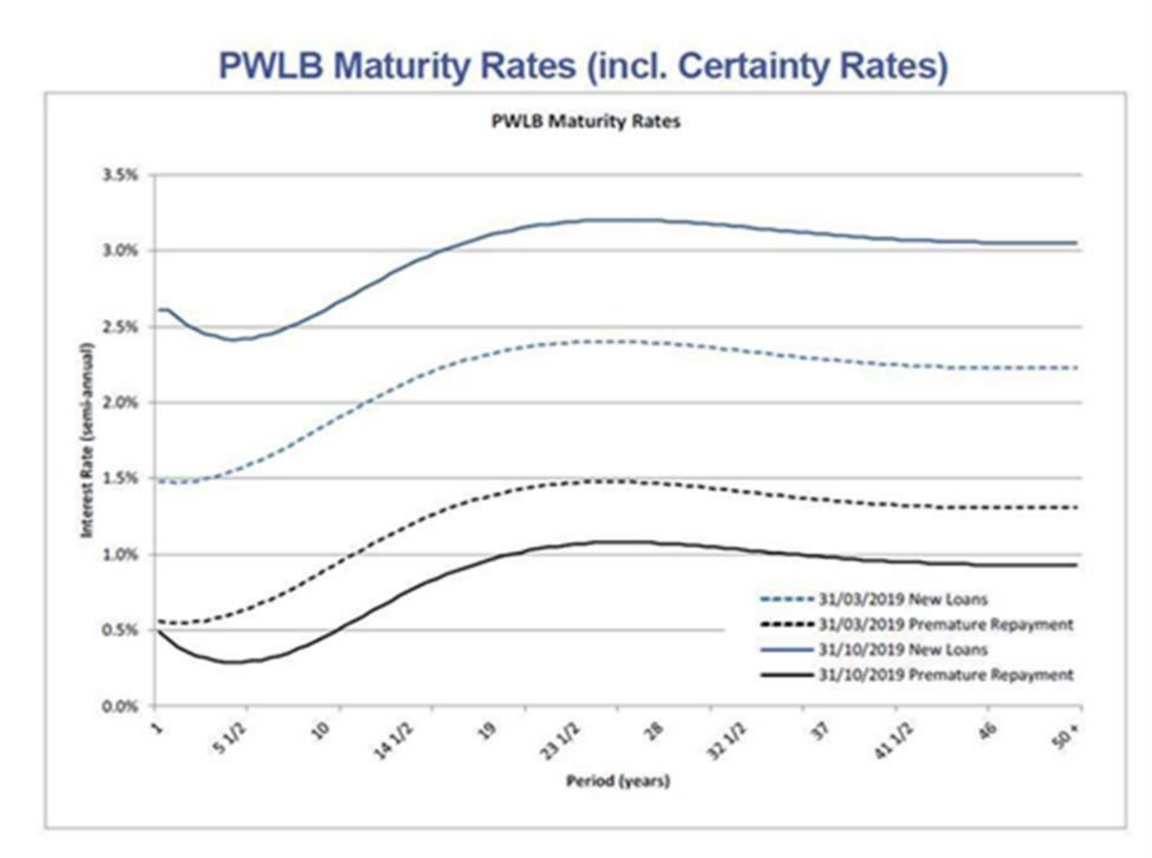
6.11 In the event that interest rates rise beyond the forecast used in the capital programme, the revenue interest cost to the Council could increase. This risk has been mitigated through the Councils agreed forward borrowing deals, totalling £400m, which are scheduled to be transacted between March 2022 and May 2023. An analysis of these loans can be found in the table 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**	

Post PWLB Interest Rate Change Borrowing Strategy

6.12 On 9 October 2019, the Public Works Loan Board (PWLB) increased the cost of borrowing for local authorities by 1%. All new loans are now subject to the relevant gilt yields +1.8% (local authority certainty rate). This increase has made the cost of loans associated with the Council's capital programme more expensive. This has also impacted on capital schemes which are 'self funding', i.e., those that generate income which offset capital financing costs, resulting in schemes having a higher bar that should be met before being financially viable. The Council's borrowing strategy has been to fund any new borrowing entirely from the PWLB, which must now be reviewed.

6.13 The Council's treasury management strategy permits borrowing from a number of sources, but it was not originally anticipated that any alternatives to PWLB would need to be utilised, given the low cost of PWLB funding previously. The key advantage of the PWLB choice was the advantageous rates, speed of processing and the low administration cost associated with the loans, achieved with a single telephone call by officers when new borrowing was arranged. Alternative funding to PWLB will result in lengthy due diligence required, Link consultancy costs, external legal advice and will be far more costly and time consuming administratively.



6.14 Alternative options for funding to PWLB could include:

- **Banks**

  Discussions with the Council's treasury consultant suggest that the Council could access borrowing at far less duration when compared with PWLB, where the majority of loans are for periods in excess of 20 years. This could change if banks see local authority lending as a long-term opportunity following the PWLB announcement.

- **Pension Fund institutional investors**

  Initial indications have suggested that the Council may be able to borrow from institutional investors at rates of around gilt yield plus 1.2% to 1.8% for periods of over 20 years, via Private Placement Agreement (PPA). Such arrangements will be subject to negotiations with the lenders, who will need to undertake due diligence on the Councils borrowing funds.

  The process of entering into such agreements is complex and would be subject to consultancy advice. Such agreements would typically be around £50m in size (i.e. the Council would need to do multiple deals to fulfil its borrowing requirement, potentially several per year).

  Councils who have strong balance sheets and considerable reserves will be able to negotiate better rates. Pension funds prefer deals with inflation linked yields to match their inflation linked liabilities. It is recommended that these be avoided due to the significant accounting complexities associated with changing levels of inflation.

