City of Westminster

Cabinet

Decision Maker	Cabinet
Date	15 February 2021
Status	General Release
Title	Treasury Management Strategy Statement for 2021/22 to 2025/26
Wards Affected	All
Policy Context	To manage the Council's finances prudently and efficiently.
Cabinet Member	Cabinet Member for Finance and Smart City
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:

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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 2021/22 to 2025/26, and Annual Investment Strategy (AIS) for the year ended 31 March 2022, 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 2021/22 to 2025/26 set out in section 6;
- 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

Borrowing

- Overall borrowing strategy
- 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 2021/22. Approved schedules of specified and non-specified investments will be updated following consideration by Members and finalisation of 2021/22 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 2020/21 TMSS, General Fund capital spend has slipped back by around £76m in the 2020/21 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

2019/20 Actual £m		2020/21 Forecast £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	Total £m
	Expenditure							
163	General Fund	**168**	**283**	**495**	**281**	**322**	**329**	**1,878**
119	HRA	**141**	**210**	**284**	**227**	**129**	**103**	**1,094**
282		**309**	**493**	**779**	**508**	**451**	**432**	**2,972**
	Funding							
	General Fund							
64	Grants & Contributions	**54**	**82**	**52**	**31**	**20**	**12**	**251**
21	Capital Receipts Applied	**25**	**1**	**43**	**64**	**0**	**43**	**176**
	HRA							
46	Grants & Contributions	**91**	**149**	**151**	**53**	**48**	**58**	**550**
31	Capital Receipts Applied	**0**	**51**	**65**	**59**	**85**	**42**	**302**
23	Major Repairs Allowance	**25**	**24**	**24**	**25**	**26**	**27**	**151**
0	Revenue Financing	**10**	**10**	**13**	**11**	**11**	**11**	**66**
185		**205**	**317**	**348**	**243**	**190**	**193**	**1,496**
97	**Net financing need for the year**	**104**	**176**	**431**	**265**	**261**	**239**	**1,476**

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. The Council has allocated funds of £120m. 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 its strategic aims. Future PWLB borrowing will not form part of the investment portfolio's source of external funding.

5.7 The Council has also invested £30m within the overall context of the Council's annual investment strategy in a residential housing partnership. This partnership was developed in response to the lack of private rented accommodation accessible to rising numbers of people living in temporary accommodation or otherwise at risk of homelessness in London.

Capital Financing Requirement (CFR)

5.8 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.

5.9 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.

5.10 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

2019/20 Actual £m		2020/21 Forecast £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
	CFR as at 31 March						
536	General Fund	**625**	**825**	**1,225**	**1,411**	**1,713**	**1,987**
294	HRA	**309**	**285**	**316**	**395**	**354**	**319**
830		**934**	**1,110**	**1,541**	**1,806**	**2,067**	**2,306**
	Annual Charge						
78	General Fund	**89**	**200**	**400**	**186**	**302**	**274**
19	HRA	**15**	**(24)**	**31**	**79**	**(41)**	**(35)**
97		**104**	**176**	**431**	**265**	**261**	**239**
	Reason for Change						
110	Net financing	**120**	**194**	**452**	**303**	**306**	**288**
(13)	Less MRP	**(16)**	**(18)**	**(21)**	**(38)**	**(45)**	**(49)**
97		**104**	**176**	**431**	**265**	**261**	**239**

5.11 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.

5.12 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

2019/20 Actual £m		2020/21 Forecast £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
221	Gross Projected Debt	**206**	**238**	**400**	**587**	**571**	**558**
830	Capital Financing Requirement	**934**	**1,110**	**1,541**	**1,806**	**2,067**	**2,306**
609	**Under / (over) borrowing**	**728**	**872**	**1,141**	**1,219**	**1,496**	**1,748**

Affordability

5.13 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

2019/20 Actual %		2020/21 Forecast %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %	2025/26 Estimate %
16.47	General Fund	**12.88**	**11.40**	**9.89**	**7.44**	**6.67**	**6.75**
35.87	HRA	**34.25**	**34.19**	**33.36**	**33.32**	**33.15**	**31.83**

5.14 For the next five years, gross capital financing charges for the General Fund capital programme are largely outweighed or balanced by income from investments and the commercial property portfolio. The capital financing charges arising from the HRA capital programme remain 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 2021/22 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 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.

