City of Westminster

Decision Maker:	Audit and Performance Committee
Date:	24 October 2023
Classification:	General Release
Title:	Treasury Management Strategy Outturn 2022/23
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 and final outturn position.
Report of:	Gerald Almeroth Executive Director for Finance and Resources
Report Author:	Kelly Martin Treasury Manager

EXECUTIVE SUMMARY

1.1. The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2022/23. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2. The purpose of this report is to:

- Present the Council's annual Treasury Management outturn report for 2022/23 in accordance with the Council's treasury management practices. It is a regulatory requirement for this outturn report to be presented to Council by the 30 September of each year.

1.3. Treasury management comprises:

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

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

- ➢ Review of the Council's investment portfolio for 2022/23 to include the treasury position as at 31 March 2023.
- ➢ Review of the Council's borrowing strategy for 2022/23.
- ➢ Review of compliance with Treasury and Prudential Limits for year to 2022/23.
- ➢ Economic update for 2022/23.

1.5. 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 management final outturn 2022/23.

3. TREASURY POSITION AS AT 31 MARCH 2023

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

3.2. As at 31 March 2023, net cash invested was £437.7m, an increase of £281.4m on the position at 31 March 2022 as shown below:

	31 March 2023 (£m)	31 March 2022 (£m)
Total Borrowing	(400.1)	(298.2)
Total Cash Invested	837.8	454.5
Net Cash Invested	**437.7**	**156.3**

Investments

3.3. 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.

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

	Investment Balance 31 March 2023 (£m)	Investment Balance 31 March 2022 (£m)	Movement (£m)
Money Market Funds	188.3	71.5	116.8
Notice Accounts	0.0	30.0	-30.0
Term Deposits	649.5	353.0	296.5
Total:	**837.8**	**454.5**	**383.3**

3.5. Liquid balances are managed through Money Market Funds, providing same day liquidity. Cash has also been invested in less liquid instruments such as term deposits. The average level of funds available for investment in 2022/23 was £1,008.3m.

3.6. Daily investment balances have steadily increased from £454.5m at 31 March 2022 to £837.8m at 31 March 2023.

3.7. The table below provides a more detailed breakdown of the Council's treasury investment position and interest rate received as at 31 March 2023:

	Investment Balance (£m)	Interest Rate (%)
Money Market Funds	188.3	4.14
UK Banks	190.0	3.98
Non UK Banks	170.0	3.66
UK Government	204.5	3.65
Local Authorities	85.0	4.58
Total:	**837.8**	**3.93**

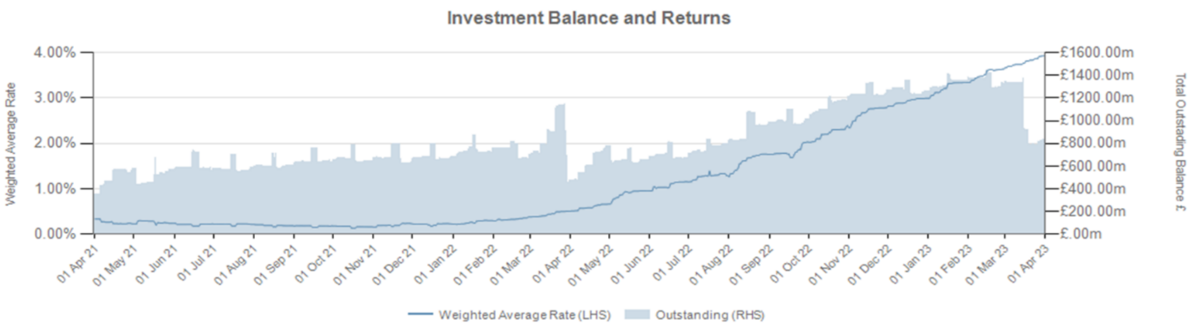
3.8. Over the last three years, the coronavirus pandemic has caused huge economic turmoil within the UK and the global economy. After the Bank of England took emergency action in March 2020 to cut the Bank Rate to 0.10%, it left the Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, to 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.