- **Bond investors**

  A bond release would first require the Council to become credit rated by one (or more) of the major rating agencies, Fitch, S&P or Moody's. This is a complex, lengthy and costly process that has to be repeated annually.

  It is thought likely that investors will lend to local authorities at rates less than the new PWLB rates of gilts +1.8%. However, the precise rate offered will be market led and be dependent on the specifics of the financial strength of the authority and the market's perception of this strength.

  Councils with existing, large reserves will be able secure the most advantageous rates. Bond releases typically require a minimum size of at least £200m. The process will be reliant on consultancy and legal advice.

- **Private Placement Bond**

  The Council has been approached by a money broker who introduced the opportunity to borrow 30-year money in the form of a private placement bond. Whilst this bond would share similarities with a public bond, the nature of a private and unlisted proposal would negate the need for the Council to obtain a credit rating and would therefore be a quicker and more straightforward transaction to arrange. The security for money borrowed section complies with Section 13 of the Local Government Act 2003 meaning that all money borrowed by a local authority, together with any interest on the money borrowed, shall be charged indifferently on all the revenues of the authority. At the time of the report initial pricing for a private bond would be expected to achieve a 40-45bps discount from the PWLB rate for a similar duration. There would be no brokerage fee payable to the Council.

- **The Municipal Bonds Agency (MBA)**

  This has been in existence since 2013 but has yet to issue a bond or advance any loans. The 1% PWLB increase will make the MBA offering more viable, but officers are still waiting to hear of any firm plans that will advance this option.

6.15 Only a handful of local authorities have raised external capital borrowing via alternative options as PWLB rates have traditionally been at levels that competitors could not offer. This could now change and the market is likely to gear up to the possibility of lending to Councils. Alternative opportunities for the Council may well present themselves, and the borrowing strategy will be designed to allow for this.

6.16 With the benchmark for borrowing opportunities now at gilts plus 1.8%, external markets could adjust the pricing for funding to below this new benchmark. It is unclear at this stage whether serious PWLB competition will materialise, and it is likely to take some time to do so.

6.17 The unavoidable scenario is that alternatives to the PWLB will require far more due diligence, borrowing will likely have to be done in large tranches, rather than taking small amounts (£10m or even £5m) incrementally, as was common practice from the PWLB, and rates offered will differ depending on the financial strength of individual authorities, as opposed to the vanilla pricing associated with PWLB.

6.18 Officers will continue to explore alternatives to the PWLB, working with the Council's treasury advisor, Link. PWLB rates will also be kept under regular and active review, as future drops in gilt rates may provide advantageous borrowing rates for the council, even with the additional 1.8% margin applied.

6.19 There is also a possibility that the PWLB will reverse on the increased rate that has been put in place. Or offer lower rates for projects associated with housing or infrastructure provision. However, this is seen as very unlikely.

Immediate liquidity needs can be satisfied by borrowing from other local authorities in the short term, consistent with the Council's current approved treasury management strategy.

Table 5 The Council's balance sheet position at 31 March 2019

	2019/20 Forecast £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Capital Financing Requirement	**905**	**1,059**	**1,415**	**1,775**	**1,972**	**2,009**
Other Long Term Liabilities						
PFI	**(7)**	**(7)**	**(6)**	**(6)**	**(6)**	**(6)**
Leases	**(45)**	**(44)**	**(43)**	**(42)**	**(41)**	**(41)**
Under / (over) borrowing	**853**	**1,008**	**1,366**	**1,727**	**1,925**	**1,962**
External Borrowing	**221**	**206**	**238**	**400**	**587**	**572**
Under borrowing/ Internal borrowing	**632**	**802**	**1,128**	**1,327**	**1,338**	**1,390**

Limits on external borrowing

6.19 The Prudential Code requires the Council to set two limits on its total external debt, as set out in Table 6 below. The Authorised Limit has been increased in line with the CFR.

The limits are:

- **Authorised Limit for External Debt (Prudential Indicator 6a)** – This is the limit prescribed by section 3(1) of the Local Government Act 2003 representing the maximum level of borrowing which the Council may incur. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term.

- **Operational Boundary (Prudential Indicator 6b)** – This is the limit which external debt is not normally expected to exceed. The boundary is based on current debt plus anticipated net financing need for future years.

Table 6 Overall borrowing limits

2018/19 Actual £m		2019/20 Forecast £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
	Authorised Limit:						
746	Borrowing and other long term liabilities	**905**	**1,059**	**1,415**	**1,775**	**1,972**	**2,009**
	Operational Boundary:						
223	Borrowing	**221**	**206**	**238**	**400**	**587**	**572**
12	Other long term liabilities	**52**	**51**	**49**	**48**	**47**	**47**
235	**Operational Boundary**	**273**	**257**	**287**	**448**	**634**	**619**

6.20 In addition, borrowing for the HRA has to remain within the HRA Debt Limit (prescribed in the HRA Self-Financing Determinations 2012) as detailed in the table below. Borrowing for the HRA is measured by the HRA CFR.

Table 7 HRA borrowing

2018/19 Actual £m		2019/20 Forecast £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
273	HRA CFR	**282**	**296**	**319**	**379**	**386**	**407**

6.21 The Executive Director of Finance and Resources reports that the Council complied with these prudential indicators in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Maturity structure of borrowing (Prudential Indicator 9)

6.22 Managing the maturity profile of debt is essential for reducing the Council's exposure to large fixed rate sums falling due for refinancing within a short period, and thus potentially exposing the Council to additional cost. Table 8 below sets out current upper and lower limits for debt maturity which are unchanged from 2019/20. The principal repayment profile for current council borrowing remains within these limits.

