City of Westminster

Decision Maker:	Audit and Performance Committee
Date:	18 June 2020
Classification:	General Release
Title:	Treasury Management Strategy Outturn 2019/20
Wards Affected:	All
Policy Context:	To manage the Council's finances prudently and efficiently
Cabinet Member:	Cabinet Member for Finance, Property and Corporate Services
Financial Summary:	This report forms part of the monitoring of the treasury function as recommended in the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code of Practice. It reviews the implementation of the strategy and final outturn position.
Report of:	Gerald Almeroth Executive Director for Finance and Resources

1. EXECUTIVE SUMMARY

1.1. This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2019/20. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2. The purpose of this report is to:

- Present the Council's Annual Treasury Management Outturn Report for 2019/20 in accordance with the Council's treasury management practices. It is a regulatory requirement for this outturn report to be presented to Council by the 30 September of each year.

1.3. Treasury management comprises:

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

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

- Review of the Council's investment portfolio for 2019/20 to include the treasury position as at 31 March 2020.
- Review of the Council's borrowing strategy for 2019/20.
- Review of compliance with Treasury and Prudential Limits for year to 2019/20.
- Economic update for 2019/20.

1.5. The Council has complied with all elements of the Treasury Management Strategy Statement (TMSS) apart from one instance (already reported in the 2019/20 mid-year review) which arose because of exceptional banking receipts which were received too late in the day to be moved from the bank until the following day. This resulted in funds in excess of the strategy limit set for the Council's current bank account on one occasion:

- £11.008m on 29th April 2019.

1.6. On the 30th October 2020, the Council breached its authorised overdraft limit by £47.4m at our clearing bank Lloyds. This arose from a failure of HSBC bank to repay £49.2m requested from the Council's HSBC call account.

2. RECOMMENDATIONS

2.1. The Committee is asked to note the annual treasury management final outturn 2019/20, noting the cases of non-compliance.

3. TREASURY POSITION AS AT 31 MARCH 2020

3.1. The Council's treasury management debt and investment position is organised by the Tri-Borough Treasury team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting, and through officer activity detailed in the Council's Treasury Management Practices.

3.2. As at 31 March 2020, net cash invested was £407.5m, a decrease of £98.3m on the position at 31 March 2019 as shown below:

	31 March 2020 (£m)	31 March 2019 (£m)
Total Borrowing	(221.2)	(223.2)
Total Cash Invested	628.7	729.0
Net Cash Invested	**407.5**	**505.8**

Investments

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

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

	Investment Balance 31 March 2020 (£m)	Investment Balance 31 March 2019 (£m)	Movement
Money Market Funds	30.1	59.7	-29.6
Notice Accounts	18.6	89.5	-70.9
Term Deposits	580.0	465.0	115.0
Tradeable Securities	0.0	114.8	-114.8
Total:	**628.7**	**729.0**	**-100.3**

3.5. Liquid balances are managed through Money Market Funds, providing same day liquidity. Cash has also been invested in less liquid instruments, particularly term deposits. The average level of funds available for investment in 2019/20 was £952.7m.

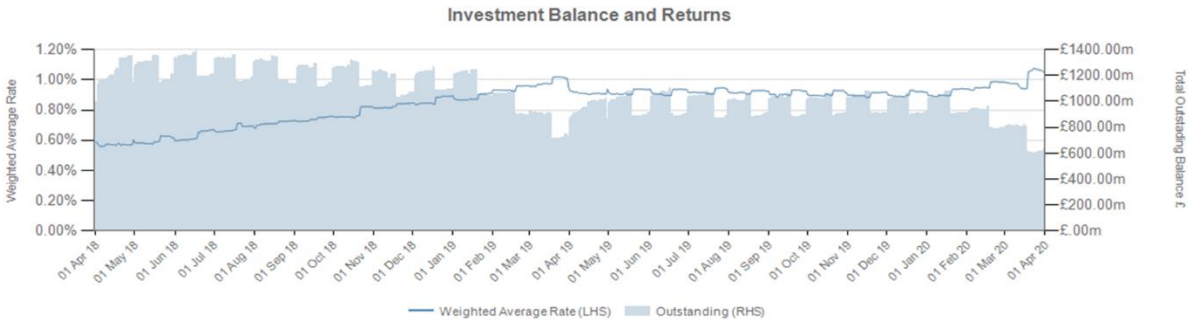
3.6. Daily investment balances have steadily decreased from £729.0m at 1 April 2019 to £628.7m at 31 March 2020.

