City of Westminster

Decision Maker:	**Audit and Performance Committee**
Date:	**1 December 2021**
Classification:	General Release
Title:	**Treasury Management Strategy Mid-Year Review 2021-22**
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:	**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**
	Mathew Dawson
Report Author:	**Strategic Finance Manager**

1. EXECUTIVE SUMMARY

1.1. The purpose of this report is to:

- update Members on the delivery of the 2021/22 Treasury Management Strategy approved by Council on 3 March 2021; 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 2021/22 to include the treasury position as at 30 September 2021;
- a review of the Council's borrowing strategy for 2021/22;
- a review of compliance with Treasury and Prudential Limits for the first six months of 2021/22; and
- an economic update for the first part of the 2021/22 financial year.

1.4. The Council has complied with all elements of the Treasury Management Strategy Statement (TMSS).

2. RECOMMENDATIONS

2.1. The Committee is asked to note the annual treasury strategy mid year review 2021/22.

3. TREASURY POSITION AS AT 30 SEPTEMBER 2021

3.1. As at 30 September 2021, the net cash position was £437.8m, an increase of £310.6m on the position at 31 March 2021 as shown below:

	30 September 2021 (£m)	31 March 2021 (£m)
Total Borrowing	(200.7)	(206.1)
Total Cash Invested	638.5	333.3
Net Cash Invested	**437.8**	**127.2**

3.2. The increase of £310.6m reflects the forecast pattern of the Council's cashflows and is mainly dependant on the timing of precept payments, receipt of grants, council tax and business rates, and progress on the capital expenditure programme.

Investments

3.3. The Council's Annual Investment Strategy, which forms part of the annual Treasury Management Strategy Statement (TMSS) for 2021/22, was approved by the Council on 3 March 2021. 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 with comparisons for the previous financial year end.

	Investment Balance 30 September 2021 (£m)	Investment Balance 31 March 2021 (£m)	Movement (£m)
Money Market Funds	140.0	77.8	62.2
Notice Accounts	100.0	20.0	80.0
Term Deposits	238.1	235.5	2.6
UK Government Treasury Bills	160.4	0.0	160.4
Total:	**638.5**	**333.3**	**305.2**

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. Given this environment and the fact that Bank Rate may only rise marginally, or not at all, before mid-2022, investment returns are expected to remain low.

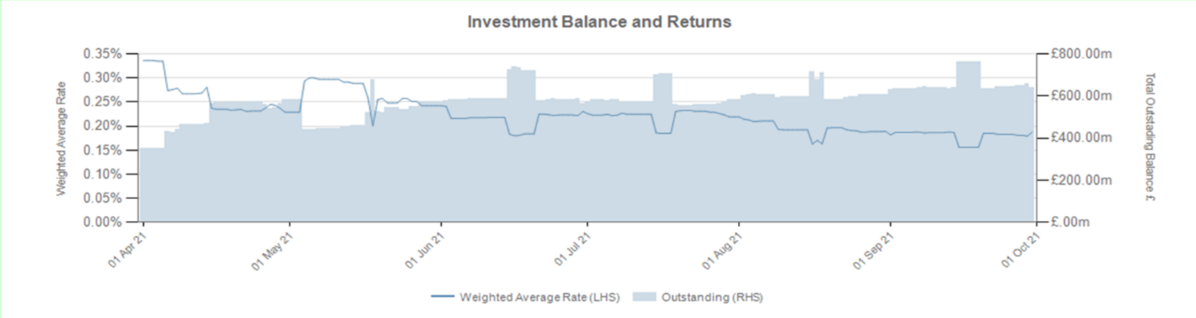
3.6. Liquid balances are managed through Money Market Funds, providing same day liquidity. Cash has been invested in alternative and less liquid instruments, particularly term deposits and UK Government Treasury Bills. The average level of funds available for investment in the first six months of 2021/22 was £579.9m.

3.7. The table below provides a more detailed breakdown of the Council's treasury investment position and interest rate generated as at 30 September 2021.

	Investment Balance (£m)	Interest Rate (%)
Money Market Funds	140.0	0.02
UK Banks	140.0	0.19
Non UK Banks	70.0	0.15
UK Government	220.5	0.03
Local Authorities	68.0	1.05
Total:	**638.5**	**0.19**

3.8. The shaded area in the chart below shows the daily investment balance from 1 April 2021 to 30 September 2021. The line shows the weighted average return of the investment portfolio, which has fallen streadily throughout the first half of 2021/22. 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.

3.9. Daily investment balances have steadily increased from £350.0m at 1 April 2021 to £638.5m at 30 September 2021. Investment returns which had been low during 2020/21, reduced further during 2021/22 to near zero or even into negative territory, though the Council avoided placing any investments at a negative rate in the year.



3.10. 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%.

