

<b>Date:</b>	<b>9 January 2017</b>
<b>Classification:</b>	<b>General Release</b>
<b>Title:</b>	<b>Treasury Management Strategy Mid-Year Review 2016-17</b>
<b>Wards Affected:</b>	<b>All</b>
<b>Policy Context:</b>	<b>City for All</b>
<b>Cabinet Member</b>	<b>Cabinet Member for Finance and Corporate Services</b>
<b>Financial Summary:</b>	<b>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.</b>
<b>Report of:</b>	<b>Steven Mair, City Treasurer</b>

## **EXECUTIVE SUMMARY**

- 1.1. This report presents the Council's Half Year Treasury Report for 2016/17 in accordance with the Council's Treasury Management practices. It is a regulatory requirement for this Half Year report to be presented to Cabinet and Full Council.
- 1.2. 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.
- 1.3. The second main function 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 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.

- 1.4. Accordingly, treasury management is defined by the CIPFA Code of Practice as 'The management of the local authority's 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.'
- 1.5. There are two aspects of treasury performance – debt management and cash investments. Debt management relates to the City Council's borrowing and investments of surplus cash balances.
- 1.6. This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:
- A review of the Council's investment portfolio for 2016/17 to include the treasury position as at 30 September 2016.
  - A review of the Council's borrowing strategy for 2016/17.
  - An economic update for the first part of the 2016/17 financial year.
  - A review of compliance with Treasury and Prudential Limits for the first six months of 2016/17.
- 1.7. The Council complied with all elements of the Treasury Management Strategy Statement (TMSS) except for placing two tranches of investments with the National Bank of Abu Dhabi (NBAD) and Qatar National Bank (QNB) and exceeding the counter party limit with Lloyds Bank because of overnight balances. Action has been taken to rectify the position at no loss to the Council and new management arrangements have been put in place. The investments with NBAD and QNB met the Council's required counterparty credit rating, the banks are included on the list of approved counterparties issued by the Council's treasury advisor, Capita, have high credit ratings which would more than meet the ratings required in the current TMSS and exceed most UK banks. They were not though included in the permitted country of domicile for banks
- 1.8. There are various areas in which the TMSS can be widened to increase the opportunities available while still investing in traditional financial instruments and retaining the emphasis on security and liquidity.

Those recommended to be added, subject to due diligence, are:

- Green Energy Bonds
- Building Societies
- Local Government Association
- Other Loans

## 2. RECOMMENDATIONS

Committee is asked to comment on the:

- a) Annual Treasury Strategy 2016-17 Mid-Year Review, noting where the TMSS has been exceeded and the action taken to rectify this
- b) The new opportunities to be added to the TMSS for investment purposes as set out in paragraphs 3.14-3.20.

## 3. TREASURY POSITION AS AT 30 SEPTEMBER 2016

- 3.1. The borrowing amounts outstanding and cash investment for the 30<sup>th</sup> September 2016 period are as follows;

	<b>30 September 2016</b>	<b>31 March 2016</b>
	<b>£m</b>	<b>£m</b>
Total Borrowing	251.3	251.5
Total Cash Balances	(911.1)	(629.3)
<b>Net Surplus</b>	<b>(659.8)</b>	<b>(377.8)</b>

- 3.2. The above table shows that during the first six months of the year, net cash inflows of £281.8m have been received. This significant movement reflects the expected pattern of the Authority's cash position and largely relates to the timing of grants, Council Tax and NNDR received.
- 3.3. The authority is in a significant cash positive position and as such, the peaks and troughs of cash movements are reflected in changes to the investment balance.