6.4 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.

Post PWLB Interest Rate Change Borrowing Strategy

6.5 On 5 November 2020, the Public Works Loan Board (PWLB) reversed its decision to increase the cost of borrowing for local authorities for general fund purposes by 1%, bringing the rates offered in line with those for housing revenue account purposes. All new loans are therefore now subject to the relevant gilt yields +0.8% (certainty rate).

6.6 The Council's treasury management strategy permits borrowing from various sources, but it has not been previously anticipated that any alternatives to PWLB would need to be utilised, given the current low cost of PWLB funding.

6.7 The key advantage of PWLB is the speed and ease of transaction processing and the low fee and administration cost associated with the loans. Alternative types of funding could result in lengthy due diligence, consultancy costs, legal advice and fees and will be far more costly administratively.

6.8 Range of Options

Alternative options for funding to PWLB include:

- **Banks**

  Discussions with the Council's treasury consultant suggest that the Council could access borrowing from banks. However the recent decision by the PWLB to reverse the 1% additional cost of general fund borrowing have resulted in banks now being placed in an overly competitive environment.

- **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 a private placement agreement (PPA). Such an arrangement will be subject to extensive negotiations with the lenders, who will need to carry out due diligence on a Council's finances, budgets and balance sheet.

- **Bond issuance**

  A bond issue would first require the Council to become credit rated by one (or more) of the major ratings agencies: Fitch, S&P or Moody's. This is a complex, lengthy, repetitive and costly process.

  The precise rate offered will be market led and dependent on the financial resilience of the authority and the market's perception of creditworthiness.

  Councils with significant reserves and a record of not overspending on budget will be able secure the most advantageous rates. Bond releases typically require a minimum size of at least £200m.

- **The Municipal Bonds Agency**

  This has been in existence since 2013 but has only recently transacted its first bond issuance and local authority borrower.

6.9 Alternative opportunities for the Council may well present themselves, and the borrowing strategy will be designed to allow for this. The 'benchmark' for a borrowing opportunity is regarded at around gilts +0.8%. It is unclear at this stage whether feasible PWLB competition will materialise, and it is likely to take some time to do so. 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.

6.10 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 2021

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
Capital Financing Requirement	**934**	**1,110**	**1,541**	**1,806**	**2,067**	**2,306**
Other Long Term Liabilities						
PFI	**(7)**	**(6)**	**(6)**	**(6)**	**(6)**	**(6)**
Leases	**(44)**	**(43)**	**(42)**	**(42)**	**(41)**	**(40)**
Under / (over) borrowing	**883**	**1,061**	**1,493**	**1,758**	**2,020**	**2,260**
External Borrowing	**206**	**238**	**400**	**587**	**571**	**558**
Under borrowing/ Internal borrowing	**677**	**823**	**1,093**	**1,171**	**1,449**	**1,702**

Limits on external borrowing

6.11 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 5a)** – 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 5b)** – 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

2019/20		2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
Actual		Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
£m		£m	£m	£m	£m	£m	£m
	Authorised Limit:						
830	Borrowing and other long term liabilities	**934**	**1,110**	**1,541**	**1,806**	**2,067**	**2,306**
	Operational Boundary:						
223	Borrowing	**206**	**238**	**400**	**587**	**571**	**558**
12	Other long term liabilities	**51**	**49**	**48**	**48**	**47**	**46**
235	**Operational Boundary**	**257**	**287**	**448**	**635**	**618**	**604**

6.12 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 report.

Maturity structure of borrowing (Prudential Indicator 8)

6.13 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 7 below sets out current upper and lower limits for debt maturity which are unchanged from 2020/21. The principal repayment profile for current council borrowing remains within these limits.