3.11. All short-term money market investment rates have only risen slightly since the Bank Rate was cut to 0.10% on 19 March 2020 until the MPC meeting on 24th September 2021 when 6 and 12 month rates rose in anticipation of a Bank Rate increase in 2022.

3.12. The Bank Rate is not expected to continue to increase after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so the UK should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021.

3.13. It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

3.14. 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, offering low 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.

3.15. 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 2021/22 is £2.013m, and performance for the year is expected to be £0.518m above budget. The total portfolio weighted average yield performance for the first half of 2021/22 to 30 September 2021 was 0.22%

Year 2021/22	Budget £000	Actual £000	Variance £000
Investment Income	2,013	2,531	518

3.16. Appendix 1 provides a full list of the Council's limits and exposures as at 30 September 2021.

Borrowing

3.17. 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 2021/22 unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.18. At £200.7m, 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 2021/22 of £1,074m.

3.19. During 2021/22, the Council maintained an under-borrowed position of £836m. 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 counterparty risk was minimised. It also saved a considerable amount of interest payable, known as the 'cost of carry'.

3.20. The table below shows the details around the Council's external borrowing as at 30 September 2021, split between the General Fund and HRA.

Total Borrowing	30 September 2021 (£m)	31 March 2021 (£m)
HRA	175.6	181.0
General Fund	25.1	25.1
Total Borrowing	**200.7**	**206.1**

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

Borrowing Type	Loan Balance 30 September 2021 (£m)	Loan Balance 31 March 2021 (£m)	Movement (£m)
PWLB	130.6	136.0	5.4
LOBO	70.0	70.0	0.0
Mortgage Annuity	0.1	0.1	0.0
Total:	**200.7**	**206.1**	**5.4**

3.22. During 2021/22, the Council repaid £5.423m of loans using investment balances. This consisted of the principal element of two mortgage annuity loans and a PWLB loan.

3.23. Gilt yields and PWLB rates were on a falling trend between May and August 2021. However, they rose sharply towards the end of September 2021. The 50-year PWLB target certainty rate for new long-term borrowing started 2021/22 at 1.90%, rose to 2.00% in May 2021, fell to 1.70% in August 2021 and returned to 2.00% at the end of September 2021 after the MPC meeting of 23rd September 2021.

3.24. The capital programme is being kept under regular review due to the effects of coronavirus and shortages of materials and labour. The Council's borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

Forward Borrowing

3.25. As anticipated in the 2021/22 TMSS, the Council took no additional 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). The monitoring process includes the setting of various trigger points, the breaking of which will require officer consideration of borrowing requirements and market conditions.

3.26. 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.

3.27. During the financial year 2019/20, the Council arranged forward borrowing loans totalling £400m. These loans have enabled the Council to agree competitive rates in advance of need which eliminates the "cost of carry", i.e., the difference between loan interest cost and the rate of return on cash investments.

3.28. An analysis of these loans can be found in the table below.

Counterparty	Amount (£m)	Start Date	Maturity Date	Rate (%)	Profile
Phoenix Group	37.5	15 March 2022	15 March 2062	2.706	Annuity
Barings LLC	150.0	15 August 2022	15 August 2052	1.970	Maturity
Phoenix Group	12.5	15 March 2023	15 March 2063	2.751	Annuity
Rothesay Life Plc	200.0	08 May 2023	08 May 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 2021, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS approved by Council on 3 March 2021 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 2021, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2021. 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		2021/22 Indicator	2021/22 Forecast	Indicator Met?
1	Capital expenditure	£493m	£493m	Met
2	Capital Financing Requirement (CFR)	£1,110m	£1,074m	Met
3	Net debt vs CFR	£872m underborrowing	£836m underborrowing	Met
4	Ratio of financing costs to revenue stream	GF 11.40% HRA 34.19%	GF (10.38)% HRA 45.10%	Met
5a	Authorised limit for external debt	£1,110m	£1,074m	Met
5b	Operational debt boundary	£287m	£287m	Met
6	Working Capital Balance	£0m	£0m	Met
7	Limit on surplus funds invested for more than 364 days (i.e. non specified investments)	£450m	£18m	Met
8	Maturity structure of borrowing	Upper limit under 12 months: 40% Lower limit 10 years and above: 35%	Upper limit under 12 months: 0% Lower limit 10 years and above: 64%	Met

Capital expenditure and borrowing limits

4.3. The capital expenditure forecast to 31 March 2022 totals £493m 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 2021/22 was £493m.

4.4. Westminster City Council's refreshed vision, City for All, will provide the strategic context for the Capital Strategy and responds to the significant impacts of the COVID-19 pandemic on the city, our communities and the council. Four distinct themes within the City for All shape the approach: Greener and Cleaner, Vibrant Communities, Smart City and Thriving Economy. These thematic areas are underpinned and enabled by key plans and programmes including Westminster's City Plan 2019 – 2040, the Customer Experience and Digital Strategy, Climate Action Programme and the delivery of affordable homes.