3.9. Investment returns picked up throughout the course of 2022/23 as central banks, including the Bank of England, realised that inflationary pressures were not transitory, and that tighter monetary policy was called for. Starting April 2022 at 0.75%, the Bank Rate moved up in stepped increases of either 0.25% or 0.50%, reaching 4.25% by the end of the financial year 2022/23, with the potential for further increases in 2023/24.

3.10. Meanwhile, throughout the autumn 2022, and then in March 2023, the Bank of England maintained various monetary policy easing measures as required to ensure specific markets, the banking system and the economy had appropriate levels of liquidity at times of stress.

3.11. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

3.12. Westminster's surplus cash for investment remained high throughout the year and the weighted average rate has increased since the start of April 2022. The level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Council's capital programme.



3.13. Interest rate forecasts were initially suggesting only gradual rises in short, medium and longer term fixed borrowing rates during 2022/23 but, by August 2022 it had become clear that inflation was moving up towards 40-year highs, and the Bank of England engaged in monetary policy tightening at every Monetary Policy Committee meeting during 2022 and into 2023. As at 31 March 2023 the CPI measure of inflation is expected to fall back towards 4% by year end 2023. Nonetheless, there remain significant risks to that central forecast.

3.14. All investment/overdraft limits specified in the 2022/23 TMSS have been complied with.

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 2022/23 was £2.013m, and performance for the year is £26.060m above budget.

Year 2022/23	Budget £000	Actual £000	Variance £000
Investment Income	2,013	28,073	26,060

3.16. Appendix 1 provides a full list of the Council's limits and exposures as at 31 March 2023.

Borrowing

3.17. The Council's underlying need to borrow for capital expenditure is referred to as 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.

3.18. A key part of the Council's treasury activities is to address the funding requirements for this borrowing need. The treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, such as the Government, through the PWLB, or the money markets, or utilising temporary cash resources within the Council.

3.19. At £400.1m, the Council's borrowing at 31 March 2023 was within the Prudential Indicator for external borrowing, namely, that borrowing should not exceed the estimated CFR for 2022/23 of £1,333m. The final CFR for 2022/23 was £1,026m.

3.20. During 2022/23, the Council maintained an under-borrowed position of £626m. This meant that the Capital Financing Requirement was not fully funded with loan debt as cash, supporting the Council's reserves, balances and cash flow, was used as an interim measure. This strategy was prudent as minimising counterparty risk on the placing of treasury investments needed to be considered.

3.21. The table below shows the details around the Council's external borrowing as at 31 March 2023, split between the General Fund and HRA.

Total Borrowing	31 March 2022 (£m)	31 March 2023 (£m)
HRA	175.6	175.6
General Fund	122.6	224.5
Total Borrowing	**298.2**	**400.1**

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

Borrowing Type	Loan Balance 31 March 2022 (£m)	Loan Balance 31 March 2023 (£m)	Movement (£m)
PWLB	130.6	130.6	0.0
LOBO	70.0	70.0	0.0
Mortgage Annuity	0.1	0.0	-0.1
Private Placement	37.5	199.5	162.0
Local Authority	60.0	0.0	-60.0
Total:	**298.2**	**400.1**	**101.9**

3.23. During 2022/23, the Council repaid £60.0m of short-term loans from other local authorities which were required in March 2022. These loans were for an average duration of 35 days and all were fully repaid by 4th May 2022. £0.001m of mortgage annuity loans were also repaid so the Council no longer holds loans of this type. Further advances from the forward borrowing loan portfolio were received in August 2022 and March 2023. This consisted of £150m from Barings LLC and £12.5m from Phoenix Group.

Forward Borrowing

3.24. As anticipated in the TMSS 2022/23, 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.

3.25. 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.

3.26. 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.

3.27. 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**	

Compliance with Treasury Limits and Prudential Indicators

3.28. During the financial year to 31 March 2023, 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.

PI Ref		2022/23 Forecast	2022/23 Actual	Indicator Met?
1	Capital expenditure	£500m	£370m	Met
2	Capital Financing Requirement (CFR)	£1,333m	£1,026m	Met
3	Net debt vs CFR	£933m underborrowing	£626m underborrowing	Met
4	Ratio of financing costs to revenue stream	GF (11.67)% HRA 44.98%	GF (113.20)% HRA 40.87%	Met
5a	Authorised limit for external debt	£1,382m	£1,042m	Met
5b	Operational debt boundary	£449m	£417m	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: 40% Actual: 3% Lower limit 10 years and above: 35% Actual: 77%	Met

Capital Expenditure and Borrowing Limits

3.29. Capital expenditure to 31 March 2023 totalled £370m for the General Fund and the HRA against a forecast for the whole year of £500m. The Council has embarked on an ambitious capital programme with a plan to invest up to £2.090bn (general fund) over the next 12 years.