Table 8 Debt maturity profile limits

Actual Maturity at 30 Nov 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**

Maturity profile of long-term borrowing

Borrowing as at 30 November 2019		
Period	General Fund £m	HRA £m
0 - 5 years	**0**	**30**
5 - 10 years	**0**	**43**
10 - 15 years	**0**	**50**
15 - 20 years	**0**	**18**
20 - 25 years	**15**	**0**
25 - 30 years	**0**	**0**
30 - 35 years	**0**	**20**
35 - 40 years	**0**	**20**
40 - 45 years	**0**	**0**
45 - 50 years	**10**	**15**
Total	**25**	**196**

6.23 The Council has £70 million of LOBOs (Lender Option Borrower Option) debt, none of which matures in the near future. Were the lender to exercise their option, officers will consider accepting the new rate of interest or repaying (with no penalty). Repayment of the LOBO may result in a need for refinancing.

6.24 In the event that there is a much sharper rise in long and short term rates than currently forecast, then the balance of the loan portfolio will be revisited with a view to taking on further longer term fixed rate borrowing in anticipation of future rate rises.

Policy on Borrowing in Advance of Need

6.25 The Council has the power to borrow in advance of need in line with its future borrowing requirements under the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended.

6.26 Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

6.27 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Forward Borrowing

6.28 As anticipated in the 2019/20 TMSS, the Council has undertaken no new borrowing for the 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).

6.29 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.

6.30 During 2019/20, the Council 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.

Debt Rescheduling

6.31 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the cost of debt repayment (premiums incurred).

6.32 The reasons for any rescheduling to take place will include:

- generating cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy; and
- enhancing the balance of the portfolio by amending the maturity profile and/or the balance of volatility.

6.33 Consideration will also be given to identifying the potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

6.34 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 basis point increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates. Any rescheduling will be reported to Cabinet.

7 SECTION 3 - MANAGING CASH BALANCES

The current cash position and cash flow forecast

7.1 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

7.2 Table 9 below shows that cash balances have increased by £186m since 1 April 2019 to 31 October 2019 which is mainly due to income such as council tax, business rates and grants received in advance. The cash balance is expected to be closer to £600m by year end.

Table 9 Cash position at 31 October 2019

As at 31 March 2019			As at 31 October 2019	
Principal	Average Rate		Principal	Average Rate
£m	%		£m	%
		Investments		
729	**0.95**	Specified	**885**	**0.90**
0	**0.00**	Non-Specified	**30**	**1.32**
729	**0.95**	**Total**	**915**	**0.92**
		Borrowing		
151	**3.86**	Public Works Loan Board	**151**	**3.86**
70	**5.08**	Market Loans	**70**	**5.08**
2	**0.00**	Other	**0**	**0.00**
223	**4.24**	**Total**	**221**	**4.24**

7.3 The medium-term cash flow forecast (see below) shows that the Council currently has a substantial positive cash flow position with the average cash position decreasing each year. Treasury officers will work closely with the capital finance team to monitor slippage within the capital program. Information relating to future business rates and the amounts held pending rating appeals will also be monitored as these are uncertain and will have an impact on the figures detailed below.

Table 10 Medium-term cashflow forecast

	2019/20 Forecast £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Balance at 1 April	**729**	**581**	**411**	**50**	**(105)**	**(107)**
Movement in Cash						
Capital Receipt	45	83	107	112	55	127
Grants & Contributions	159	161	152	90	58	38
Revenue Financing / MRA	24	33	34	34	35	34
Cash In	**228**	**277**	**293**	**236**	**148**	**199**
Other Cash movements	0	0	(97)	11	11	11
HRA Cash movements	11	(1)	59	33	(13)	(89)
Capital Programme	(387)	(431)	(649)	(596)	(345)	(236)
Cash Out	**(376)**	**(432)**	**(687)**	**(552)**	**(347)**	**(314)**
Forward Borrowing	0	0	38	162	200	0
Repayment of debt	0	(15)	(5)	(1)	(3)	(15)
Balance 31 March	**581**	**411**	**50**	**(105)**	**(107)**	**(237)**
Average Balance	**655**	**496**	**230**	**(28)**	**(106)**	**(172)**

7.4 The Council aims to manage daily cash flow peaks and troughs to achieve a nil current account balance throughout the year. As such the average yearly surplus cash balances should be fully invested throughout.

Prospects for investment returns

7.5 It has been little surprise that the Bank of England's Monetary Policy Committee (MPC) has left the Bank Rate unchanged at 0.75% in 2019 due to the ongoing uncertainty over the UK's exit from the European Union and, more recently, due to the impending general election. In its meeting on 7 November 2019, the MPC became more dovish due to increased concerns over the outlook for the domestic economy. In the event that the UK's exit from the European Union became more uncertain, and if weaker global economic growth was prevalent, then it would be likely that the MPC would further cut the Bank Rate. However, if these risks were both to dissipate, then rates would need to rise only at a gradual pace and to a limited extent.

7.6 The exit from the European Union uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were an eventual exit from the European Union with no agreement on the terms of trade between the UK and EU, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth.

7.7 In October 2019, MPs approved an outline of an exit deal to enable the UK to leave the EU on 31 January 2020. There will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020.

7.8 While inflation targeting by the major central banks has been successful over the last thirty 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 thirty years.

Council policy on investing and managing risk

7.10 The aim is to manage risk and reduce the impact of any adverse movement in interest rates on the one hand but, at the same time, not setting the limits to be so restrictive that they impair opportunities to reduce costs or improve performance.

Balancing short and longer term investments

7.11 Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed. During 2019/20, investments of £45m took place which exceeded 364 days. This means the Council remains well within the upper limit for such investments of £450m.

