Audit and Performance Committee Report

Date:	2 December 2020
Classification:	General Release
Title:	Treasury Management Strategy Mid-Year Review 2020-21
Wards Affected:	All
City for All Summary	To manage the Council's finances prudently and efficiently
Financial Summary:	This report forms part of the monitoring of the treasury function as recommended in the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code of Practice. It reviews the implementation of the strategy to date and allows for any changes to be made depending on market conditions.
Report of:	Gerald Almeroth Executive Director for Finance and Resources
Author:	Mathew Dawson, Strategic Finance Manager mdawson@westminster.gov.uk

1. EXECUTIVE SUMMARY

1.1 The purpose of this report is to:

- update Members on the delivery of the 2020/21 Treasury Management Strategy approved by Council on 4 March 2020; and

- approve the recommendations in paragraph 2.1.

1.2 Treasury management comprises:

- 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. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

- managing the City Council's borrowing to ensure funding of the Council's future capital programme is at optimal cost. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council can meet its

capital spending operations. This management of longer-term cash may involve arranging long- or short-term loans or using longer term cash flow surpluses.

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

- a six-monthly review of the Council's investment portfolio for 2020/21 to include the treasury position as at 30 September 2020;
- a review of the Council's borrowing strategy for 2020/21;
- a review of compliance with Treasury and Prudential Limits for the first six months of 2020/21; and
- an economic update for the first part of the 2020/21 financial year.

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

- £8.490m on 4th May 2020

2. RECOMMENDATIONS

2.1 The Committee is asked to approve the annual treasury strategy mid-year review 2020/21, noting the case of non-compliance.

3. TREASURY POSITION AS AT 30 SEPTEMBER 2020

3.1 As at 30 September 2020, the net cash position was £432.7m, an increase of £25.2m on the position at 31 March 2020 as shown below:

	30 September 2020 (£m)	31 March 2020 (£m)
Total Borrowing	(221.2)	(221.2)
Total Cash Invested	653.9	628.7
Net Cash Invested	**432.7**	**407.5**

3.2 The increase of £25m reflects the forecast pattern of the Council's cashflows and largely relates to the timing of grants, council tax and business rates received.

Investments

3.3 The Council's Annual Investment Strategy which forms part of the annual Treasury Management Strategy Statement (TMSS) for 2020-21 was approved by the Council on 4 March 2020. The Council's policy objective is the prudent investment of balances to achieve optimum returns on investments, subject to maintaining adequate security of capital and a level of liquidity appropriate to the Council's projected need for funds over time.

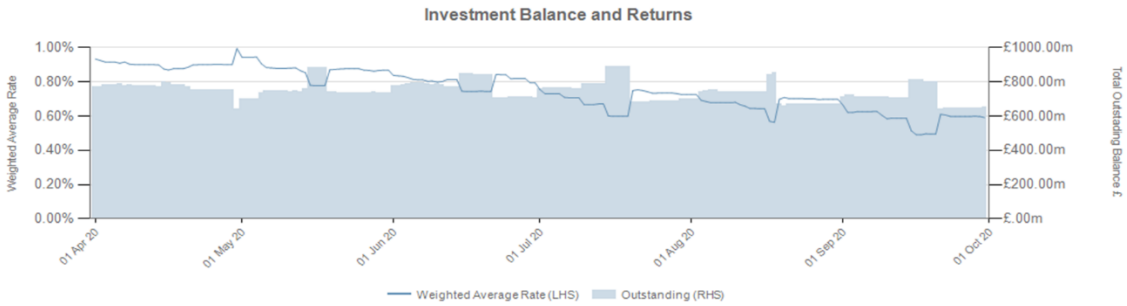
3.4 The table below provides a breakdown of investments, together with comparisons for the previous financial year end.