Table 7 Debt maturity profile limits

Actual Maturity at 31 Dec 2020	Duration	Upper Limit	Lower Limit
9	Under 12 months	**40**	**0**
0	12 Months and within 24 Months	**35**	**0**
12	24 Months and within 5 Years	**35**	**0**
16	5 Years and within 10 Years	**50**	**0**
63	10 Years and Above	**100**	**35**

Table 8 Maturity profile of long-term borrowing

Borrowing as at 31 December 2020		
Period	General Fund	HRA
	£m	£m
0 - 5 years	**0**	**47**
5 - 10 years	**0**	**36**
10 - 15 years	**0**	**50**
15 - 20 years	**0**	**8**
20 - 25 years	**15**	**0**
25 - 30 years	**0**	**20**
30 - 35 years	**0**	**20**
35 - 40 years	**0**	**0**
40 - 45 years	**0**	**0**
45 - 50 years	**10**	**15**
Total	**25**	**196**

6.14 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.

6.15 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

6.16 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.

6.17 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.

6.18 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

6.19 As anticipated in the 2020/21 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).

6.20 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.

6.21 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. 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	**400.0**			**2.579**	

Debt Rescheduling

6.22 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).

6.23 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.

6.24 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.

Investing Primarily For Yield

6.25 Under the new Public Work Loans Board (PWLB) framework, the Council will need to submit its three-year capital plan to the PWLB and classify under different areas of spend, listed below, with classification the responsibility of the S151 officer. Any monies lent by the PWLB would also need to be classified under the following areas of spend:

- Service spending
- Housing
- Regeneration
- Preventative action
- Treasury Management: refinancing and externalisation of internal borrowing

6.26 Under the PWLB criteria, it is stipulated: "Local authorities must not pursue a deliberate strategy of using private borrowing or internal borrowing to support investment in an asset that the PWLB would not support and then refinancing or externalising this with a PWLB loan."

6.27 On transacting a PWLB loan, the S151 officer is required to confirm that the local authority is not borrowing in advance of need and does not intend to buy investment assets primarily for yield. When applying for a new PWLB loan, the Council will be asked to confirm that the latest plans submitted remain current and the assurance that they do not intend to buy investment assets primarily for yield remains valid.

6.28 The PWLB guidance defines investment assets bought primarily for yield as:

- buying land or existing buildings to let out at market rate;
- buying land or buildings which were previously operated on a commercial basis which is then continued by the local authority without any additional investment or modification;
- buying land or existing buildings, other than housing, which generate income and are intended to be held indefinitely, rather than until the achievement of some meaningful trigger, such as the completion of land assembly.

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 decreased by £11m since 1 April 2020 to 31 December 2020 which is mainly due to the forecast pattern of the Council's cashflows and largely relates to the timing of grants, council tax and business rates received. The cash balance is expected to be closer to £500m by 31 March 2021.

Table 9 Cash position at 31 December 2020

As at 31 March 2020			As at 31 December 2020	
Principal	Average Rate		Principal	Average Rate
£m	%		£m	%
		Investments		
571	**1.00**	Specified	**590**	**0.26**
58	**1.53**	Non-Specified	**28**	**1.68**
629	**1.05**	**Total**	**618**	**0.32**
		Borrowing		
151	**3.86**	Public Works Loan Board	**151**	**3.86**
70	**5.08**	Market Loans	**70**	**5.08**
221	**4.24**	**Total**	**221**	**4.24**

7.3 The medium-term cash flow forecast below demonstrates 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

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
Balance at 1 April	**772**	**663**	**509**	**175**	**112**	**(155)**
Movement in Cash						
Capital Receipt	25	52	108	123	85	85
Grants & Contributions	145	231	203	84	68	70
Revenue Financing / MRA	35	34	37	36	37	38
Cash In	**205**	**317**	**348**	**243**	**190**	**193**
Other Cash movements	0	(13)	(70)	11	11	11
HRA Cash movements	10	2	6	4	0	0
Capital Programme	(309)	(493)	(779)	(508)	(451)	(432)
Cash Out	**(299)**	**(504)**	**(843)**	**(493)**	**(440)**	**(421)**
Forward Borrowing	0	38	162	200	0	0
Repayment of debt	(15)	(5)	(1)	(13)	(16)	(13)
Balance 31 March	**663**	**509**	**175**	**112**	**(155)**	**(396)**
Average Balance	**718**	**586**	**342**	**143**	**(22)**	**(275)**

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 Investment returns are likely to remain exceptionally low during 2021/22 with little change in the following two years. While the Bank of England said in September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next six to 12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank of England and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID-19 crisis. This has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

7.6 As for Money Market Funds (MMFs), yields have continued to drift lower. Some managers have resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money available at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer 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 for investments at the very short end of the yield curve.