Table 11 Investment limits

2018/19 Actual £m		2019/20 Forecast £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
	Upper limit for fixed interest rate exposure						
223	Net principal re fixed rate borrowing	**905**	**1,059**	**1,415**	**1,775**	**1,972**	**2,009**
	Upper Limit for variable rate exposure						
0	Net Principal for variable rate borrowing	**0**	**0**	**0**	**0**	**0**	**0**
0	Upper Limit for principal sums invested for more the 364 days	**450**	**450**	**450**	**450**	**450**	**450**

Improving Investment Returns

7.12 An Investment Executive was set up to ensure that the Council made best use of its resources and ensure value for money was being achieved in its overall investment strategy. The task force contains both Council Members and Officers and meets on a quarterly basis.

8. SUMMARY OF PRUDENTIAL INDICATORS (PIs)

8.1 The purpose of prudential indicators (PIs) is to provide a reference point or "dashboard" so that senior officers and Members can:

- easily identify whether approved treasury management policies are being applied correctly in practice and,
- take corrective action as required.

8.2 As the Council's S151 officer, the Executive Director of Finace and Resources has a responsibility to ensure that appropriate PIs are set and monitored and that any breaches are reported to Members.

8.3 The Executive Director has confirmed that the PIs set out below are all expected to be complied with in 2019/20 and he does not envisage at this stage that there will be any difficulty in achieving compliance with the suggested indicators for 2020/21.

PI Ref	Paragraph Ref		2018/19 Actual	2019/20 Forecast	2020/21 Proposed
1	5.3	Capital expenditure	£325m	£387m	£431m
2	5.11	Capital Financing Requirement (CFR)	£746m	£905m	£1,059m
3	5.12	Net debt vs CFR	£523m underborrowing	£684m underborrowing	£853m underborrowing
4	5.13	Ratio of financing costs to revenue stream	GF (4.06)% HRA 33.61%	GF 1.69% HRA 34.22%	GF (1.95)% HRA 24.07%
5a	6.11	Authorised limit for external debt	£746m	£905m	£1,059m
5b	6.12	Operational debt boundary	£235m	£273m	£257m
6	7.3	Working Capital Balance	£0m	£0m	£0m
7a	7.10	Upper limit for variable interest rate borrowing	£0m	£0m	£0m
7b	7.10	Upper limit for fixed interest rate borrowing	£223m	£905m	£1,059m
7c	7.10	Limit on surplus funds invested for more than 364 days (i.e. non specified investments)	£0m	£450m	£450m
8	6.15	Maturity structure of borrowing	Upper limit under 12 months: 40% Actual: 0% Lower limit 10 years and above: 35% Actual: 73%	Upper limit under 12 months: 40% Forecast: 0% Lower limit 10 years and above: 35% Forecast: 67%	Upper limit under 12 months: 40% Forecast: 7% Lower limit 10 years and above: 35% Forecast: 62%

9. LEGAL IMPLICATIONS

9.1 The Local Government Act 2003 provides that a local authority has the power both to borrow and invest money for any purpose relevant to its functions and for the prudent management of its financial affairs. The Act requires the Council to determine and to keep under review how much money it can afford to borrow. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, provide that, in complying with this duty, the Council must have regard to the Prudential Code for Capital Finance in Local Authorities published by CIPFA. The Council is also required to have regard to the CIPFA Treasury Management Code of Practice.

9.2 The current CIPFA Treasury Management Code of Practice 2017 and the Secretary of State's Investment Code both require the Section 151 officer (Executive Director) to present an Annual Treasury Management Strategy Statement, which includes an Annual Investment Strategy, for the forthcoming year for approval by the Full Council before the beginning of each financial year.

9.3 The revised CIPFA Prudential Code for Capital Finance in Local Authorities sets out various indicators that are to be used to support capital expenditure plans and treasury management decisions. The prudential and treasury indicators have to be set by the Full Council when the budget is set and are monitored during the year. The prudential indicators are included in section 8 of this report.

9.4 The Council is also required to approve a Treasury Management Policy Statement setting out the overarching framework for treasury management services within the Council. This statement is set out in sections 5-7 of this report.

10. APPENDICES

1 Annual Investment Strategy
2 Minimum Revenue Provision (MRP) Policy
3 CIPFA Requirements
4 Prospect for Interest Rates/ Economic Update

BACKGROUND PAPERS

Treasury Management Strategy Statement 2019/20 (Approved by Council March 2019)

1. Section 3 Local Government Act 2003

2. Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended

3. MHCLG Guidance on Minimum Revenue Provision (fourth edition) February 2018

4. MHCLG Capital Finance Guidance on Local Government Investments February 2018

5. CIPFA Prudential Code for Capital Finance in Local Authorities, 2017
6. CIPFA Treasury Management Code of Practice, 2017
7. CIPFA Treasury Management Guidance Notes 2018

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

Gerald Almeroth, Executive Director of Finance and Resources

Tel: 020 7641 2904

Email: galmeroth@westminster.gov.uk

APPENDIX 1

ANNUAL INVESTMENT STRATEGY

1. The Council holds significant invested funds, representing income received in advance of expenditure, balances and reserves. During the first half of the current year, the Council's average investment balance has been around £978m and the cash flow projections show this pattern is expected to decrease in the forthcoming year. Investments are made with reference to the core balance, future cash flow requirements and the outlook for interest rates.

2. The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments ("the Investment Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then yield.