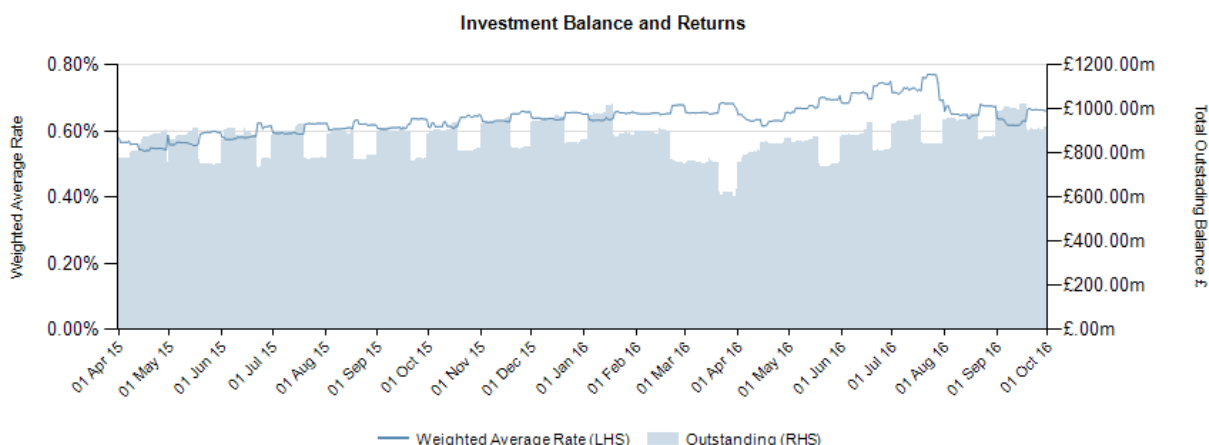
### Investments

- 3.4. The Annual Treasury Management Strategy for 2016-17 was approved by the Council on 2 March 2016. The Council's Annual Investment Strategy, which forms part of this document, sets out the Council's policy for giving priority to the security and liquidity of its investments, rather than yield. The Council's agreed policy objective is the prudent investment of treasury balances.
- 3.5. The Council's investment priorities are to achieve optimum returns on investments subject to a very high level of security of capital and a level of liquidity in its investments appropriate to the Council's projected need for funds over time.
- 3.6. The table below provides a breakdown of investments, together with comparisons for the last financial year end.

	<b>30 September 2016</b>	<b>31 March 2016</b>
	<b>£m</b>	<b>£m</b>
Money Market Funds	132.2	79.9
Call Accounts	-	6.0
Notice Accounts	49.2	78.9
Term Deposits	237.0	44.0
Tradable Securities	455.8	388.8
Enhanced Cash Funds	36.9	31.7
<b>Total</b>	<b>911.1</b>	<b>629.3</b>

3.7. Liquid balances are managed through Money Market Funds which offer same day liquidity. Cash has been invested in alternative and less liquid instruments, particularly term deposits and tradable securities. The average level of funds available for investment in the first six month of 2016-17 was £882.6m

3.8. The shaded area in the chart below shows the daily investment balance from April 2015 to September 2016. The line shows the weighted average return of the investment portfolio, which has fluctuated throughout the period but remained relatively stable increasing by 0.01%



3.9 The 2016/17 investment strategy was complied with in the first half-year of 2016/17 except for two tranches of investments placed between May and July 2016 with the National Bank of Abu Dhabi (NBAD) and Qatar National Bank (QNB) totalling £59.8m and exceeding the counterparty limit on the Lloyds bank account since August 2016 because of overnight balances.

3.10 Whilst the investments with NBAD and QNB met the Council's required counterparty credit rating and are included on the list of approved counterparties issued by the Council's treasury advisor, Capita, they were not included in the permitted country of domicile for banks. Nonetheless both banks have high credit ratings which more than meet the ratings required in the current TMSS and exceed most UK banks.

- 3.11 Since the matters above came to light £49.8m of the investments with NBAD and QNB have been sold at a gain of £0.1m to the Council. The remaining £10m investment is fixed until May 2017 when it will be sold at a further gain of £0.1m. Overnight limits with Lloyds will be managed by not re-investing maturing funds with this bank. A fixed term deposit will mature on the 13<sup>th</sup> January 2017, at which point the Council will not exceed limits on a daily basis.
- 3.12 Treasury management practices have also been reviewed and improved to prevent recurrence of the above matters
- 3.13 **Appendix 1** provides a full list of the Council's limits and exposures as at 30<sup>th</sup> September 2016.

### **New Treasury Opportunities**

- 3.14 An update to the Annual Investment Strategy for 2016-17 has been presented to the Council's senior management and the Housing, Finance and Corporate Services Policy and Scrutiny Committee detailing ways in which the return from the Council's short-term cash portfolio can be enhanced while maintaining security and liquidity. This is due to be reviewed by Cabinet and Full Council.
- 3.15 The opportunities presented include; Green Energy Bonds, Building Societies, Local Government Association and Other Bonds.

