



City of Westminster

Decision Maker:	Audit and Performance Committee
Date:	29 November 2022
Classification:	General Release
Title:	Treasury Management Strategy Mid-Year Review 2022-23
Wards Affected:	All
Policy Context:	To manage the Council's finances prudently and efficiently
Cabinet Member:	Cabinet Member for Finance and Council Reform
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
Report Author:	Kelly Martin Treasury Manager

1. EXECUTIVE SUMMARY

1.1. The purpose of this report is to:

- update Members on the delivery of the 2022/23 Treasury Management Strategy approved by Council on 2 March 2022; 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 ensures 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, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

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

- A review of the amendment made to the Treasury Management Strategy approved by full council;
- a six-monthly review of the Council's investment portfolio for 2022/23 to include the treasury position as at 30 September 2022;
- a review of the Council's borrowing strategy for 2022/23;
- a review of compliance with Treasury and Prudential Limits for the first six months of 2022/23; and
- an economic update for the first part of the 2022/23 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 2022/23.

3. TREASURY MANAGEMENT STRATEGY STATEMENT UPDATE

3.1. The underlying TMSS approved on 2 March 2022 was amended by Full Council on 21 September 2022. The Council approved an amendment to the Council's borrowing strategy, allowing greater flexibility in the range of long-term financing options available.

3.2. The suggested amendment allows the immediate adoption of community municipal investments which will help facilitate the Council's commitment to lower carbon in the Council's strategy reference global climate change.

4. TREASURY POSITION AS AT 30 SEPTEMBER 2022

4.1. As at 30 September 2022, the net cash position was £627.8m, an increase of £471.5m on the position at 31 March 2022 as shown below:

	30 September 2022 (£m)	31 March 2022 (£m)
Total Borrowing	(387.9)	(298.2)
Total Cash Invested	1,015.7	454.5
Net Cash Invested	627.8	156.3

4.2. The increase of £471.5m 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

4.3. The Council's Annual Investment Strategy, which forms part of the annual Treasury Management Strategy Statement (TMSS) for 2022/23, was approved by the Council on 2 March 2022. 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.

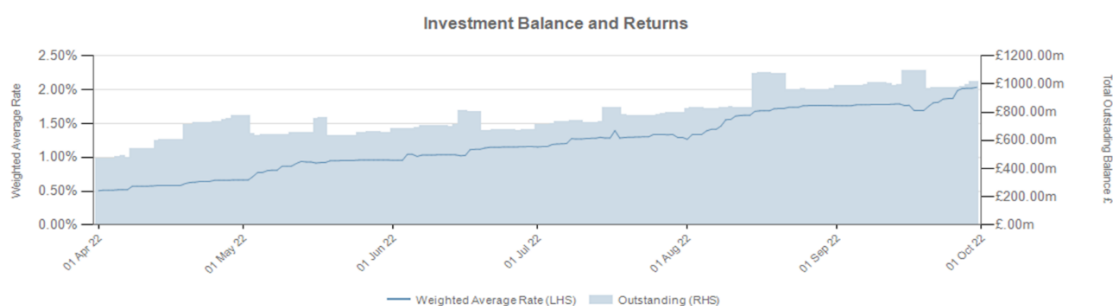
4.4. The table below provides a breakdown of investments with comparisons for the previous financial year end.

	Investment Balance 30 September 2022 (£m)	Investment Balance 31 March 2022 (£m)	Movement (£m)
Money Market Funds	264.3	71.5	192.8
Notice Accounts	0.0	30.0	-30.0
Term Deposits	632.5	353.0	279.5
UK Government Treasury Bills	118.9	0.0	118.9
Total:	1,015.7	454.5	561.2

- 4.5. 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 highly credit rated financial institutions. Given this environment and the fact that Bank Rate will rise, before mid-2023, investment returns are expected to increase significantly.
- 4.6. 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 2022/23 was £781.9m.
- 4.7. The table below provides a more detailed breakdown of the Council's treasury investment position and interest rate generated as at 30 September 2022.