	Investment Balance 30 September 2020 (£m)	Investment Balance 31 March 2020 (£m)	Movement (£m)
Money Market Funds	195.9	30.1	165.8
Notice Accounts	40.0	18.6	21.4
Term Deposits	418.0	580.0	-162.0
Total:	**653.9**	**628.7**	**25.2**

3.5 In the current economic climate it is considered appropriate to keep new investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions. Liquid balances are managed through Money Market Funds providing same day liquidity. Cash has been invested in alternative and less liquid instruments, particularly term deposits. The average level of funds available for investment in the first six months of 2020-21 was £746.1m.

3.6 The shaded area in the chart below shows the daily investment balance from 1 April 2020 to 30 September 2020. The line shows the weighted average return of the investment portfolio, which has fallen streadily throughout the first half of 2020-21. The daily investment balance is shown by the grey shaded area. This balance rises and then falls each month and follows a monthly fluctuating cycle.

3.7 Daily investment balances have steadily decreased from £772.1m at 1 April 2020 to £653.9m at 30 September 2020.



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 further decrease on 19 March 2020 to 0.10%. Given this risk environment and the fact that increases in the Bank Rate are unlikely to occur before the end of the current forecast horizon of 31 March 2023, investment returns are expected to remain low.

3.9 While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next six to 12 months, a few deposit accounts are already offering negative rates for shorter periods. Money Market Funds yields have drifted lower since the start of the financial year. Some have reduced their fee levels to ensure that net yields for investors remain in positive territory where possible and practical.

3.10 Investor cash flow uncertainty and the need to maintain liquidity in these unprecedented times, has meant there is a surplus of cash available at the very short end of the market. This has seen a number of market operators, now including the DMADF, offering nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions. Inter local authority lending and borrowing rates have also declined.

3.11 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 2020/21 is £6.748m, and performance for the year is expected to be £0.218m below budget. The total portfolio weighted average yield performance for the first half of 2020/21 to 30 September 2020 was 0.76%.

Year 2020/21	Budget £000	Forecast Income £000	Variance £000
Investment Income	6,748	6,530	-218

3.12 Appendix 1 provides a full list of the Council's limits and exposures as at 30 September 2020.

Borrowing

3.13 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 2020/21 unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.14 At £221.2m, the Council's borrowing was well within the Prudential Indicator for external borrowing, namely, that borrowing should not exceed the estimated capital financing requirement (CFR) for 2020/21 of £880.0m.

3.15 During 2020/21, the Council maintained an under-borrowed position of £658.8m. 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 funding measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing treasury investments also needed to be considered.

3.16 The table below shows the details around the Council's external borrowing as at 30 September 2020, split between the General Fund and HRA.

Total Borrowing	30 September 2020 (£m)	31 March 2020 (£m)
HRA	196.0	196.0
General Fund	25.2	25.2
Total Borrowing	**221.2**	**221.2**

3.17 The breakdown of the existing loans is shown below:

Borrowing Type	Loan Balance 30 September 2020 (£m)	Loan Balance 31 March 2020 (£m)	Movement (£m)
PWLB	151.0	151.0	0.0
LOBO	70.0	70.0	0.0
Mortgage Annuity	0.2	0.2	0.0
Total:	**221.2**	**221.2**	**0.0**

3.18 During 2020/21, the Council repaid £0.02m of loans using investment balances. This consisted of the repayment of two mortgage annuity loans.

3.19 Due to the increase in PWLB margins over gilt yields in October 2019, and the subsequent consultation on these margins by HM Treasury, which ended on 31st July 2020, the Authority has refrained from undertaking new long-term PWLB borrowing for the present.

Forward Borrowing

3.20 As anticipated in the 2020/21 TMSS, the Council has undertaken no new borrowing for this financial year due to the high level of cash holdings. Officers are monitoring market conditions and reviewing the need to borrow at current low rates if a requirement is identified for either the General Fund or Housing Revenue Account (HRA).