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

	2022/23 Indicator (£m)	2022/23 Actual (£m)
General Fund Capital Expenditure	302	197
HRA Capital Expenditure	198	173
Total Capital Expenditure	**500**	**370**
Financed by:		
Capital Receipts	152	62
Capital Grants	126	151
Funded from Revenue	0	17
Major Repairs Allowance	22	22
Prudential Borrowing	200	118
Total Finance	**500**	**370**

	General Fund £m	Housing Revenue Account £m	Total £m
Adjusted Opening CFR 31/03/2022	672	326	998
Capital Investment	197	173	370
Capital receipts, government grants & other contributions applied to reduce CFR	-63	-151	-214
Direct Revenue Contributions	-17	0	-17
Major Repairs Allowance	0	-22	-22
Debt Repayment	-89	0	-89
Closing CFR	**700**	**326**	**1026**

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

- The Authorised Limit is a level for which the external borrowing cannot be exceeded without reporting back to Full Council. It therefore provides sufficient headroom such that, in the event that the planned capital programme required new borrowing to be raised over the medium term, if interest rates were deemed favourable and a thorough risk analysis determined that 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. Officers are monitoring the need for new borrowing in the short/medium term.

3.32. The purpose of the maturity structure of borrowing indicator is to highlight any potential refinancing risk that the Council may be facing if in any one particular period there was a disproportionate level of loans maturing. The table below shows that the maturity structure of the Council's borrowing as at 31 March 2023 was within the limits set and does not highlight any significant issues.

Actual Maturity at 31 March 2023	Duration	Upper Limit	Lower Limit
3	Under 12 Months	40	0
3	12 Months and within 24 Months	35	0
4	24 Months and within 5 Years	35	0
13	5 Years and within 10 Years	50	0
77	10 Years and Above	100	35

3.33. The purpose of the interest rate exposure indicators is to demonstrate the extent of exposure to the Council from any adverse movements in interest rates. The Council is not subject to any adverse movement in interest rates as it only holds fixed interest borrowing.

3.34. The average rate on the fixed interest borrowing is 3.18% with an average redemption period of 23 years. This reflects the historical legacy of borrowing taken out some years ago which is now lower than current PWLB interest rates for comparable loans if they were taken out at today's levels. Officers have considered loan refinancing but premia for premature redemptions are prohibitively high, making this option poor value for money.

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

Investment limits

3.36. There are no deposits in non-specified investments as at 31 March 2022 as all of the Council's investments have a life of less than 12 months.

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

3.38. There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate first rises to dampen inflationary pressures and a tight labour market, and is then cut as the economy slows, unemployment rises, and inflation (on the Consumer Price Index measure) moves closer to the Bank of England's 2% target.

4. THE ECONOMY AND INTEREST RATES

4.1. Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022/23.

4.2. Market commentators' misplaced optimism around inflation has been the root cause of the volatility in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps in 2022.

4.3. Q2 of 2022 saw UK GDP deliver growth of +0.1% q/q, but this was quickly reversed in the third quarter. Q4 GDP was positive at 0.1% q/q. Most recently, January 2023 saw a 0.3% m/m increase in GDP as the number of strikes reduced compared with December. In addition, the resilience in activity at the end of 2022 was, in part, due to a 1.3% q/q rise in real household disposable incomes. A big part of that reflected the £5.7bn payments received by households from the government under the Energy Bills Support Scheme.

4.4. CPI inflation picked up to what should be a peak reading of 11.1% in October 2022, although hopes for significant falls from this level will very much rest on the movements in the gas and electricity markets, as well as the supply side factors impacting food prices. On balance, most commentators expect the CPI measure of inflation to drop back towards 4.0% by the end of 2023. As of February 2023, CPI was 10.4%.