3. In accordance with the above guidance and to minimise the risk to investments, the Council applies minimum acceptable credit criteria to generate a list of highly creditworthy counterparties which will provide security of investments, enable diversification and minimise risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Investment returns expectations

4. On the assumption that the UK and EU agree a European Union exit deal including the terms of trade by the end of 2020 or soon after, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.00% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

   2020/21: 0.75%
   2021/22: 1.00%
   2022/23: 1.00%

5. The suggested budgeted investment earnings rates for returns on investments placed for periods up to 3 months during each financial year are as follows:

   2019/20: 0.75%
   2020/21: 0.75%
   2021/22: 1.00%
   2022/23: 1.25%
   2023/24: 1.50%
   2024/25: 1.75%
   Later years: 2.25%

6. The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over the European Union exit, as well as a softening global economic picture. The balance of risks to increases in the Bank Rate and shorter term PWLB rates are broadly similarly to the downside. In the event that an exit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

Investment time limits

7. This limit is set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment. For the year 2020/21, the proposed limit of investments for over 364 days is £450m as set out in table 11 of the TMSS.

Investment Policy

8. The Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to assess continually and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

9. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector to establish the most robust scrutiny process on the suitability of potential investment counterparties and the impact of our exit on a potential counterparty.

Creditworthiness Policy

10. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

After this main principle, the Council will ensure that:

- it maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- it has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

10.1 The Executive Director of Finance and Resources will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

10.1.1 Credit rating information is supplied by Link Asset Services, our treasury advisors. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing.

11. The Council takes into account the following relevant matters when proposing counterparties:

- the financial position and jurisdiction of the institution;
- the market pricing of credit default swaps[1] for the institution;
- any implicit or explicit Government support for the institution;
- Standard & Poor's, Moody's and Fitch's short and long term credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries; and
- core Tier 1 capital ratios[2].

12. Changes to the credit rating will be monitored and, in the event, that a counterparty is downgraded and does not meet the minimum criteria specified in Appendix 1, the following action will be taken immediately:

- no new investments will be made;
- existing investments will be recalled if there are no penalties; and
- full consideration will be given to recall or sale of existing investments which would be liable to penalty clause.

Specified and Non-specified investments

13. The DCLG Guidance on Local Government Investments made under section 15(1) of the Local Government Act 2003, places restrictions on local authorities around the use of specified and non-specified investments.

A specified investment is defined as an investment which satisfies all of the conditions below:

- the investment and any associated cash flows are denominated in sterling;
- the investment has a maximum maturity of one year;
- the investment is not defined as capital expenditure; and
- the investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or parish/community council.

14. **Non-specified investments** are those with less high credit quality, may be for

[1] Credit Default Swaps (CDS) are tradable instruments where the buyer receives a pay-out from the seller if the party to whom the CDS refers (often a financial institution) has a "credit event" (e.g. default, bankruptcy, etc.). The price of the CDS gives an indication to the market's view of likelihood – the higher the price the more likely the credit event.

[2] The Tier 1 capital ratio is the ratio of a bank's core equity capital to its total risk-weighted assets (RWA). Risk-weighted assets are the total of all assets held by the bank weighted by credit risk according to a formula determined by the Regulator (usually the country's central bank). Most central banks follow the Basel Committee on Banking Supervision (BCBS) guidelines in setting formulae for asset risk weights.

periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. In addition to the long-term investments listed in the table at the end of Appendix 1, the following non-specified investments that the Council may make include:

- **Green Energy Bonds** - Investments in solar farms are a form of Green Energy Bonds that provide a secure enhanced yield. The investments are structured as unrated bonds and secured on the assets and contracts of solar and wind farms. Before proceeding with any such investment, internal and external due diligence will be undertaken in advance of investments covering the financial, planning and legal aspects.

- **Social Housing Bonds** – Various fund managers facilitate the raising of financing housing associations via bond issues. The investment is therefore asset backed and provides enhanced returns. Officers will need to undertake due diligence on each potential investment in order to understand the risks and likelihood of default.

- **Asset Backed Securities (ABS) / Residential Mortgage backed securities (RMBS)** – As these securities by their nature are asset backed they are regarded as low risk should a default take place, but have a higher return. These are available for direct investment, or as pooled / segregated assets managed by a third party fund manager. In the event of a fund manager option being selected, this would need to be procured through a proper procurement process.

- **Loans** - The Council will allow loans (as a form of investment) to be made to organisations delivering services for the Council where this will lead to the enhancement of services to Westminster Stakeholders. The Council will undertake due diligence checks to confirm the borrower's creditworthiness before any sums are advanced and will obtain appropriate levels of security or third party guarantees for loans advanced. The Council would expect a return commensurate with the type, risk and duration of the loan. A limit of £50 million for this type of investment is proposed with a duration commensurate with the life of the asset and Council's cash flow requirements. All loans will need to be in line with the Council's Scheme of Delegation and Key Decision thresholds levels.

- **Shareholdings in limited companies and joint ventures** – The Council invests in three forms of company:

    - Small scale businesses funded through the Civic Enterprise Fund aimed at promoting economic growth in the area. Individual investments are no more than £0.5m and the aim is for the Fund to be self-financing over the medium-term.

    - Trading vehicles which the Council has set up to undertake particular functions. These are not held primarily as investments but to fulfil Council service objectives. Any new proposals will be subject to due diligence as part of the initial business case. As these are not to be held primarily as investment vehicles, then there is an expectation that they will break even.

    - Trading vehicles held for a commercial purpose where the Council is obliged to undertake transactions via a company vehicle. These will be wholly owned subsidiaries of the Council with the aim of diversifying the investment portfolio risk

- o Westminster Housing Investment Ltd

15. For any such investments, specific proposals will be considered by the Tri-Borough Director of Treasury and Pensions, and approved by the S151 Officer after taking into account:

    - ➢ cash flow requirements
    - ➢ investment period
    - ➢ expected return
    - ➢ the general outlook for short to medium term interest rates
    - ➢ creditworthiness of the proposed investment counterparty
    - ➢ other investment risks.