3.7. The table below provides a more detailed breakdown of the Council's treasury investment position and interest rate received as at 31 March 2020:

	Investment Balance (£m)	Interest Rate (%)
Money Market Funds	30.1	0.46
UK Banks	150.0	1.09
Non UK Banks	68.6	0.89
Local Authorities	380.0	1.11
Total:	**628.7**	**1.05**

3.8. On 4 August 2016, the Bank of England reduced the bank rate to 0.25%, staying at this level until 2 November 2017 when there was an interest rate increase to 0.50%. On 2 August 2018, there was another rate rise to 0.75% where it stayed until 11 March 2020 when it reduced to 0.25%. This was followed by a second decrease on 19 March 2020 to 0.10%.

3.9. Although surplus cash for investment has reduced, cash has been invested with higher interest rate paying counterparties. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Council's capital programme.



3.10. All investment/overdraft limits specified in the 2019/20 investment strategy have been complied with except for one instance of cash received after close of banking business:

- £11.008m on 29th April 2019.

3.11. The original/ budgeted average balance for 2019/20 was £900m, while the actual outturn average investment balance for the year was 952.7m. The average investment balance peaked in July 2019, reaching £994.6m.

3.12. The table below shows the forecast investment income to be achieved in the year: budget versus actual and the variance. The Council's budgeted investment return for 2019/20 was £9.810m, and performance for the year is £3.120m above budget.

	Budget £000	Actual £000	Variance £000
Investment Income	-9,810	-12,930	-3,120

3.13. Appendix 1 provides a full list of the Council's limits and exposures as at 31 March 2020.

Borrowing

3.14. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2019/20 unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.15. At £221.2m, the Council's borrowing was within the Prudential Indicator for external borrowing, namely, that borrowing should not exceed the estimated CFR for 2019/20 of £905.0m. The final CFR for 2019/20 was £830.0m.

3.16. During 2019/20, the Council maintained an under-borrowed position of £609.0m. This meant that the capital borrowing need (the Capital Financing Requirement) was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing treasury investments also needed to be considered.

3.17. The table below shows the details around the Council's external borrowing as at 31 March 2020, split between the General Fund and HRA.

Total Borrowing	31 March 2019 (£m)	31 March 2020 (£m)
HRA	196.0	196.0
General Fund	27.2	25.2
Total Borrowing	**223.2**	**221.2**

3.18. The breakdown of the existing loans is shown below:

Borrowing Type	Loan Balance 31 March 2019 (£m)	Loan Balance 31 March 2020 (£m)	Movement
PWLB	151.0	151.0	0.0
LOBO	70.0	70.0	0.0
Mortgage Annuity	0.2	0.2	0.0
Greater London Authority	2.0	0.0	-2.0
Total:	**223.2**	**221.2**	**-2.0**

3.19. During 2019/20, the Council repaid £2.042m of loans using investment balances. These consisted of a £2.0m interest free loan from the Greater London Authority and £0.042m principal of mortgage annuity loans.

Forward Borrowing

3.20. As anticipated in the TMSS 2019/20, 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).

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

3.22. 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”, i.e., the difference between loan interest cost and the rate of return on cash investments.

3.23. 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 2066	2.751	Annuity
Rothesay Life Plc	200.0	08 May 2023	08 May 2063	2.887	Equal Instalment of Principal
Weighted average interest rate				**2.579**	

Compliance with Treasury Limits and Prudential Indicators

3.24. During the financial year to 31 March 2020, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS approved by Council on 6 March 2019 as set out below.

PI Ref		2019/20 Forecast	2019/20 Actual	Indicator Met?
1	Capital expenditure	£387m	£283m	Met
2	Capital Financing Requirement (CFR)	£905m	£830m	Met
3	Net debt vs CFR	£684m underborrowing	£609m underborrowing	Met
4	Ratio of financing costs to revenue stream	GF 1.69% HRA 34.22%	GF 1.96% HRA 32.32%	Met
5a	Authorised limit for external debt	£905m	£830m	Met
5b	Operational debt boundary	£273m	£273m	Met
6	Working Capital Balance	£0m	£30m	Met
7a	Upper limit for variable interest rate borrowing	£0m	£0m	Met
7b	Upper limit for fixed interest rate borrowing	£905m	£830m	Met
7c	Limit on surplus funds invested for more than 364 days (i.e. non specified investments)	£450m	£58m	Met
8	Maturity structure of borrowing	Upper limit under 12 months: 40% Forecast: 0% Lower limit 10 years and above: 35% Forecast: 67%	Upper limit under 12 months: 0% Lower limit 10 years and above: 67%	Met

Capital Expenditure and Borrowing Limits

3.25. Capital expenditure to 31 March 2020 totalled £283.0m for the General Fund and the HRA against a forecast for the whole year of £387.0m. This relates to a number of large development projects and related acquisitions. The forecast for development projects are contingent on progress by developers which is anticipated will improve over the remainder of the year. Acquisitions are reactive and depend on properties becoming available on the market and as such the forecast can be volatile but will continue to be monitored by officers.