4.5. The UK unemployment rate fell through 2022 to a 48-year low of 3.6%. Without an increase in the labour force participation rate, it will be a challenge to the UK economy to grow further and, with average wage increases running at over 6%, the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food (up 18.3% y/y in February 2023) and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

4.6. In the interim period, September and October 2022 saw a tumultuous seven weeks where the markets reacted negatively to unfunded tax-cutting and heavy spending policies. With a new prime minister and chancellor, the Autumn Statement in November gave rise to a net £55bn fiscal tightening. The markets reacted positively, and UK gilt yields reversed accordingly, although they remain elevated in line with developed economies generally.

4.7. GDP was weak throughout 2022/23. Whether that means a shallow recession, or a recession possibly avoided, is still unclear. Ultimately, the MPC will want to see material evidence of a reduction in inflationary pressures and a loosening in labour markets. Realistically, that is an unlikely outcome without unemployment rising and wage settlements falling from their current levels. While the number of job vacancies fell for the ninth consecutive month in February 2023, they remained around 40% above pre-pandemic levels.

4.8. Our economic analysts, Capital Economics, expect real GDP to contract by around 0.2% q/q in Q1 and forecast a recession this year involving a 1.0% peak-to-trough fall in real GDP.

4.9. The Pound has remained resilient of late, recovering from a record low of $1.035, following the September 2022 "fiscal event", to $1.23 by March 2023. The new financial year is likely to see a housing correction of some magnitude as fixed rate mortgages have moved above 4.5% and affordability has been squeezed.

4.10. The FTSE 100 started 2023 strongly, rising to a record high of 8,014 in February 2023, as resilient data and falling inflation boosted earnings. But global equities fell sharply after concerns over the health of the global banking system emerged in early March 2023.

5. BACKGROUND

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

6. FINANCIAL IMPLICATIONS

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

7. LEGAL IMPLICATIONS

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

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

8. BACKGROUND PAPERS

Full Council Report

Treasury Management Strategy Statement 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 31st March 2023 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	Bradford Metropolitan Borough Council	15.0	4.58
			East Ayrshire Council	10.0	4.55
			Hertfordshire County Council	20.0	4.65
			London Borough of Lambeth	20.0	4.65
			West Yorkshire Combined Authority	10.0	4.90
			Worcestershire County Council	10.0	4.00
DMO Deposits	Unlimited	6 months	DMADF	30.0	3.16
			DMADF	30.0	3.40
			DMADF	30.0	3.56
			DMADF	30.0	3.70
			DMADF	30.0	3.73
			DMADF	54.5	4.05
Money Market Funds	£70m per fund. £300m in aggregate.	Three day notice	Aberdeen Sterling Liquidity Fund	48.3	
			Deutsche Sterling Platinum Fund	70.0	
			Morgan Stanley Sterling Liquidity Fund	70.0	
UK Banks (A-/A3/A)	£50m	3 years	Goldman Sachs International	20.0	3.90
			Goldman Sachs International	20.0	4.12
	£50m	3 years	National Westminster Bank	20.0	2.25
			National Westminster Bank	20.0	4.25
			National Westminster Bank	10.0	4.45
	£50m	3 years	Santander UK Bank	10.0	3.93
			Santander UK Bank	20.0	4.23
			Santander UK Bank	20.0	4.30
	£50m	3 years	Standard Chartered Bank	20.0	4.22
			Standard Chartered Bank	30.0	4.26
Non-UK Banks (AA-/Aa2/ AA-)	£50m	5 years	Toronto Dominion Bank	20.0	2.21
			Toronto Dominion Bank	10.0	4.50
			Toronto Dominion Bank	20.0	4.58
	£50m	5 years	Svenska Handelsbanken	25.0	2.61
			Svenska Handelsbanken	25.0	4.21
Non-UK Banks (A/A2/A)	£35m	3 years	Australia and New Zealand Banking Group	20.0	2.88
			Australia and New Zealand Banking Group	15.0	4.69
	£35m	3 years	National Bank of Canada	20.0	4.00

	National Bank of Canada	15.0	4.25
TOTAL		**837.8**	**3.93**