4.5. The programme's delivery objectives continue to take place against the background of financial challenges. Covid has had a significant impact on the Council, from delays caused to existing projects meaning budgets being reprofiled and reviewed. The programme reflects the Council's approach to support the rebuilding of the economy and ensure all our residents have access to employment opportunities.

4.6. The pandemic has accelerated the Council's ambition to become smarter in how it connects, collaborates and responds to both challenges and opportunities in the city. An ambitious smart city vision has since been outlined which seeks to position Westminster as a global centre of innovation, empowered by creative partnerships that work with our residents and communities to deliver a better quality of life for all.

4.7. 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.

4.8. 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 2021 was within the limits set and does not highlight any significant issues.

Actual Maturity at 30 September 2021	Duration	Upper Limit	Lower Limit
0	Under 12 Months	40	0
0	12 Months and within 24 Months	35	0
13	24 Months and within 5 Years	35	0
23	5 Years and within 10 Years	50	0
64	10 Years and Above	100	35

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

4.10. The average rate on the fixed interest borrowing is 4.21% with an average redemption period of 19 years. This reflects the historical legacy of borrowing taken out some years ago which is now higher than PWLB interest rates for comparable loans if they were taken out now. Officers have considered loan re-financing but premiums for premature redemption are prohibitively expensive making this option poor value for money.

4.11. 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

4.12. Investment in non-specified investments at £18.0m is well within the limit of £450.0m for such investments. This reflects the fact that 97% of the Council's investments have a life of less than 12 months. The highest level of non-specified investments during the year was £18.0m.

4.13. 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. The Bank of England's Monetary Policy Committee (MPC) voted unanimously at its September 2021 meeitng to leave Bank Rate unchanged at 0.10% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn. Two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures.

5.2. There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August 2021 which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August 2021 MPC meeting, Governor Andrew Bailey said, "The challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures."

5.3. This pointed to a potential danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system. The MPC are prepared to look through a temporary spike in inflation.

5.4. The MPC's dialogue indicate there has been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October 2021 and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. To emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement.

5.5. This is a reversal of its priorities in August 2021 and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. In August 2021, the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021. Now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

5.6. Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in early 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furloughing ends at the end of September 2021. At the MPC's meeting in February 2022, it will only have available the employment figures for November 2021: to get a clearer picture of employment trends, it would need to wait until the May 2022 meeting when it would have data up until February 2022. At its May 2022 meeting, it will also have a clearer understanding of the likely peak of inflation.

5.7. The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -

- Placing the focus on raising Bank Rate as “the active instrument in most circumstances”.
- Raising Bank Rate to 0.50% before starting on reducing its holdings.
- Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
- Once Bank Rate had risen to at least 1%, it would start selling its holdings.

5.8. Covid 19 vaccines have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

5.9. The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

5.10. As a footnote to the above commentary, on 4 November 2021, the BoE MPC voted 7-2 to maintain the official Bank Rate at 0.1% and also voted unanimously to maintain the corporate bond purchase at £20bn. The MPC also voted by a majority of 6-3 to maintain the UK government bond purchases at £875bn, leaving the total target stock of asset purchases at £895bn.

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.

9. BACKGROUND PAPERS

Full Council Report

Treasury Management – Annual Strategy for 2021/22, including Prudential Indicators and Statutory Borrowing Determinations – 3 March 2021.

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

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APPENDIX
See Appendix 1

Limits and exposures as at 30 September 2021 — 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
			Dudley Metropolitan Borough Council	10.0	1.55
				10.0	1.70
			East Ayrshire Council	30.0	0.30
			Thurrock Council	10.0	1.55
Money Market Funds	£70m per fund. £300m in aggregate.	Three day notice	Deutsche Platinum Sterling Liquidity Fund	70.0	
			Morgan Stanley Sterling Liquidity Fund	70.0	
UK Government	Unlimited	Unlimited	Debt Management Office	6.5	0.01
			Debt Management Office	53.6	0.01
			Treasury Bill	10.4	0.02
			Treasury Bill	30.0	0.02
			Treasury Bill	30.0	0.03
			Treasury Bill	30.0	0.06
			Treasury Bill	30.0	0.06
			Treasury Bill	30.0	0.06
UK Banks (A-/A3/A)	£50m	3 years	Goldman Sachs International	20.0	0.18
				20.0	0.31
			Lloyds Bank	20.0	0.10
			Santander UK Plc	20.0	0.20
				20.0	0.25
				10.0	0.20
			Standard Chartered	30.0	0.15
Non-UK Banks (AA-/Aa2/ AA-)	£50m	5 years	Svenska Handelsbanken	40.0	0.05
Non-UK Banks (A/A2/A)	£35m	3 years	Australia & New Zealand Banking Group	30.0	0.28
TOTAL				**638.5**	**0.19**