	2019/20 Indicator (£m)	2019/20 Actual (£m)
General Fund Capital Expenditure	229	164
HRA Capital Expenditure	158	119
Total Capital Expenditure	**387**	**283**
Financed by:		
Capital Receipts	45	52
Capital Grants	159	110
Funded from Revenue	0	0
Major Repairs Allowance	24	23
Prudential Borrowing	159	98
Total Finance	**387**	**283**

3.26. The impact on the Council's Capital Financing Requirement is also shown in the table below:

	General Fund £m	Housing Revenue Account £m	Total £m
Adjusted Opening CFR 31/03/2019	472	275	747
Prudential Borrowing in 2019/20	99	50	149
Capital Receipts applied to reduce CFR	-21	-31	-52
Minimum Revenue Provision	-13	0	-13
MRP in respect of Other Long Term Liabilities	-1	0	-1
Closing CFR	**536**	**294**	**830**

3.27. External borrowing was well within the Capital Financing Requirement, Authorised Borrowing Limit and the Operational Boundary:

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

- The Operational Boundary is set at a lower level and should take account of the most likely level of external borrowing. Operationally, in accordance with CIPFA best practice for Treasury Risk Management, a liability benchmark is used to determine the point at which any new external borrowing should take place. As a result of the significant level of cash balances, it is deemed unlikely that any new borrowing will be required in the short-term.

3.28. The purpose of the maturity structure of borrowing indicator is to highlight any potential refinancing risk that the Council may be facing if in any one particular period there was a disproportionate level of loans maturing. The table below shows that the maturity structure of the Council's borrowing as at 31 March 2020 was within the limits set and does not highlight any significant issues.

Actual Maturity at 31 March 2020	Duration	Upper Limit	Lower Limit
7	Under 12 Months	40	0
2	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

3.29. The purpose of the interest rate exposure indicators is to demonstrate the extent of exposure to the Council from any adverse movements in interest rates. The table at paragraph 3.23 shows that the Council is not subject to any adverse movement in interest rates as it only holds fixed interest borrowing.

3.30. The average rate on the fixed interest borrowing is 4.24% with an average redemption period of 17 years. This reflects the historical legacy of borrowing taken out some years ago which is now higher than PWLB interest rates for comparable loans if they were taken out at current levels. Officers have considered loan refinancing but premia for premature redemptions are prohibitively high, making this option poor value for money.

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

3.32. HM Treasury has imposed two changes in the margins over gilt yields for PWLB rates in 2019/20 with no advance warning: the first on 9 October 2019, added an additional 1.0% margin over gilts to all PWLB rates. That increase was then partially reversed for HRA associated borrowing on 11 March 2020, at the same time as the Government announced in the Budget a programme of increased spending on infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins. This will conclude on 31 Juky 2020.

Investment limits

3.33. Investment in non-specified investments at £58.0m is well within the limit of £450.0m for such investments. This reflects the fact that 91% of the Council's investments have a life of less than 12 months. The highest level of non-specified investments during the year was £73.0m.

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

3.35. Rising concerns over the possibility that the UK could leave the European Union at the end of October 2019 caused longer term investment yields to be on a falling trend for most of April 2019 to September 2019. They then rose after the end of October 2019 deadline after a further postponement of the exit process, but fell back again in January 2020 before recovering again after the 31 January 2020 departure of the UK from the EU.

3.36. When the COVID-19 outbreak hit the UK in February/March 2020, rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this.

4. THE ECONOMY AND INTEREST RATES

4.1. The main issue in 2019 was difficulty experienced in the House of Commons to agree a way forward for the UK to leave the EU. This resulted in the resignation of Theresa May as the leader of the Conservative minority government and the election of Boris Johnson as the new leader, on a platform of taking the UK out of the EU on 31 October 2019. A general election on 12 December 2019 resulted in a decisive victory for the Conservative Party that then enabled the UK to leave the EU on 31 January 2020.

4.2. However, this still leaves much uncertainty as to whether there will be a workable trade deal required to be achieved by the target deadline of 31 December 2020. It is also unclear as to whether the COVID-19 outbreak may yet impact on this deadline with the second and third rounds of negotiations having been cancelled due to the virus.

4.3. Economic growth in 2019 has been very volatile with Q1 unexpectedly strong at 0.5%, Q2 weaker at -0.2%, Q3 bouncing back up to +0.5% and Q4 flat at 0.0%, resulting in +1.1% year on year. The new decade started with optimistic business surveys pointing to an upswing in growth after the ending of political uncertainty as a result of the decisive result of the general election.

4.4. However, the three monthly GDP statistics in January 2020 were disappointing, being stuck at 0.0% growth. Since then, the whole world has changed as a result of the COVID-19 outbreak. It now looks likely that the closedown of whole sections of the economy will result in a fall in GDP of at least -15% in Q2. What is uncertain, however, is the extent of the damage that will be done to businesses by the end of the lockdown period, when the end of the lockdown will occur, whether there could be a second wave of the outbreak, how soon a vaccine will be created and how quickly it can be administered to the population. This leaves huge uncertainties as to how quickly the economy will recover.