	Investment Balance (£m)	Interest Rate (%)
Money Market Funds	264.3	2.09
UK Banks	200.0	1.92
Non UK Banks	135.0	2.04
UK Government	398.4	2.07
Local Authorities	18.0	1.74
Total:	1,015.7	2.04

- 4.8. The shaded area in the chart below shows the daily investment balance from 1 April 2022 to 30 September 2022. The line shows the weighted average return of the investment portfolio, which has increased steadily throughout the first half of 2022/23. The daily investment balance is shown by the grey shaded area. This balance rises and then falls slightly each month but follows a monthly upwards cycle.
- 4.9. Daily investment balances have increased from £473.3m at 1 April 2022 to £1,015.7m at 30 September 2022. Investment returns which had been lower during 2021/22, have increased steadily during 2022/23 and the Council's return on 30 September 2022 was 2.04%



- 4.10. The Monetary Policy Committee (MPC) has now increased interest rates seven times in as many meetings in 2022 and has raised rates to their highest level since the Global Financial Crisis. Even so, coming after the US Fed and European Central Bank raised rates by 75 basis points (bps) in their most recent meetings, the Bank of England's latest 50 basis points hike looks relatively mild. However, the UK's status as a large importer of commodities, which have jumped in price, means that households in the UK are now facing a much larger squeeze on their real incomes.
- 4.11. Since the government's 'fiscal event' on 23 September 2022, we now expect the MPC to increase interest rates further and faster, from 2.25% currently, to a peak of 5.00% in February 2023. The combination of the government's fiscal policy, the tight labour

market and future inflation expectations mean we expect the MPC to raise interest rates by 75bps at the policy meetings in November (to 3.00%) and 100 basis points in December (to 4%) followed by further 50 basis point hikes in February and March 2023 (to 5.00%).

- 4.12. Market expectations for what the MPC will do are volatile. If Bank Rate climbs to these levels the housing market looks very vulnerable, which is one reason why the peak in our forecast is lower than the peak of 5.50% - 5.75% priced into the financial markets at present.
- 4.13. The latest forecast sets out a view that both short and long-dated interest rates will be elevated for some time, as the Bank of England seeks to squeeze inflation out of the economy, whilst the government is providing a package of fiscal support to try and protect households and businesses from ultra-high wholesale gas and electricity prices.
- 4.14. The recent increase in PWLB rates reflects a broad sell-off in UK sovereign bonds internationally but more so the disaffection global investors have with the position of the UK public finances after September's 'fiscal event'. To that end, the MPC has tightened short-term interest rates with a view to trying to slow the economy sufficiently to keep the secondary effects of inflation, as measured by wage rises, under control, but its job is that much harder now.
- 4.15. 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 2022/23 is £2.013m, and performance for the year is expected to be £13.309m above budget. The total portfolio weighted average yield performance for the first half of 2022/23 to 30 September 2022 was 1.29%

	Budget £000	Forecast £000	Variance £000
Investment Income	2,013	15,322	13,309

- 4.16. Appendix 1 provides a full list of the Council's limits and exposures as at 30 September 2022.

Borrowing

- 4.17. 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 2022/23 unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.
- 4.18. At £387.9m, the Council's borrowing was well within the Prudential Indicator for external borrowing, namely, that borrowing should not exceed the CFR for 2022/23 of £1,193m.
- 4.19. During 2022/23, the Council maintained an under-borrowed position of £793m. This meant that the capital borrowing need (the CFR) 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. These reserves are expected to remain part of the Council's balance sheet throughout the remainder of 2022/23 and 2023/24.

4.20. The table below shows the details around the Council's external borrowing as at 30 September 2022, split between the General Fund and HRA.

	30 September 2022 (£m)	31 March 2022 (£m)
HRA	175.6	175.6
General Fund	212.3	122.6
Total Borrowing	387.9	298.2

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

	Loan Balance 30 September 2022 (£m)	Loan Balance 31 March 2022 (£m)	Movement (£m)
PWLB	130.6	130.6	0.0
LOBO	70.0	70.0	0.0
Private Placement	187.3	37.5	149.8
Local Authority	0.0	60.0	-60.0
Mortgage Annuity	0.0	0.1	-0.1
Total:	387.9	298.2	89.7

4.22. During 2022/23, the Council repaid £60.288m of loans using investment balances. This consisted of short-term local authority loans and the principal element of mortgage annuity and private placement loans.

4.23. Gilt yields and PWLB rates were on a rising trend between 1 April and 30 September, the exception being a short rally in gilts in July/August. However, they rose exceptionally sharply towards the end of September. The 50-year PWLB target certainty rate for new long-term borrowing started 2022/23 at 2.20% and finished the half year at 4.80%, albeit rates are forecast to fall back to 3.10% by the end of September 2025.

4.24. The capital programme is being kept under regular review due to the effects of inflationary pressures, 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

4.25. As anticipated in the 2022/23 TMSS, the Council took no additional long-term borrowing for the financial year due to the high level of cash holdings. Officers are monitoring market conditions and reviewing the need to borrow 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.

4.26. 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.

4.27. 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. The loans for 2022 have all been received and are included in the borrowing figures detailed above.