#### 3.16 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.

- 3.17 The following limitations will apply when investing in green energy bonds;
- Maximum duration of 10 years
  - Maximum investment of £20 million per bond representing less than 25% of the aggregate project investment. Maximum of £50 million in Green Energy Bonds.

#### 3.18 Building Societies

Building Societies are mainly smaller institutions than high street banks that focus on retail customers. Investment types that refer to rated UK banks have been extended to building societies. This will enable building societies with credit ratings of A- to be utilised, including the largest society, Nationwide. A limit of £10m per counterparty and £50m in total for building societies is proposed.

### 3.19 Local Government Association

The Local Government Association (LGA) approached Westminster City Council to act as an intermediary to enable the LGA to effectively borrow from the soon to be operational Municipal Bond Agency (MBA). The LGA is unable to borrow directly, as it is not a local authority, and is thus seeking to use three local authorities to borrow from the MBA and lend on. The borrowing will be secured on properties owned by the LGA and is to be used to refurbish the properties. A limit of £20m is proposed. If agreed the return on this borrowing will be 0.5% above the rate that the Council will be charged by the MBA. The amount would be secured via a separate agreement with the LGA against Layden House, 76-86 Turnmill Street, London, EC1M 5LG as the first Legal Mortgage against the property

### 3.20 Other 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. A limit of £50 million for this type of investment is proposed. The operator of Westminster's leisure centres is seeking to borrow £1.25 million to finance a refurbishment of the leisure centres and this would be the first call on this type of investment opportunity

### **Borrowing**

- 3.21 The Council's capital financing requirement (CFR) for 2016-17 was agreed at £612.35. The CFR denotes the Council's underlying need to borrow for capital purposes. The outstanding debt as at 30<sup>th</sup> September was £251.3m.
- 3.22 Where the CFR exceeds borrowing the Council may choose to cover the difference by borrowing either from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.
- 3.23 As anticipated in the Strategy for 2016/17, to date the Council has undertaken no new borrowing due to the high level of cash holdings. It is anticipated that no borrowing will be undertaken during the financial year; however officers are monitoring market conditions and although it remains highly unlikely, may choose to borrow at current low rates if a requirement is identified for either the General Fund or Housing Revenue Account (HRA).
- 3.24 The table overleaf shows the details around the Council's external borrowing as at 30<sup>th</sup> September 2016, split between the General Fund and HRA.

	30 <sup>th</sup> September 2016		31 <sup>st</sup> March 2016	
	Balance (£m)	Average Rate	Balance (£m)	Average Rate
HRA External Borrowing	226.0	4.9%	226.0	4.9%
General Fund External Borrowing	25.3	4.1%	25.5	4.1%
<b>Total Borrowing</b>	<b>251.3</b>	<b>4.8%</b>	<b>251.5</b>	<b>4.8%</b>

3.25 There has been little activity during the first half of 2016-17. A reduction in General Fund External Borrowing of £0.2m has occurred as a result of the early repayment of a mortgage annuity loan as well as small repayments of principal on other General Fund annuity loans.

3.26 As part of the Strategy the Council sets a number of prudential limits for borrowing;

- The Capital Financing Requirement which is the underlying need to borrow for capital purposes.
- The Authorised Limit which is the expected maximum borrowing need with some headroom for unexpected movements; and
- The Operational Boundary which is the expected normal upper requirement of the capital programme were it to be funded by borrowing.

3.27 The limits set for 2016-17 as shown in the tables below and are still considered to be appropriate and no changes are proposed at this time.