7.7 Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties producing accurate forecasts when disbursements of funds received will occur or when further large receipts will be received from the Government.

Council policy on investing and managing risk

7.8 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 long term investments

7.9 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 2020/21, investments of £58m exceeded 364 days. This means the Council remains well within the upper limit for such investments of £450m.

Table 11 Investment limits

2019/20 Actual £m		2020/21 Forecast £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
58	Upper Limit for principal sums invested for more the 364 days	**450**	**450**	**450**	**450**	**450**	**450**

Improving investment returns

7.10 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 Finance 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 of Finance and Resources has confirmed that the PIs set out below are all expected to be complied with in 2020/21 and he does not envisage at this stage that there will be any difficulty in achieving compliance with the suggested indicators for 2021/22.

PI Ref	Paragraph Reference		2019/20 Actual	2020/21 Forecast	2021/22 Proposed
1	5.3	Capital expenditure	£283m	£309m	£493m
2	5.10	Capital Financing Requirement (CFR)	£830m	£934m	£1,110m
3	5.12	Net debt vs CFR	£609m underborrowing	£728m underborrowing	£872m underborrowing
4	5.13	Ratio of financing costs to revenue stream	GF 16.47% HRA 35.87%	GF 12.88% HRA 34.25%	GF 11.40% HRA 34.19%
5a	6.11	Authorised limit for external debt	£830m	£934m	£1,110m
5b	6.11	Operational debt boundary	£235m	£257m	£287m
6		Working Capital Balance	£30m	£0m	£0m
7	7.10	Limit on surplus funds invested for more than 364 days (i.e. non specified investments)	£58m	£38m	£450m
8	6.13	Maturity structure of borrowing	Upper limit under 12 months: 40% Actual: 0% Lower limit 10 years and above: 35% Actual: 67%	Upper limit under 12 months: 40% Forecast: 9% Lower limit 10 years and above: 35% Forecast: 63%	Upper limit under 12 months: 40% Lower limit 10 years and above: 35%

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 2020/21 (Approved by Council March 2020)

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:

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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 £746m 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 MHCLG'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. The Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising, so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

5. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long term forecast is for periods over ten years in the future):

Average earnings in each year	
2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.25%
2024/25	0.75%
Long term later years	2.00%

6. The overall balance of risk to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the COVID-19 virus. It may also be affected by what, if any, deal the UK agrees as part of the UK's exit from the EU. There is relatively little UK domestic risk of increases or decreases in the Bank Rate and shorter term PWLB rates until 2023/24 at the earliest.

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 2021/22, 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.

11. 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.

12. 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.

13. 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 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.

14. 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

15. The MHCLG 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.

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

  - Westminster Housing Investment Ltd

17. 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.

18. 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

19. 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

20. 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:

21. 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)	Due Diligence	£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 limit. 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. Its core membership comprises 335 councils. 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 limit. 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 limit. 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 or £50m 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 or £35m (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 limit (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 limit. Same rationale as UK banks, see above.

Loans to organisations delivering services to the Council: £50m limit. 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.

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, Audit and Performance Committee and Section 151 officer are summarised below. Further details are set out in the Treasury Management Practices.

<u>Council</u>

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.

<u>Cabinet</u>

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.

<u>Audit and Performance Committee</u>

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 Group Interest Rate View 9.11.20 (The Capital Economics forecasts were done 11.11.20)
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Bank Rate														
Link	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Capital Economics	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
5yr PWLB Rate														
Link	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80
Capital Economics	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	-	-	-	-	-
10yr PWLB Rate														
Link	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
Capital Economics	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	-	-	-	-	-
25yr PWLB Rate														
Link	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
Capital Economics	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	-	-	-	-	-
50yr PWLB Rate														
Link	1.30	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60
Capital Economics	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	1.70	-	-	-	-	-

2. The COVID-19 outbreak has inflicted huge economic damage to the UK and global economies. After the Bank of England took emergency action on 19 March to cut the Bank Rate to 0.10%, with some forecasters suggesting future negative territory could happen.