3.21 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, while 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 £400.0m. 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 the loan interest cost and the rate of return on cash investments. An analysis of the deals arranged is shown below:

Counterparty	Amount (£m)	Start Date	Maturity Date	Rate (%)	Profile
Phoenix Group	37.5	15 March 2022	15 March 2062	2.706	Annuity
Barings LLC	150.0	15 August 2022	15 August 2052	1.970	Maturity
Phoenix Group	12.5	15 March 2023	15 March 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	**400.0**			**2.579**	

4. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

4.1 During the financial year to 30 September 2020, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS approved by Council on 4 March 2020 as set out below.

4.2 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30 September 2020, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2020. The Executive Director of Finance and Resources reports that no difficulties are envisaged for the current or future years in complying with these indicators.

PI Ref		2020/21 Indicator	2020/21 Forecast	Indicator Met?
1	Capital expenditure	£431m	£237m	Met
2	Capital Financing Requirement (CFR)	£1,059m	£880m	Met
3	Net debt vs CFR	£853m underborrowing	£659m underborrowing	Met
4	Ratio of financing costs to revenue stream	GF (1.95)% HRA 24.07%	GF 15.05% HRA 21.92%	Met
5a	Authorised limit for external debt	£1,059m	£880m	Met
5b	Operational debt boundary	£257m	£257m	Met
6	Working Capital Balance	£0m	£0m	Met
7a	Upper limit for variable interest rate borrowing	£0m	£0m	Met
7b	Upper limit for fixed interest rate borrowing	£1,059m	£880m	Met
7c	Limit on surplus funds invested for more than 364 days (i.e. non specified investments)	£450m	£38m	Met
8	Maturity structure of borrowing	Upper limit under 12 months: 40% Forecast: 7% Lower limit 10 years and above: 35% Forecast: 62%	Upper limit under 12 months: 40% Forecast: 9% Lower limit 10 years and above: 35% Forecast: 63%	Met

Capital expenditure and borrowing limits

4.4 The capital expenditure forecast to 31 March 2021 totals £237.0m for both the General Fund and the HRA. The initial capital expenditure budget at the time of the approval of the annual Treasury Management Strategy Statement 2020/21 was £431.0m. The Council has worked hard to keep its development sites open and working during the pandemic. However, inevitably, there has been an impact with delays in projects that have been affected by the lockdown restrictions and social distancing. These delays will mean that projects will complete later than planned and this will create slippage in the capital programme. The Council has an ambitious capital programme, investing in delivery of new affordable homes, as well as significant public realm schemes such as the Oxford Street District Strategy programme.

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

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

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

4.6 The purpose of the maturity structure of borrowing indicator is to highlight any potential refinancing risk that the Council may be facing if, in any one particular period there was a disproportionate level of loans maturing. The table below shows that the maturity structure of the Council's borrowing as at 30 September 2020 was within the limits set and does not highlight any significant issues.

Actual Maturity at 30 September 2020	Duration	Upper Limit	Lower Limit
9	Under 12 Months	40	0
0	12 Months and within 24 Months	35	0
9	24 Months and within 5 Years	35	0
19	5 Years and within 10 Years	50	0
63	10 Years and Above	100	35

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

4.8 The average rate on the fixed interest borrowing is 4.24% with an average redemption period of 18 years. This reflects the historical legacy of borrowing taken out some years ago which is now higher than PWLB interest rates for comparable loans if they were taken out now. Officers have considered loan re-financing but premiums for premature redemption are prohibitively expensive making this option poor value for money.

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

Investment limits

4.10 Investment in non-specified investments at £38m is well within the limit of £450m for such investments. This reflects the fact that 94% of the Council's investments have a life of less than 12 months. The highest level of non-specified investments during the year was £58m.

