City of Westminster

Cabinet Report

Decision Maker:	Cabinet
Date:	30 October 2017
Classification:	General Release
Title:	Treasury Management Strategy Mid-Year Review 2017-18
Wards Affected:	All
Policy Context:	To manage the Council's finances prudently and efficiently
Cabinet Member	Cabinet Member for Finance, Property and Corporate Services
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:	Steven Mair, City Treasurer

1. EXECUTIVE SUMMARY

1.1. The purpose of this report is to:

- update Members on the delivery of the 2017/18 Treasury Management Strategy approved by Council on 1 March 2017; and

- approve the recommendations in paragraph 2.1

1.2. Treasury management comprises:

- managing the City 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 and liquidity.

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

- a review of the Council's investment portfolio for 2017/18 to include the treasury position as at 30 September 2017.

- a review of the Council's borrowing strategy for 2017/18.

- a review of compliance with Treasury and Prudential Limits for the first six months of 2017/18.

- an economic update for the first part of the 2017/18 financial year.

1.4. The Council has complied with all elements of the Treasury Management Strategy Statement (TMSS) apart from one instance reported last year which has been successfully managed out this year on the maturity of the investment and four instances which arose either because the relevant bank ratings were changed after deposits had been made or in one instance because of an exceptional receipt which was received late on one day too late to be moved from the bank until the following day:

- A historic investment reported last year and successfully managed out in May 2017

- Three investments with banks whose ratings changed after the deposits had been made; and

- One evening excess cash balance due to a receipt for £23m being received after close of business.

2. RECOMMENDATIONS

2.1. Cabinet is asked to approve:

- the Annual Treasury Strategy 2017-18 Mid-Year Review, noting the cases of non-compliance and the action taken to rectify this;

- Increase the maximum loan period for the LGA loan from 12 to 15 years;

- Reduce the credit rating limit for investments in Supra-national banks and European agencies from AA+/Aa1/AA+ to AA/Aa/AA;

- Increase the aggregate limit for lending to local authorities from £100m to £200m;

- Amend the limit on lending to individual local authorities from £50m to £100m subject to lending criteria;

- Increase the limit for collateralised deposits from £60m to £100m;

- Reduce the minimum working capital balance from £150m to £nil to make better use of the Council's cash resources.

3. TREASURY POSITION AS AT 30 SEPTEMBER 2017

3.1. As at 30 September 2017 net cash invested was £958m, an increase of £300m on the position at 31 March 2017 as shown below:

	30 September 2017 £m	31 March 2017 £m
Total borrowing	(251)	(251)
Total cash invested	1,209	909
Net cash invested	**958**	**658**

3.2. The significant increase reflects the forecast pattern of the Authority's cashflows and largely relates to the timing of grants, council tax and business rates received.

Investments

3.3. The Council's Annual Investment Strategy which forms part of the annual Treasury Management Strategy Statement (TMSS) for 2017-18 was approved by the Council on 1 March 2017. 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.

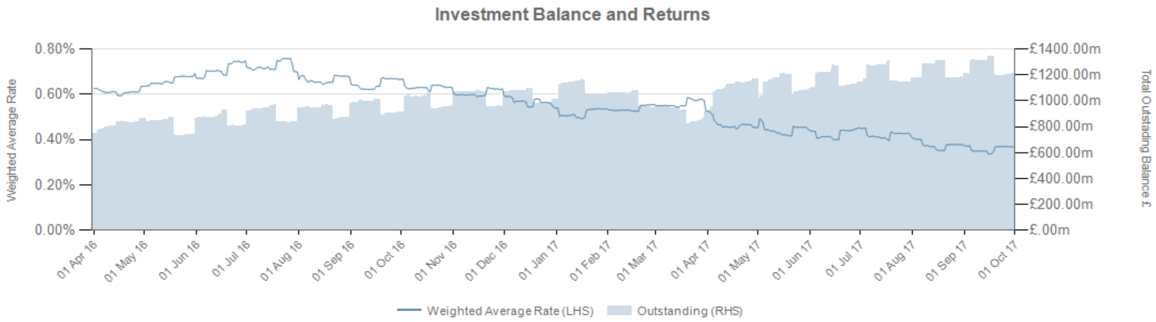
3.4. The table below provides a breakdown of investments, together with comparisons for the last financial year end.