#### **4 THE ECONOMY AND INTEREST RATES**

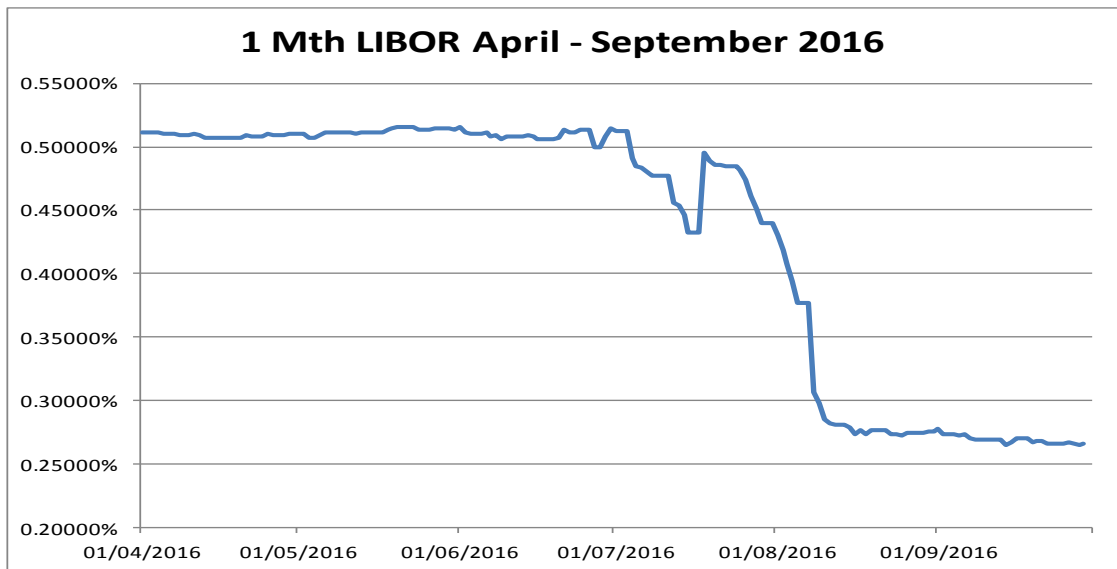
4.1 UK Gross Domestic Product (GDP) rose in the first quarter of the financial year, showing a 2.2% year on year increase. Following the referendum vote to leave the European Union, the Organisation for Economic Cooperation and Development (OECD) reduced its forecast for growth in 2017 to 1%. However, the Office for National Statistics suggested the result had not had a major effect on the UK economy so far.

4.2 Consumer Price Inflation (CPI) is running at 0.6% year on year. However the forecast is that inflation will rise over the next few years, rising above the Monetary Policy Committee's (MPC) 2% target in 2018. This is mainly due to the recent fall in the value of Sterling following the referendum result.

4.3 Bank Rate remained at 0.5% until the August meeting of the MPC when the committee voted to cut Bank Rate to 0.25% and increase quantitative easing by £60 billion. This was in response to the immediate aftermath of the

referendum result. The Governor of the Bank of England also indicated further measures would be taken if required.

- 4.4 Long term interest rates have also fallen with 20 to 30 year Public Works Loan Board rates lower by around 70 basis points.
- 4.5 The chart below shows movements in the 1 month London Interbank Offer Rate during the first half of the financial year:



UK data releases over the last few weeks were little different from that forecasted. They showed that many sectors of the economy have exceeded their performance expectations following the UK's decision to leave the European Union in June.

## 5 COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

- 5.1 During the financial year to September 2016, the Council has operated within the Prudential Indicators set out in the Annual Treasury Strategy and in compliance with the Council's Treasury Management Practices. The table below sets out the limits on borrowing required under the Prudential Code (namely the authorised limit and the operational boundary) and approved by Council in the TMSS on 2 March 2016. The actual level of Council borrowing was well within both limits during the first half of 2015/16 reaching a maximum level of £251.5m as shown in the table below:



<b>External debt indicator</b>	<b>Approved Limit (£m)</b>	<b>Maximum Borrowing in the period to date (£m)</b>	<b>Days exceeded</b>
Authorised limit	612	251.5	None
Operational boundary	270	251.5	None

- 5.2 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, the cost of carry was appropriate, this borrowing could be raised ahead of when the spend took place.
- 5.3 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. As a result of the significant level of cash balances, it is deemed unlikely that any new borrowing will be required in the foreseeable future.
- 5.4 The maturity structure of borrowing shows the proportion of loans maturing in each time period. The purpose of this indicator is to highlight any potential refinancing risk that the authority may be facing if any one particular period had a disproportionate level of maturing loans
- 5.5 The table below shows the maturity structure as at 30<sup>th</sup> September 2016 was within the limits set and does not highlight any significant issues.