4.28. 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
Rothsay Life Plc	200.0	08 May 2023	08 May 2063	2.887	Equal Instalment of Principal
Weighted average interest rate	400.0			2.579	

5. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

5.1. During the financial year to 30 September 2022, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS approved by Council on 2 March 2022 as set out below.

5.2. 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 2022, the Council has operated within the treasury and prudential indicators set out in the Council’s Treasury Management Strategy Statement for 2022. 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		2022/23 Indicator	2022/23 Forecast	Indicator Met?
1	Capital expenditure	£500m	£500m	Met
2	Capital Financing Requirement (CFR)	£1,333m	£1,193m	Met
3	Net debt vs CFR	£933m underborrowing	£793m underborrowing	Met
4	Ratio of financing costs to revenue stream	GF (11.67)% HRA 44.98%	GF 21.42% HRA 34.62%	Met
5a	Authorised limit for external debt	£1,382m	£1,242m	Met
5b	Operational debt boundary	£449m	£449m	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	£0m	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: 78%	Met

Capital expenditure and borrowing limits

- 5.3. The capital expenditure forecast to 31 March 2023 totals £500m 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 2022/23 was £500m.
- 5.4. 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.
- 5.5. External borrowing was well within the Capital Financing Requirement, Authorised Borrowing Limit and the Operational Boundary as shown in the table above:
- The Authorised Limit is a level for which the external borrowing cannot be exceeded without reporting back to Full Council. It therefore provides sufficient headroom such that if the planned capital programme required new borrowing to be raised over the medium term, interest rates were deemed favourable 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.
- 5.6. The purpose of the maturity structure of borrowing indicator is to highlight any potential refinancing risk that the Council may be facing if, in any one particular period, there was a disproportionate level of loans maturing. The table below shows that the maturity structure of the Council's borrowing as at 30 September 2022 was within the limits set and does not highlight any significant issues.

Actual Maturity at 30 September 2022	Duration	Upper Limit	Lower Limit
0	Under 12 Months	40	0
5	12 Months and within 24 Months	35	0
3	24 Months and within 5 Years	35	0
14	5 Years and within 10 Years	50	0
78	10 Years and Above	100	35

- 5.7. The Council is not subject to any adverse movement in interest rates in its current loans portfolio as it only holds fixed interest borrowing.
- 5.8. The average rate on the fixed interest borrowing is 3.20% with an average redemption period of 23 years. This reflects the historical legacy of borrowing taken out some years ago. Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year. However, now that

the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

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

Investment limits

- 5.10. Investment in non-specified investments at £0m does not break into the limit of £450.0m for such investments. This reflects the fact that all 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.
- 5.11. Whilst the short duration is within approved limits, there is scope within the Investment Strategy to extend the duration of investments for up to five years. Using longer duration investments and marginally lower credit ratings is likely to increase the yield the Council generates from its investments.

6. THE ECONOMY AND INTEREST RATES

- 6.1. The second quarter of 2022/23 saw:

- GDP revised upwards in Q1 2022/23 to +0.2% q/q from -0.1%, which means the UK economy has avoided recession for the time being.
- Signs of economic activity losing momentum as production fell due to rising energy prices.
- CPI inflation easing to 9.9% y/y in August, having been 9.0% in April, but domestic price pressures showing little sign of abating in the near-term.
- The unemployment rate fall to a 48-year low of 3.6% due to a large shortfall in labour supply.
- The Bank Rate rising by 100bps over the quarter, taking Bank Rate to 2.25% with further rises to come
- Gilt yields surge and sterling fall following the 'fiscal event' of the new Prime Minister and Chancellor on 23 September.

- 6.2. The UK economy grew by 0.2% q/q in Q1 2022/23, though revisions to historic data left it below pre-pandemic levels. There are signs of higher energy prices creating more persistent downward effects in economic activity. Both industrial production (-0.3% m/m) and construction output (-0.8% m/m) fell in July 2022 for a second month in a row. Although some of this was probably due to the heat wave at the time, manufacturing output fell in some of the most energy intensive sectors (e.g., chemicals), pointing to signs of higher energy prices weighing on production. With the

drag on real activity from high inflation having grown in recent months, GDP is at risk of contracting through the autumn and winter months.