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

5. THE ECONOMY AND INTEREST RATES

5.1 As expected, the Bank of England's Monetary Policy Committee (MPC) kept the Bank Base Rate unchanged on 6 August 2020. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- The fall in GDP in the first half of 2020 was revised from -28.0% to -23.0% (subsequently revised to -21.8%). This is one of the largest falls in output of any developed nation. However, it is to be expected as the UK economy is heavily skewed towards consumer facing services, an area which was particularly vulnerable to being damaged by lockdown.

- The peak in the unemployment rate was revised down from 9.0% in Q2 to 7.5% by Q4 2020.

- It forecast that there will be excess demand in the economy by Q3 2022, causing CPI inflation to rise above the 2.0% target in Q3 2022 (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation is still projected to be above 2.0% in 2023.

5.2 It also discounted the possibility of imposing negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including QE and the use of forward guidance.

5.3 The MPC expected the £300bn of quantitative easing purchases announced between its March 2020 and June 2020 meetings to continue until the "turn of the year". This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

5.4 In conclusion, this would indicate that the Bank could now monitor the situation as the economy was recovering better than expected. However, the MPC acknowledged that the "medium-term projections were a less informative guide than usual" and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term.

5.5 In addition, uncertainties arising from the UK's exit from the EU ahead of the year-end deadline are likely to be a drag on economic recovery. The absence of an EU trade deal by 31 December 2020 is a current major concern for the UK economy.

5.6 Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June 2020 through to August 2020 which left the economy 11.7% smaller than in February 2020. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending.

5.7 One key addition to the Bank's forward guidance was a new phase in the policy statement, namely, that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2.0% inflation target sustainably". That seems designed to say, in effect that, even if inflation rises to 2.0% in a couple of years' time, we should not expect any action from the MPC to raise Bank Rate until it can clearly see a level of inflation that is going to be persistently above target if it takes no action to raise Bank Base Rate.

5.8 The Financial Policy Committee (FPC) report on 6 August 2020 revised down its expected credit losses for the banking sector. It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

6. BACKGROUND

6.1 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. These are contained within this report.

7. FINANCIAL IMPLICATIONS

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

8. LEGAL IMPLICATIONS

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

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

Mathew Dawson, Strategic Finance Manager
(07890 380286 or mdawson@westminster.gov.uk)

BACKGROUND PAPERS:

Full Council Report

Treasury Management – Annual Strategy for 2020/21, including Prudential Indicators and Statutory Borrowing Determinations – 4 March 2020.

Appendix 1: Limits and Exposures as at 30th September 2020 (below)

Limits and exposures as at 30th September 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	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	1.30
			Isle of Wight Council	10.0	1.10
			London Borough of Croydon	10.0	1.30
			London Borough of Southwark	10.0	1.00
			London Borough of Sutton	15.0	0.93
			Redcar & Cleveland Borough Council	10.0	0.88
				20.0	1.10
			Thurrock Council	20.0	1.25
				10.0	1.55
			West Dunbartonshire Council	5.0	0.20
Money Market Funds	£70m per fund. £300m in aggregate.	Three day notice	Aberdeen Sterling Liquidity Fund	60.0	
			Deutsche Platinum Sterling Liquidity Fund	0.1	
			Federated Sterling Liquidity Fund	16.5	
			JP Morgan Sterling Liquidity Fund	60.0	
			Morgan Stanley Sterling Liquidity Fund	59.3	
UK Banks (A-/A3/A)	£50m	3 years	Goldman Sachs International	20.0	1.00
				5.0	1.02
				25.0	0.56
			Lloyds Bank	10.0	1.10
				20.0	0.15
			Santander UK Plc	20.0	0.40
				20.0	0.36
				10.0	0.40
			Standard Chartered	20.0	0.98
				30.0	0.17

Non-UK Banks (AA-/ Aa2/ AA-)	£50m	5 years	Svenska Handelsbanken	40.0	0.20
Non-UK Banks (A/A2/ A)	£35m	3 years	Hessen-Thueringen Girozentrale (Helaba)	20.0	0.47
TOTAL				**653.9**	**0.60**