<b>Maturity structure of borrowing</b>	<b>Upper Limit (%)</b>	<b>Lower Limit (%)</b>	<b>Actual as at 30 September 2016 (%)</b>
Under 12 months	40	0	0
12 months and within 24 months	35	0	12
24 months and within 5 years	35	0	8
5 years and within 10 years	50	0	11
10 years and above	100	35	69

- 5.6 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 limits for 2016/17 were set sufficiently wide as to permit all loans to be at fixed rates and all investments to be at variable rates. If the portfolios were managed on this basis, it would expose the Council to the risk of interest rates being low for an extended period of time.

<b>Upper limits on Interest Rate Exposure</b>	<b>Approved maximum limit</b>	<b>Actual as at 30 September 2016 (£m)</b>
Fixed Rate Debt	258	251
Variable Rate Debt	0	0

- 5.7 The final treasury management prudential indicator relates to containing investment risk by setting a maximum amount which can be invested for more than 364 days. As referred to earlier in this report, the short duration of the portfolio demonstrates that the current position is within the approved limits.

	<b>Approved maximum limit (£m)</b>	<b>Actual as at 30 September 2016 (£m)</b>
Limit on investments for periods over 364 days	200	24.9

## **6 BACKGROUND AND FINANCIAL AND LEGAL IMPLICATIONS**

- 6.1 The Local Government Act 2003 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.
- 6.2 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. The Annual Investment Strategy must have regard to guidance issued by CLG and must be agreed by the full Council.

## **7 BACKGROUND PAPERS**

### **Full Council Report**

Treasury Management – Annual Strategy for 2016/17, including Prudential Indicators and Statutory Borrowing Determinations – 2<sup>nd</sup> March 2016.

**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 – Limits and exposures as at 30<sup>th</sup> September 2016

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)
UK Government (Gilts/ T-Bills/ Repos)	Unlimited	Unlimited	Treasury Bills	19.9
			Gilt	24.9
European Agencies	£200m	5 years	European Investment Bank	45.8
			Kunta (Municipal Finance Ltd)	8.8
			KBN (Kommunalbanken)	10.0
			FMS Wertmanagement	5.2
Network Rail	Unlimited	Oct 2052	Network Rail Infrastructure PLC	10.0
UK Local Authorities	£50m per local authority; £100m in aggregate	3 years	Leeds City Council	10.0
Money Market Funds	£70m per fund. £300m in total	Three day notice	Aberdeen Sterling Fund Flexible Income F130 Fund	70.0
			Deutsche Managed Sterling Platinum	15.0
			Federated Prime Rate Sterling Liquidity 3	47.2
Enhanced Cash Funds	£25m per fund. £75m in total	Up to seven day notice	Deutsche Sterling Ultra Short Fixed Income Fund	5.0
			Federated Prime Rate Cash Plus	15.2
			Payden & Rygel Sterling Reserve	16.6
UK Banks (AA-/ Aa3/ AA-)	£75m	5 years	HSBC Bank Plc	49.2
UK Banks (A-/ A3/ A-)	£50m	3 years	Barclays Bank Plc	50.0
			Lloyds Bank	50.0
			Santander UK Plc	20.0
			Standard Chartered	40.0
			Sumitomo Mitsui Banking Corporation	20.0
UK Bank (BBB+)			The Royal Bank of Scotland Plc	14.0
Non-UK Banks (AA-/ Aa2/ AA-)	£50m	5 years	Canadian Imperial Bank of Commerce	30.0

			Commonwealth Bank of Australia	48.0
			National Australia Bank	10.0
			National Bank of Abu Dhabi	10.0
			Nordea Bank AB	10.0
			Qatar National Bank	26.8
			Toronto Dominion Bank	50.0
			Svenska Handelsbanken AB	50.0
Non-UK Banks (A/ A2/ A)	£35m	3 years	Credit Industriel et Commercial	30.0
			Helaba	35.0
			ING Bank NV	20.0
			UBS AG	30.0
			Skandinaviska Enskilda Banken AB	14.2