- 6.3. There are some signs of higher energy prices creating more persistent downward effects in economic activity. Both industrial production (-0.3% m/m) and construction output (-0.8% m/m) fell in July 2022 for the second month in a row. Although some of this was probably due to the heat wave at the time, manufacturing output fell in some of the most energy intensive sectors (e.g., chemicals), pointing to signs of higher energy prices weighing on production. With the drag on real activity from high inflation having grown in recent months, GDP is at risk of contracting through the autumn and winter months.
- 6.4. Retail sales volumes fell by 1.6% m/m in August, which was the ninth fall in 10 months. That left sales volumes in August just 0.5% above their pre-Covid level and 3.3% below their level at the start of the year. There are also signs that households are spending their excess savings in response to high prices. Indeed, cash in households' bank accounts rose by £3.2bn in August, which was below the £3.9bn rise in July and much smaller than the 2019 average of £4.6bn.
- 6.5. The labour market remained exceptionally tight. Data for July and August provided further evidence that the weaker economy is leading to a cooling in labour demand. Labour Force Survey (LFS) employment rose by 40,000 in the three months to July (the smallest rise since February). But a renewed rise in inactivity of 154,000 over the same period meant that the unemployment rate fell from 3.8% in June to a new 48-year low of 3.6%. The single-month data showed that inactivity rose by 354,000 in July itself and there are now 904,000 more inactive people aged 16+ compared to before the pandemic in February 2020. The number of vacancies has started to level off from recent record highs but there have been few signs of a slowing in the upward momentum on wage growth. Indeed, in July, the 3my/y rate of average earnings growth rose from 5.2% in June to 5.5%.
- 6.6. CPI inflation eased from 10.1% in July to 9.9% in August, though inflation has not peaked yet. The easing in August was mainly due to a decline in fuel prices reducing fuel inflation from 43.7% to 32.1%. And with the oil price now just below \$90pb, we would expect to see fuel prices fall further in the coming months.
- 6.7. However, utility price inflation is expected to add 0.7% to CPI inflation in October when the Ofgem unit price cap increases to, typically, £2,500 per household (prior to any benefit payments). But, as the government has frozen utility prices at that level, energy price inflation will fall sharply after October and have a big downward influence on CPI inflation.
- 6.8. Nonetheless, the rise in services CPI inflation from 5.7% y/y in July to a 30-year high of 5.9% y/y in August suggests that domestic price pressures are showing little sign of abating. A lot of that is being driven by the tight labour market and strong wage growth. CPI inflation is expected to peak close to 10.4% in November and, with the supply of workers set to remain unusually low, the tight labour market will keep underlying inflationary pressures strong until early next year.
- 6.9. Concerns around government finances has meant that the pound has weakened again, adding further upward pressure to interest rates. Whilst the pound fell to a record low of \$1.035 on the Monday following the government's 'fiscal event', it has since recovered to around \$1.12. That is due to hopes that the Bank of England will deliver a rise in interest rates at the policy meeting on 3 November and the government will

lay out a credible medium-term plan in the near term. With concerns over a global recession growing, there are downside risks to the pound.

7. BACKGROUND

7.1. 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.

8. FINANCIAL IMPLICATIONS

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

9. LEGAL IMPLICATIONS

9.1. 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.

10. BACKGROUND PAPERS

Full Council Report

Treasury Management – Annual Strategy for 2022/23, including Prudential Indicators and Statutory Borrowing Determinations – 2 March 2022.

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

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Limits and exposures as at 30 September 2022

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	1.70

Money Market Funds	£70m per fund. £300m in aggregate.	Three day notice	Aberdeen Sterling Liquidity Fund	70.0	
			Deutsche Platinum Sterling Liquidity Fund	54.3	
			Federated Sterling Liquidity Fund	70.0	
			Morgan Stanley Sterling Liquidity Fund	70.0	
UK Government	Unlimited	Unlimited	Debt Management Office	37.8	3.24
			Debt Management Office	70.0	2.15
			Debt Management Office	30.0	2.095
			Debt Management Office	70.0	2.05
			Debt Management Office	30.0	1.96
			Debt Management Office	11.7	1.825
			Debt Management Office	30.0	1.35
			Treasury Bill	29.6	3.05
			Treasury Bill	29.7	1.85
			Treasury Bill	29.8	1.37
Treasury Bill	29.8	1.25			
UK Banks (A-/A3/A)	£50m	3 years		10.0	4.51
			Goldman Sachs International	20.0	2.47
				20.0	1.65
				20.0	2.25
			National Westminster Bank	10.0	0.82
				20.0	0.62
				20.0	2.70
			Santander UK Plc	10.0	1.60
				20.0	1.34
			Standard Chartered	30.0	2.18
Non-UK Banks (AA-/Aa2/ AA-)	£50m	5 years		25.0	2.61
				25.0	2.30
				20.0	2.21
			Toronto Dominion Bank	10.0	0.86
				20.0	0.75
				20.0	2.88
Non-UK Banks (A/A2/A)	£35m	3 years	Australia & New Zealand Banking Group	10.0	2.36
				5.0	0.86
			TOTAL	1,015.7	2.04