	30 September 2017 £m	31 March 2017 £m
Money Market Funds	181	143
Notice Accounts	94	49
Term Deposits	290	310
Tradable Securities	592	374
Enhanced Cash Funds	52	33
Total cash invested	**1,209**	**909**

3.5. 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 tradable securities. The average level of funds available for investment in the first 6 months of 2017-18 was £1,184m.

3.6. Daily investment balances have steadily increased from £751m at April 2016 to the current £1,209m as shown by the shaded area in the chart overleaf. At the same time average returns have fallen by 0.26% as shown by the solid line in the chart. This reflects the lowering of base rate by the Bank of England in August 2016.

3.7. Although surplus cash for investment has risen by £300m since April 2017, because cash invested with higher interest rate paying counterparties is already at the maximum thresholds permitted within the 2017/18 annual Investment Strategy, cash can only be invested in lower rate paying counterparties such as the UK government. This has contributed to the 0.26% fall in returns.



3.8. All investments limits specified in the 2017/18 investment strategy have been complied with except for:

- A historic investment reported last year and successfully managed out in May 2017
- Three investments with banks whose ratings changed after the deposits had been made; and
- One evening excess cash balance due to a receipt for £23m being received after close of business.

3.9. Appendix 1 provides a full list of the Council's limits and exposures as at 30 September 2017.

Borrowing

3.10. At £251m the Council's borrowing was well within the Prudential Indicator for external borrowing (namely that borrowing should not exceed the capital financing requirement (CFR) for 2017/18 of £692m.[1]

3.11. Currently the Council is "under borrowed" by £748m because it has used internal resources to fund capital expenditure.

3.12. As anticipated in the TMSS for 2017/18, to date the Council has undertaken no new borrowing 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).

3.13. The table below shows the details around the Council's external borrowing as at 30th September 2017, split between the General Fund and HRA.

External borrowing	30 September 2017		31 March 2017	
	Balance	Rate	Balance	Rate
	£m	%	£m	%
HRA	226	4.9%	226	4.9%
General Fund	25	4.1%	25	4.1%
Total borrowing	**251**	**4.8%**	**251**	**4.8%**

3.14. No new borrowing was incurred in the first half of 2017-18. General Fund external borrowing reduced by £0.1m from repaying the principal on General Fund annuity loans.

[1] The CFR measures the Council's underlying need to borrow for capital purposes.

4. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

4.1. During the financial year to September 2017, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS approved by Council on 1 March 2017 as set out below.

PI ref	Indicator	2017/18 indicator	2017/18 actual	Indicator met?
1	Net financing need	£158m	£nil to date	Met
2	Capital Financing Requirement (CFR)	£692m	£521m	Met
3	Net debt vs CFR	£215m underborrowing	£279m underborrowed	Met
4	Ratio of financing costs to revenue stream	GF (0.91%) HRA 32.21%	Nil	Met
5	Incremental impact of new capital investment decisions on council tax	£6.72 decrease in Band D council tax charge per annum	Nil	Met
6	Impact of new capital investment decisions on housing rents	£0.76 increase in average rent per week	Nil	Met
7a	Authorised limit for external debt	£692m	£251m	Met
7b	Operational debt boundary	£464m	£251m	Met
7c	HRA debt limit	£334m		
8	Working capital balance	£150m	£200m	Met
9a	Upper limit for fixed interest rate borrowing	£476m	£251m	Met
9b	Upper limit for variable rate	£0m	£0m	Met
9c	Limit on surplus funds invested for more than 364 days (i.e. non-specified investments)	£450m	£73.7m	Met
10	Maturity structure of borrowing	Upper limit under 12 months - 40% Lower limit 10 years and above - 35%	12% 68%	Met Met

Capital expenditure and borrowing limits

4.2. Capital expenditure to 30 September 2017 was £102m for both the General Fund and the HRA against a forecast for the whole year of £468m. This relates to a number of large development projects and related acquisitions. The forecast for development projects are contingent on progress by developers which is anticipated will improve over the remainder of the year. Acquisitions are reactive and depend on properties becoming available on the market and as such the forecast can be volatile but will continue to be monitored by officers. The £102m capital expenditure incurred to date is well within the forecast use of capital resources of £342m, hence the net financing need to date is £nil.

4.3. 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, 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. 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.

4.4. The purpose of the maturity structure of borrowing indicator is to highlight any potential refinancing risk that the Council may be facing if 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 30th September 2017 was within the limits set and does not highlight any significant issues.