3. However, the Governor of the Bank of England has made it clear that he thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in the Bank Rate is expected as economic recovery is expected to be only gradual and prolonged.

4. **Gilt yields / PWLB rates**. There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields.

5. 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. The consequence of this has been the gradual

lowering of the overall level of interest rates and bond yields in financial markets during this time period.

6. Over the year prior to COVID-19, bond yields up to 10 years have turned negative in the Eurozone. Additionally, 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. Conversely, bond prices have been 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 therefore selling out of equities.

7. Gilt yields had therefore already been on a generally falling trend up until the COVID-19 crisis hit western economies during March 2020. After gilt yields spiked up during March 2020, we have seen these yields fall sharply to unprecedented lows as investors panicked in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds, resulting in downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by the issuance of government bonds. Such unprecedented levels of issuance in "normal" times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have remained at remarkably low rates so far in 2020/21.

8. As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the COVID-19 shut down period. From time to time, gilt yields and therefore PWLB rates can be subject to exceptional levels of volatility due to geopolitical events, sovereign debt crises, emerging market developments and sharp changes in investor sentiment, as shown on 9 November 2020 when the first results of a successful COVID-19 vaccine trial were announced. Such volatility could occur at any time during the forecast period.

Economic Update

9. **UK** The Bank of England's Monetary Policy Committee kept the Bank Rate unchanged on 5 November 2020. However, it revised its economic forecasts to take account of a second national lockdown from 5 November to 2 December 2020 which is obviously going to delay any economic recovery and result in further damage to the economy. It therefore decided to commit to a further tranche of quantitative easing (QE) of £150bn, to start in January 2020 when the current programme of £300bn of QE announced in March to June expires. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".

10. Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:
    - The economy would recover to reach its pre-pandemic level in Q1 2022
    - The Bank also expects there to be excess demand in the economy by Q4 2022.

- CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the “inflation risks were judged to be balanced”
-

11. Significantly, there was no mention of negative interest rates in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next six to 12 months. However, rather than saying that it “stands ready to adjust monetary policy”, the MPC this time said that it will take “whatever additional action was necessary to achieve its remit”. The latter seems stronger and wider and may indicate the Bank’s willingness to embrace new tools.

12. One key addition to the Bank’s forward guidance in August 2020 was a new phrase 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% target sustainably”. One interpretation is that, even if inflation rises to 2% in a couple of years’ time, do not expect any action from the MPC to raise the Bank Rate until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise the Bank Rate. Link’s bank Rate forecast currently shows no increase through to Q1 2024 but there could well be no increase during the next five years due to the slow rate of recovery of the economy and the need for the Government to see the burden of the elevated debt to GDP ratio falling significantly. Inflation is unlikely to pose a threat requiring increases in the Bank Rate during this period as there is likely to be spare capacity in the economy for a considerable time. It is expected to briefly peak at around 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern.

13. However, the minutes did contain several references to downside risks. The MPC reiterated that the “recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside”. It also said, “the risk of a more persistent period of elevated unemployment remained material”. Downside risks could well include severe restrictions remaining in place in some form during the rest of December 2020 and most of January 2021 too. That could involve some or all of the lockdown being extended beyond 2 December, a temporary relaxation of restrictions over Christmas, a resumption of the lockdown in January 2021 and many regions being subject to Tier 3 restrictions when the lockdown ends. Hopefully, restrictions should progressively ease during spring 2021. It is only to be expected that some businesses that have barely survived the first lockdown will fail to survive the second lockdown, especially those businesses that depend on a surge of business in the run up to Christmas each year. This will mean that there will be some level of further permanent loss of economic activity, although the extension of the furlough scheme to 31 March 2021 will limit the degree of damage done.