16. The value of non-specified investments will not exceed their investment allocation. The Council must now formulate a strategy that allocates its cash in the most effective manner to short, medium and long term non-specified investments.

Country of Domicile

17. The current TMSS allows deposits/ investments with financial entities domiciled in the following countries: Australia, Canada, Denmark, Finland, France, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden, Switzerland, UK and USA. This list will be kept under review and any proposed changes to the policy reported to the next meeting.

Schedule of investments

18. The criteria for providing a pool of high quality short, medium and long-term, cash-based investment counterparties along with the time and monetary limits for institutions on the Council's counterparty list are in the table below:

19. Officers will monitor the impact of the UK's exit from the European Union on the names within the Council's counterparty list.

All investments listed below must be sterling denominated

Investments	Minimum Credit Rating Required (S&P/Moody's/Fitch)	Maximum Individual Counterparty Investment Limit (£m)	Maximum tenor
DMO Deposits	Government Backed	Unlimited	6 months
UK Government (Gilts/T-Bills/Repos)	Government Backed	Unlimited	Unlimited
Supra-national Banks, European Agencies	LT: AA/Aa/AA	£200m	5 years
Covered Bonds	LT: AA/Aa/AA	£300m	10 years
Network Rail	Government guarantee	Unlimited	Oct 2052
TFL	LT: AA/Aa/AA	£100m	5 years
Greater London Authority (GLA)	N/A	GLA: £100m	5 years
UK Local Authorities (LA)		LA: £100m per LA, per criteria £500m in aggregate	3 years
Local Government Association (LGA)		LGA: £20m	15 years
Commercial Paper issued by UK and European Corporates	ST: A-1/P-1/F-1	£40m per name, £200m in aggregate	6 months
Money Market Funds (MMF)	LT: AAA/Aaa/AAA By at least two of the main credit agencies	£70m per Fund Manager £300m in aggregate	3 day notice
Ultra Short Dated Bond Funds (USDBFs)	LT: AAA/Aaa/AAA By at least one of the main credit agencies	£25m per fund manager, £75m in aggregate	Up to 7 day notice
Collateralised Deposits	Collateralised against loan	£100m	50 years
Social Housing Bonds	Due Diligence	£200m	10 years
Asset backed securities (ABS) and Residential mortgage backed securities (RMBS)	Asset Backed / Due Diligence	£200m	10 years
UK Bank (Deposit or Certificates of Deposit)	LT: AA-/Aa3/AA- ST: F1+	£75m	5 years
	LT: A-/A3/A ST: F1	£50m	3 years
Non-UK Bank (Deposit or Certificates of Deposit)	LT: AA-/Aa2/AA- ST: F1+	£50m	5 years
	LT: A/A2/A ST: F1	£35m	3 years
Green Energy Bonds	Internal and External due diligence	Less than 25% of the total project investment or maximum £20m per bond. £50m in aggregate	10 years
Rated UK Building Societies	LT: A-/A3/A ST: F1	£10m per Building Society, £50m in aggregate	1 year
Loans to organisations delivering services for the Council	Due diligence	£50m in aggregate	Over the life of the asset
Sovereign approved list (AA rated and above): Australia, Canada, Denmark, Finland, France, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden, Switzerland, UK and USA			

Rationale for investment limits

Debt Management Office (DMO): Unlimited. The DMO is an executive agency of Her Majesty's Treasury. Being fully UK government backed, the DMO is the ultimate low risk depositary. Being ultra-low risk, the investment return is very low.

UK Government Gilts/T-Bills/Repos: Unlimited. UK Government gilts are regarded by the market as high quality and ultra-low risk. Being ultra-low risk, the investment return is low.

Supranational Banks, European Agencies: £200m limit. A supra-national bank is a financial institution, such as the European Investment Bank or the World Bank, whose equity is owned by sovereign states. Being owned by overseas states, they are regarded as being low risk, but not in the same safe risk category as UK. The investment return is low.

Covered Bonds: £300m limit. Covered bonds are debt securities issued by a bank or mortgage institution and collateralised against a pool of assets that, in case of failure of the issuer, can cover claims at any point of time. They are subject to specific legislation to protect bond holders. With slightly more risk, the investment return is higher than UK Gilts.

Network Rail: Unlimited. Network Rail is the owner and infrastructure manager of most of the rail network in England, Scotland and Wales. Having a UK government guarantee, they are regarded as being reasonably low risk with a lower investment return.

Transport for London (TfL): £100m limit. Transport for London is a local government body responsible for the transport system in Greater London. Its parent organisation is the Greater London Authority (GLA). Being a GLA owned entity, the investment is regarded as safe and the return is low.

Greater London Authority (GLA): £100m limit. The Greater London Authority is the top-tier administrative body for Greater London, consisting of a directly elected executive Mayor of London and an elected 25-member London Assembly. Being categorised alongside UK local authorities, the investment is regarded as safe and the return is low.

UK Local Authorities: £100 limit per authority, £500m in total. Local authorities have always been regarded as safe counterparties. As an additional safeguard, each new local authority counterparty will be subject to checks regarding latest accounts, audit opinion, financial budget projections, and financial reputation. There are 326 billing authorities with tax-raising powers in England, consisting of 201 non-metropolitan district councils, 55 unitary authority councils, 36 metropolitan borough councils, 32 London borough councils, the City of London Corporation and the Council of the Isles of Scilly. Additionally, there are levying authorities, consisting of 45 police authorities, 52 fire authorities and six waste disposal authorities. UK local authorities and levying authorities are regarded as safe and the return is relatively low.