4.5. After the Monetary Policy Committee (MPC) raised the Bank Rate from 0.5% to 0.75% on 2 August 2018, Brexit uncertainty caused the MPC delay further moves until 11 March 2020. At this point it was abundantly clear that the COVID-19 outbreak posed a huge threat to the UK's economy. Two emergency cuts in the Bank Rate from 0.75% occurred on 11 March 2020, first to 0.25% and then to 0.10% on 19 March 2020. These cuts were accompanied by an increase in quantitative easing (QE), essentially the purchases of gilts by the Bank of England of £200bn.

4.6. The Government and the Bank of England were also very concerned to stem rises in unemployment during the lockdown period. Accordingly, the Government introduced various schemes to subsidise both employed and self-employed jobs for three months while the country is in lockdown. It also put in place a raft of other measures to help

businesses access loans from their banks (with the Government providing guarantees to the banks against losses) to tide them over the lockdown period when some firms may have little or no income.

4.7. The measures to support jobs and businesses already taken by the Government will result in a huge increase in the annual budget deficit in 2020/21 from 2% to nearly 11%. The ratio of debt to GDP is also likely to increase from 80% to around 105%. In the Chancellor's Budget on 11 March 2020, the Government also announced a large increase in spending on infrastructure. This will also help the economy to recover once the lockdown is ended. Provided the COVID-19 outbreak is brought under control relatively swiftly, and the lockdown is eased, then it is hoped that there will be a sharp recovery, but one that would take a prolonged time to fully recover previous lost momentum.

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

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

5. BACKGROUND

5.1. The Local Government Act 2003 ("the Act") requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

6. FINANCIAL IMPLICATIONS

6.1. Financial implications are contained in the body of this report.

7. LEGAL IMPLICATIONS

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

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

8. BACKGROUND PAPERS

Full Council Report

Treasury Management Strategy Statement 2019/20, including Prudential Indicators and Statutory Borrowing Determinations: 6 March 2019.

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

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Limits and exposures as at 31st March 2020 Appendix 1

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)	Interest Rate (%)
UK Local Authorities	£100m per local authority; £500m in aggregate	3 years	Canterbury City Council	12.0	1.05
			Cardiff Council	8.0	1.80
			Colchester Borough Council	10.0	1.38
			Denbighshire County Council	10.0	1.00
			Doncaster Metropolitan Borough Council	5.0	1.05
				5.0	1.16
				5.0	1.16
			Dudley Metropolitan Borough Council	10.0	1.32
				10.0	1.55
				10.0	1.70
			East Ayrshire Council	30.0	1.10
			Fife Council	5.0	1.20
				5.0	1.30
			Isle of Wight Council	10.0	1.10
			London Borough of Brent	15.0	0.89
				20.0	0.90
			London Borough of Croydon	20.0	0.94
				10,0	1.30
			London Borough of Enfield	20.0	0.98
			London Borough of Southwark	10.0	0.90
				10.0	1.00
			London Borough of Sutton	15.0	0.93
			Plymouth City Council	10.0	0.95
			Redcar & Cleveland Borough Council	10.0	0.88
				20.0	1.10
			Rhondda Cynon Taff Council	10.0	0.95
			Rotherham Borough Council	15.0	0.90
				5.0	0.90
			Telford & Wrekin Council	10.0	0.90
				5.0	1.30
				5.0	1.30
			Thurrock Council	20.0	1.25
				10.0	1.55
			West Dunbartonshire Council	5.0	0.95

Money Market Funds	£70m per fund. £300m in aggregate.	Three day notice	Aberdeen Sterling Liquidity Fund	29.8	
			Federated Sterling Liquidity Fund	0.1	
			JP Morgan Sterling Liquidity Fund	0.1	
			Morgan Stanley Sterling Liquidity Fund	0.1	
UK Banks (A-/A3/A)	£50m	3 years	Goldman Sachs International	20.0	1.00
				5.0	1.02
				25.0	1.03
			Lloyds Bank	10.0	1.10
				10.0	1.25
				10.0	1.25
			Santander UK Plc	20.0	1.10
				20.0	1.15
				10.0	1.15
Non-UK Banks (AA-/ Aa2/ AA-)	£50m	5 years	Standard Chartered Bank	20.0	0.98
Non-UK Banks (A/A2/ A)	£35m	3 years	Svenska Handelsbanken	18.6	0.80
			Australia and New Zealand Banking Group	15.0	0.85
				20.0	0.96
TOTAL			Hessen-Thueringen Girozentrale (Helaba)	15.0	0.97
				628.7	**1.05**