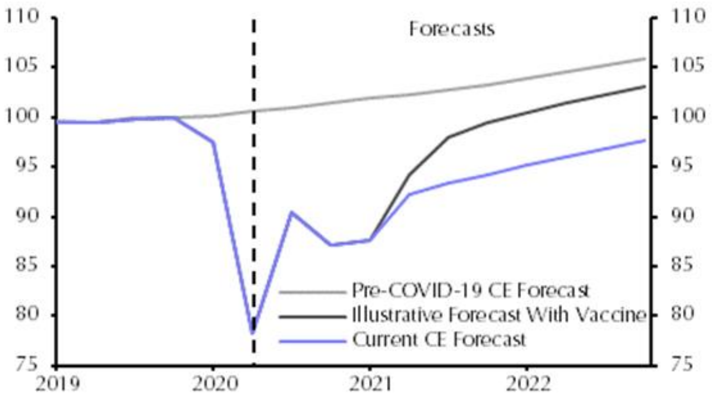
14. As for the upside risk, the Pfizer announcement on 9 November 2020 was very encouraging as its 90% rate of effectiveness was much higher than the 50-60% rate of effectiveness reference flu vaccines which might otherwise have been expected. There has been even further encouraging news since then with another two vaccines, also announcing high success rates. Together, these three announcements have enormously boosted confidence that life could largely return to normal during the second half of 2021, with activity in the still depressed sectors, including restaurants, travel and hotels, returning to their pre-COVID-19 levels, which would help to bring the unemployment rate down. With the household saving rate currently being exceptionally high, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete but, if these vaccines prove to be highly effective, there is a possibility that

restrictions could begin to be eased, possibly in Q2 2021, once vulnerable people and front-line workers had been vaccinated. At that point, there would be less reason to fear that hospitals could be further overwhelmed. Effective vaccines would radically improve the economic outlook once they have been widely administered and may allow GDP to rise to its pre-COVID-19 level a year earlier than otherwise, resulting in unemployment rate peaks at 7% next year instead of 9%. But, while this would reduce the need for more QE and/or negative interest rates, increases in the Bank Rate would still remain some years away. There is also a potential question as to whether the relatively optimistic outlook of the Monetary Policy Report was swayed by making positive assumptions around effective vaccines being available soon. It should also be borne in mind that as effective vaccines will take time to administer, economic news could well get worse before it starts getting better.

15. Public borrowing is now forecast by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE undertaken by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt is being issued, and this is being done across the whole yield curve in all maturities. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running an annual budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a less optimistic view of the impact that vaccines could make in the speed of economic recovery.

16. Overall, the pace of recovery was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp but after a disappointing increase in GDP of only 2.1% in August 2020, this left the economy still 9.2% smaller than in February 2020. This suggested that the economic recovery was running out of steam after recovering 64% of its total fall during the crisis. The last three months of 2020 were originally expected to show zero growth due to the impact of widespread local lockdowns, consumers probably remaining cautious in spending, and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year also being a headwind. However, the second national lockdown starting on 5 November 2020 for one month is expected to depress GDP by 8% in November 2020 while the rebound in December 2020 is likely to be muted and vulnerable to the previously mentioned downside risks. It was expected that the second national lockdown would push back recovery of GDP to pre pandemic levels by six months and into sometime during 2023. However, the graph below shows the Capital Economics forecast on what happens if successful vaccines were widely administered in the UK in the first half of 2021: this could cause a much quicker recovery.

Level of real GDP   (Q4 2019 = 100)



17. There will be some painful longer-term adjustments, e.g., office space and air travel, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a reversal of globalisation as this crisis has exposed how vulnerable long-distance supply chains are. Conversely, digital services is one area that has already seen huge growth.

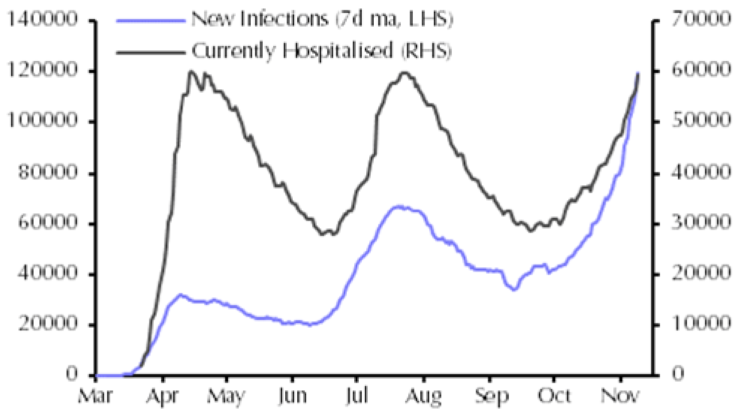
18. The Financial Policy Committee (FPC) report on 6 August 2020 revised down the expected credit losses for the banking sector to “somewhat less than £80bn”. It stated that in its assessment “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC’s 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%.