Local Government Association: £20m. The Local Government Association (LGA) is a charitable organisation, funded largely from subscriptions, which comprises local authorities in England and Wales, representing the interests of local government to national government. 435 authorities are members of the LGA as of 2016, including 349 English councils and the 22 Welsh councils, as well number of smaller authorities including fire authorities and national parks.

Despite being an entity which represents local authorities, this entity is not regarded as risk free as local authorities and therefore the limit is lower at £20m.

Commercial Paper issued by the UK and European Corporates: £40m per name, £200m in total. Commercial paper is an unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. Investment is confined to high quality investment grade corporates. The risk and investment return are higher than the sovereign categories.

Money Market Funds (MMF): £70m per manager, £300m in total. Money market funds are open-ended funds that invests in short-term high quality debt securities such as Treasury bills and commercial paper.

Ultra short dated bond funds (USDBFs): £25m per manager, £75m in total. Enhanced money market funds increase returns via increasing interest rate, credit and liquidity risk in order to enhance the return. Being well diversified reduces the impact of a single default within the portfolio.

Collateralised Deposits: £100m. In lending agreements, collateral is a borrower's pledge of specific property to a lender to secure repayment of a loan, serving as a lender's protection against a borrower's default. Being asset backed, they are regarded as being reasonably low risk should a default take place, but with a higher return.

Social Housing Bonds: £200m in total. Housing associations are increasingly issuing public bonds, secured against social housing assets, to meet financing requirements. This category is greater risk and will provide an enhanced return.

Residential Mortgage Backed Securities (RMBS): £200m limit. A residential mortgage backed security is a pool of mortgage loans created by banks and other financial institutions. The cash flows from each of the pooled mortgages is packaged by a special-purpose entity into classes and tranches, which then issues securities and can be purchased by investors. Being asset backed, they are regarded as being reasonably low risk should a default take place, but with a higher return.

UK Bank Deposits: £75m per bank. Banks have become a riskier counterparty since the bail outs of Lloyds and RBS. The Financial Services (Banking Reform) Act 2013 confers on the Bank of England a bail-in stabilisation option for the resolution for banks and building societies, ensuring that shareholders and creditors/depositors of the failed institution, rather than the taxpayer, meet the costs of the failure. Despite the bail-in risk, the return on UK bank deposits is relatively low.

Non-UK Bank Deposits: £50m (Sterling deposits only) per bank. Overseas banks incorporated in the UK provide a number of options for high quality institutions with returns largely similar to UK banks.

Green Energy Bonds: £20m per bond, £50m in total (subject to due diligence). This comprises of finance for the supply of electricity from renewable energy sources, particularly in areas such as energy storage and electric vehicle networks. This category is greater risk and will provide an enhanced return. Use should be made of regulated markets where available in order to provide additional investment security and risk reduction.

Rated Building Societies: £10m per building society, £50m in total. Same rationale as UK banks, see above.

Loans to organisations delivering services to the Council: £50m in total. Assessed individually and subject to due diligence. At markets rates of interest and reflecting the risk of the borrower, this will offer an enhanced rate of return.

APPENDIX 2

Minimum Revenue Provision (MRP) Policy

1. Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year. The accounting approach is to spread the cost over the estimated useful life of the asset. The mechanism for spreading these costs is through an annual MRP. The MRP is the means by which capital expenditure, which is financed by borrowing or credit arrangements, is funded by Council Tax.

2. Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended (Statutory Instrument (SI) 3146/2003) requires full Council to approve a Minimum Revenue Provision (MRP) Statement setting out the policy for making MRP and the amount of MRP to be calculated which the Council considers to be prudent. In setting a level which the Council considers to be prudent, the Guidance states that the broad aim is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits to the Council.

3. The Council is recommended to approve the following MRP Statement:

   - For capital expenditure incurred before 1 April 2007, MRP will be calculated using Option 1 (the 'Regulatory Method') of the CLG Guidance on MRP. Under this option MRP will be 4% of the closing non-HRA CFR for the preceding financial year.

   - For all capital expenditure incurred after 1 April 2007 financed from unsupported (prudential) borrowing (including PFI and finance leases), MRP will be based upon the asset life method under Option 3 of the DCLG Guidance.

   - In some cases, where a scheme is financed by prudential borrowing it may be appropriate to vary the profile of the MRP charge to reflect the future income streams associated with the asset, whilst retaining the principle that the full amount of borrowing will be charged as MRP over the asset's estimated useful life.

   - The Council reserves the right to adopt an annuity MRP structure where appropriate to match an assets cash flows

   - A voluntary MRP may be made from either revenue or voluntarily set aside capital receipts.

   - Estimated life periods and amortisation methodologies will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

   - As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

- Charges included in annual PFI or finance leases to write down the balance sheet liability shall be applied as MRP.

- Where borrowing is undertaken for the construction of new assets, MRP will only become chargeable once such assets are completed and operational.

- If property investments are short-term (i.e. no more than 4 years) and for capital appreciation, the Council will not charge MRP as these will be funded by the capital receipt on disposal

4. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made. For the Council this is componentised based on the life of component and the gross replacement cost within the overall existing use value – social housing of the HRA stock.