Maturity structure of borrowing	Upper Limit (%)	Lower Limit (%)	Actual as at 30 September 2017 (%)
Under 12 months	40	0	12
12 months and within 24 months	35	0	0
24 months and within 5 years	35	0	8
5 years and within 10 years	50	0	12
10 years and above	100	35	68

4.5. 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 table at paragraph 4.1 shows that the Council is not subject to any adverse movement in interest rates as it only holds fixed interest borrowing.

4.6. The average rate on the fixed interest borrowing is 4.84% with an average redemption period of 19½ 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 high making this option poor value for money.

4.7. The Council's borrowing portfolio contains £70m of Lender Option Borrower Option loans (LOBOs). There 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 re-financing 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 and officers will remain alert to such opportunities as they arise.

Investment limits

4.8. Investment in non-specified investments at £73.7m is well within the limit of £450m for such investments. This reflects the fact that 97% of the Council's investments have a life of less than 12 months.

4.9. Whilst the short duration is within approved limits, there is scope within the Investment Strategy to extend the duration of investments for up to 5 years. Using longer duration investments and marginally lower credit ratings is likely to increase the yield the Council earns from its investments by up to £20m in a full year.

Changes to Investment Strategy

4.10. The TMSS approved in March 2017 included approval for a loan to the Local Government Association (LGA) over a life of 12 years subject to due diligence. Since April officers have been working with the LGA to firm up the details of the loan. As part of the negotiations the LGA have requested the loan to be over 15 years. Therefore approval is sought to increase the maximum period of the loan from 12 to 15 years.

4.11. To facilitate the changes set out in the Integrated Investment Framework, the following changes are proposed to the investment limits:

- Reduce the credit rating limit for investments in Supra-national banks and European agencies from AA+/Aa1/AA+ to AA/Aa/AA;
- Increase the aggregate limit for lending to local authorities from £100m to £200m;
- Amend the limit on lending to individual local authorities from £50m to £100m subject to lending criteria;
- Increase the limit for collateralised deposits from £60m to £100m;
- Reduce the minimum working capital balance from £150m to £nil to make better use of the Council's cash resources. Peaks in day to day cashflow needs will be met through daily cashflow management.

5. THE ECONOMY AND INTEREST RATES

5.1. UK Gross Domestic Product (GDP) rose in the first quarter of the financial year, showing a 1.7% year on year increase. This is however the slowest rate of growth since June 2016. Following the referendum vote to leave the European Union, the Organisation for Economic Cooperation and Development (OECD) initially reduced its forecast for growth in 2017 to 1%. However, the OECD now predicts that growth for the year will be 1.6%, with a forecast of 1% growth for 2018.

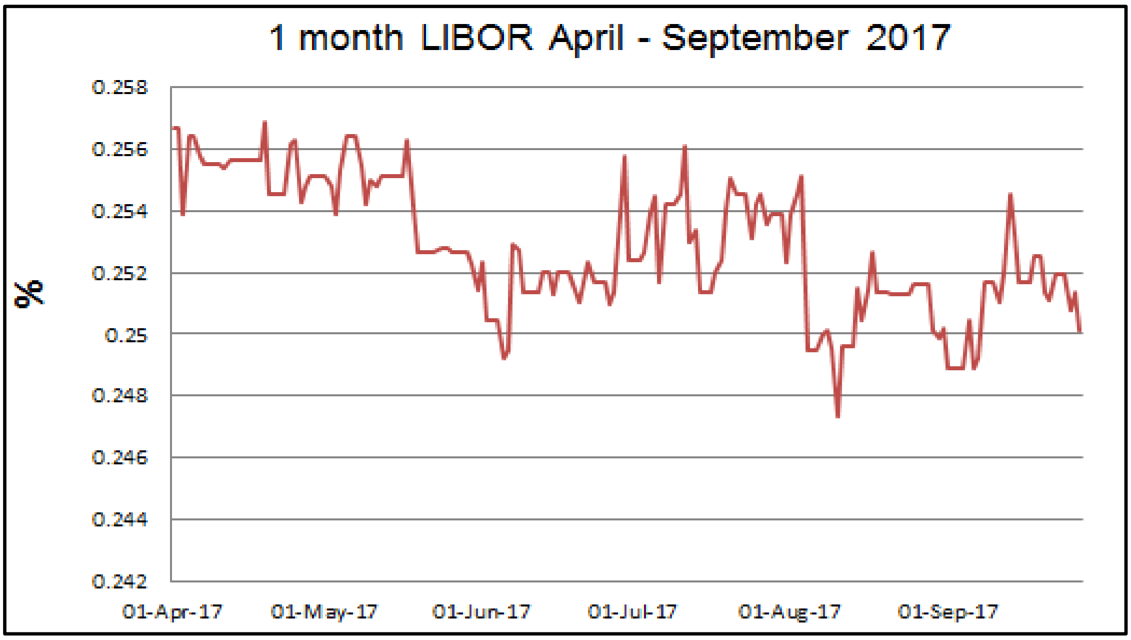
5.2. Consumer Price Inflation (CPI) is running at 2.6% year on year (0.6%, Q2 2016), rising above the Monetary Policy Committee's (MPC) 2% target sooner than the 2018 prediction, with expectations it will stay this way for the next two years. This has been mainly due to the recent fall in the value of Sterling having filtered through following the referendum result.