19. **US** The result of the November 2020 US election means that while the Democrats have gained the presidency and a majority in the House of Representatives, it looks as if the Republicans will retain their slim majority in the Senate. This means that the Democrats will not be able to commit to significant fiscal stimulus, as they had been hoping to do after the elections, as they will have to get agreement from the Republicans. That would have resulted in another surge of debt issuance and could have put particular upward pressure on debt yields, which could have resulted in upward pressure on gilt yields. On the other hand, equity prices leapt up on 9 November 2020 on the first news of a successful vaccine and have risen further during November 2020 as more vaccines announced successful results. This could cause a big shift in investor sentiment, i.e., a swing to sell out of government debt to buy into equities which would normally be expected to cause debt prices to fall and yields to rise. However, the rise in yields has been quite muted so far and it is too early to say whether the US Federal Reserve would feel it necessary to take action to suppress any further rise in debt yields. It is likely that the next two years, and possibly four years in the US, could be a political stalemate where neither party can do anything radical.

20. The US economy had been recovering quite strongly from its contraction seen in 2020 of -10.2% due to the pandemic, with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during Q4, to the highest level since mid-August 2020, suggests that the US could be in the early stages of a third wave. While the first wave in March and April 2020 was concentrated in the north-east, and the second wave in the south and west, the latest wave has been driven by a growing outbreak in the mid-west. The latest upturn poses a threat that the recovery in the economy could stall. This is the single biggest downside risk to the

shorter term outlook, a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

COVID-19 New infections & hospitalisations



21. After the Federal Reserve adopted its flexible average inflation target in late August 2020, the mid-September 2020 meeting of the Federal Reserve agreed to a toned down version of the new inflation target, stating that, "it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time." This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary “trap” like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline, with long-term bond yields duly rising after its meeting. The Federal Reserve also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared with more directed central government fiscal policy. The FOMC’s updated economic and rate projections in mid-September 2020 showed that officials expect to leave the Federal Reserve funds rate at near-zero until at least end of 2023 and probably for another year or two beyond that. There is now some expectation that where the Federal Reserve has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

22. **EU** The economy was recovering well towards the end of Q2 and into Q3 2020 after a sharp drop in GDP caused by the COVID-19 virus,(e.g., France -18.9%, Italy -17.6%). However, growth is likely to stagnate during Q4 and Q1 of 2021 as a second wave of the virus has affected many countries, and is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package, eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the worst affected countries. With inflation unlikely to get much above 1% over the next two years, the ECB has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. It is therefore expected that it will have to provide more monetary policy support through more

quantitative easing purchases of bonds in the absence of sufficient fiscal support from governments. The current PEPP scheme of €1,350bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a Euro crisis while the ECB is able to maintain this level of support. However, the PEPP scheme is regarded as being a temporary measure during this crisis so it may need to be increased once the first PEPP runs out during early 2021. It could also decide to focus on using the Asset Purchase Programme to make more monthly purchases, rather than the PEPP scheme, and it does have other monetary policy options.

23. **China** After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4, enabling China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared with western economies. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years

24. **Japan** Japan's success in containing the virus without imposing draconian restrictions on activity should enable a faster return to pre COVID-19 virus levels of output than in many major economies. While the second wave of the virus has been abating, the economy has been continuing to recover at a reasonable pace from its earlier total contraction of -8.5% in GDP. However, there now appears to be the early stages of the start of a third wave. It has also been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. There has also been little progress on fundamental reform of the economy. The change of Prime Minister is not expected to result in any significant change in economic policy.

25. **World growth** While Latin America and India have, until recently, been hotspots for COVID-19 virus infections, infection rates have begun to stabilise. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.