APPENDIX 3

CIPFA requirements

The Council has formally adopted CIPFA's Code of Practice on Treasury Management (updated 2017) and complies with the requirements of the Code as detailed in this appendix. There are no changes to the requirements formally adopted in the 2017 update with regard to reporting: these are listed below:

- Maintaining a Treasury Management Policy Statement setting out the policies and objectives of the Council's treasury management activities.
- Maintaining a statement of Treasury Management Practices that sets out the manner in which the Council will seek to achieve these policies and objectives.
- Presenting the Full Council with an annual TMSS statement, including an annual investment strategy and Minimum Revenue Provision policy for the year ahead (this report) a half year review report and an annual report (stewardship report) covering compliance during the previous year.
- A statement of delegation for treasury management functions and for the execution and administration of statement treasury management decisions. (see below)
- Delegation of the role of scrutiny of treasury management activities and reports to a specific named body. At Westminster City Council this role is undertaken by the Audit and Performance Committee

Treasury Management Delegations and Responsibilities

The respective roles of the Council, Cabinet, Housing, Finance and Corporate Services Policy and Scrutiny committee and Section 151 officer are summarised below. Further details are set out in the Treasury Management Practices.

Council

Council will approve the annual treasury strategy, including borrowing and investment strategies. In doing so Council will establish and communicate their appetite for risk within treasury management having regard to the Prudential Code

Cabinet

Cabinet will recommend to Council the annual treasury strategy, including borrowing and investment strategies and receive a half-year report and annual out-turn report on treasury activities.

Cabinet also approves revenue budgets, including those for treasury activities.

Audit and Performance Committee

This committee is responsible for ensuring effective scrutiny of the Treasury strategy and policies.

Section 151 Officer

Council has delegated responsibility for the implementation and monitoring of treasury management decisions to the Section 151 Officer to act in accordance with approved policy and practices. The s151 Officer has full delegated powers from the Council and is responsible for the following activities:

- investment management arrangements and strategy;
- borrowing and debt strategy;
- monitoring investment activity and performance;
- overseeing administrative activities;
- ensuring compliance with relevant laws and regulations;
- provision of guidance to officers and members in exercising delegated powers.

Tri-Borough Director of Treasury and Pensions

Has responsibility for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Policy Statement and CIPFA's 'Standard of Professional Practice on Treasury Management'.

Treasury Team

Undertakes day to day treasury investment and borrowing activity in accordance with strategy, policy, practices and procedures.

Training

The CIPFA code requires the s151 officer to ensure that Members with responsibility for making treasury management decisions and for scrutinising treasury functions receive adequate training. The training needs of all officers are reviewed periodically as part of the Learning and Development programme. Officers attend various seminars, training sessions and conferences during the year and appropriate Member training is offered as and when is needed, and suitable opportunities, are identified.

APPENDIX 4

Prospects for Interest Rates

1. The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

2. The above forecasts have been based on an assumption that there is a pathway to an agreed deal on our exit from the European Union, including agreement on the terms of trade between the UK and EU, at some point in time. Given the current level of uncertainties around the result of the general election due on 12 December and then subsequent developments, this is a major assumption and so forecasts may need to be materially reassessed in the light of events over the coming weeks or months.

3. Bond yields / PWLB rates. There has been much speculation recently that we are currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields.

4. While inflation targeting by the major central banks has been successful over the last thirty 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 thirty years.

5. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-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. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

6. During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. There is though, an expectation that financial markets have gone too far in their fears

about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this and how strong the correlation is likely to be is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

7. One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.

8. Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

9. The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

10. Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Economic Update

11. **UK. European Union Exit.** 2019 has been a year of upheaval 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 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. Now that the Conservative Government has gained a large overall majority in the general election on 12 December, this outline deal will be passed by Parliament by that date. However, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open two possibilities; one, the need for an

extension of negotiations, probably two years, or, a no deal Brexit in December 2020. GDP growth has taken a hit from Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero.

12. While the Bank of England went through the routine of producing another quarterly Inflation Report, (now renamed the Monetary Policy Report), on 7 November, it is very questionable how much all the writing and numbers are worth when faced with the uncertainties of where the UK will be after the general election. The Bank made a change in their European Union exit assumptions to now include a deal being eventually passed. Possibly the biggest message that is worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for European Union exit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or European Union exit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence the MPC views inflation as causing little concern in the near future. The MPC meeting of 19 December repeated the previous month's vote of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. they were going to sit on their hands and see how the economy goes in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that domestic "unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and both of the largest parties have made significant promises in their election manifestos to increase government spending. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure. In addition, it has to be borne in mind that even if the post-election Parliament agrees the deal on 31 January 2020, the current transition period for negotiating the details of the terms of a trade deal with the EU only runs until 31 December 2020. This could prove to be an unrealistically short timetable for such major negotiations which leaves open two possibilities; one the need for an extension of negotiations, probably two years, or a no deal exit from the European Union in December 2020.

13. As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of to 1.3%. It is likely to remain close to or under 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

14. With regard to the **labour market,** growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000 which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady a 44 year low of 3.8% on the Independent Labour Organisation measure in October.

Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

15. In the **political arena**, a general election could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

16. **USA.** President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. Growth in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening. However; CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

17. **The Fed** finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%.. At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy $60bn , whereas it had been reducing its balance sheet by $50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt).

18. Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China. However, in early November, a phase one deal was agreed between the US and China to roll back some of the tariffs which gives some hope of resolving this dispute.

19. **EUROZONE. Growth** has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, +1.1% in quarter 3; there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y.

Germany would be particularly vulnerable to a no deal European Union exit depressing exports further and if President Trump imposes tariffs on EU produced cars.

20. **The European Central Bank (ECB)** ended its programme of quantitative easing purchases of debt in December 2018, which then 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 quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, 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%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September, 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 for an unlimited period;** (at its October meeting it said this would start in November at €20bn per month - a relatively small amount compared to the previous buying programme). It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments will need to help stimulate growth by 'growth friendly' fiscal policy.

21. On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU. The results of the Spanish general election in November have not helped the prospects of forming a stable coalition.

22. **CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

23. **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.

24. **WORLD GROWTH.** Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy.

    The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support (i.e. subsidies) to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates.

25. The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.