5.3. Bank Rate has remained at 0.25% for the year to date, with quantitative easing unchanged at £435bn. Following the recent inflation rises, the Bank of England (BoE) has signalled a potential increase in the Bank Rate. The minutes of the

September BoE meeting stated “some withdrawal of monetary stimulus would be appropriate if inflationary pressures continued”.

5.4. Long term interest rates have risen marginally, with 20 to 30 year Public Works Loan Board rates higher by around 15 basis points. If inflationary pressures continue and the Bank of England does raise interest rates, it will increase the Council’s cost of borrowing. This is potentially significant as the Council is currently well below its near term capital financing requirement having delayed borrowing due to current surplus cash reserves. The Council may wish to consider taking on new long term borrowing should the threat of significant long term interest rate rises increase

5.5. The chart below shows movements in the 1 month London Interbank Offer Rate during the first half of the financial year:



6. BACKGROUND

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.

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 Local Government Act 2003 to monitor its borrowing and investment activities.

8.2. Legal implications verified by Rhian Davies, Chief Solicitor (Litigation and Social Care)

9. BACKGROUND PAPERS

Full Council Report

Treasury Management – Annual Strategy for 2017/18, including Prudential Indicators and Statutory Borrowing Determinations – 1 March 2017.

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 30th September 2017

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)
UK Government (Gilts/ T-Bills/ Repos)	Unlimited	Unlimited	Treasury Bills	132.9
			Gilt	60.7
European Agencies	£200m	5 years	European Investment Bank	160.5
Network Rail	Unlimited	Oct 2052	Network Rail Infrastructure PLC	28.6
UK Local Authorities	£50m per local authority; £100m in aggregate	3 years	Aberdeenshire Council	5
			Buckinghamshire Council	10
			Cambridgeshire County Council	10
			Dudley Borough Council	10
			Kingston upon Hull Council	10
			Medway Council	10
			Rhondda Cynon Taff Council	5
			South Ayrshire Council	5
			Tameside Borough Council	10
			West Lothian Council	5
			Wrexham Council	20
Money Market Funds	£70m per fund. £300m Total	Three day notice	Federated Sterling Liquidity Fund	46.0
			JP Morgan Sterling Liquidity Fund	70
			Morgan Stanley Sterling Liquidity Fund	65.33
Enhanced Cash Funds	£25m per fund. £75m in total	Up to seven day notice	Payden & Rygel Sterling Reserve	16.8
			Royal London Asset Mgmt Cash Plus	20
			Federated Prime Rate Cash Plus	15.4
UK Banks (AA-/ Aa3/ AA-)	£75m	5 years	HSBC	49.2
UK Banks (A-/ A3/ A-)	£50m	3 years	Barclays Bank Plc	50
			Lloyds Bank	30
			Santander UK Plc	50
			Standard Chartered	50
			Sumitomo Mitsui Banking Corporation	50
Non-UK Banks (AA-/ Aa2/ AA-)	£50m	5 years	Svenska Handelsbanken AB	45
			Canadian Imperial Bank of Commerce	14
			Toronto Dominion Bank	50

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)
Non-UK Banks (A/ A2/ A)	£35m	3 years	Commonwealth Bank of Australia	30
			National Australia Bank	20
			Nordea Bank AB	35
			Skandinaviska Enskilda Banken AB	20