City of Westminster

Cabinet Briefing

Decision Maker	Cabinet
Date:	30 October 2017
Status:	General Release
Title:	Treasury Management Strategy Statement for 2018/19 to 2022/23
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:	The Annual Treasury Management Strategy Statement sets out the Council's strategy for ensuring that: 1. Its capital investment plans are prudent, affordable and sustainable; 2. The financing the Council's capital programme and ensuring that cash flow is properly planned 3. Cash balances are appropriately invested to generate optimum returns having regard to security and liquidity of capital.
Report of:	Steven Mair, City Treasurer

1. EXECUTIVE SUMMARY

1.1 The Local Government Act 2003 requires the Council to ‘have regard to’ the Prudential Code for Capital Finance in Local Authorities 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.

1.2 The Act also requires the Council to set out a statement of its treasury management 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 Treasury Management Strategy Statement and Annual Investment Strategy must both have regard to guidance issued by CLG and must be agreed by the full Council.

1.3 This report sets out the Council’s proposed Treasury Management Strategy Statement (TMSS) for the period 2018/19 to 2022/23, and Annual Investment Strategy (AIS) for the year ended 31 March 2019, together with supporting information.

1.4 The TMSS and AIS form part of the Council’s overall budget setting and financial framework, and will be finalised and updated as work on the Council’s 2018/19 budget is progressed in January and February 2018.

2. RECOMMENDATIONS

2.1 The Cabinet is asked approve:

- The Treasury Management Strategy Statement set out in sections 5 to 7;
- The prudential Indicators set out in section 8;
- The overall borrowing strategy and borrowing limits for 2018/19 to 2022/23 as detailed in section 6;
- Investment strategy and approved investments set out in Appendix 1;
- The Minimum Revenue Provision Policy set out in Appendix 2.

3. REASONS FOR DECISIONS

3.1 To comply with the Local Government Act 2003, other regulations and guidance and to ensure that the Council’s borrowing and investment plans are prudent, affordable and sustainable and comply with statutory requirements.

4. BACKGROUND INFORMATION

4.1 The Council is required to operate a balanced budget, which broadly means that monies received during the year will cover expenditure. The function of treasury management is to ensure that:

- The Council's capital programme and corporate investment plans are adequately funded;
- Cash is available when it is needed on a day to day basis, to discharge the Council's legal obligations and deliver Council services;
- Surplus monies are invested wisely.

4.2 The Council has formally adopted CIPFA's Code of Practice on Treasury Management, and follows the key requirements of the Code as set out in Appendix 3.

4.3 The TMSS covers three main areas summarised below:

4.3.1 Capital spending

- Capital spending plans
- Other investment opportunities
- CFR projections
- Affordability
- The Minimum Revenue Provision (MRP) policy (Appendix 2)

4.3.2 Borrowing

- Overall borrowing strategy
- Prospect for interest rates
- Limits on external borrowing
- Maturity structure of borrowing;
- Policy on borrowing in advance of need;
- Debt rescheduling.

4.3.3 Managing cash balances

- The current cash position and cash flow forecast
- Prospects for investment returns
- Council policy on investing and managing risk
- Balancing short and longer term investments.

4.4 The Annual Investment Strategy (AIS) at Appendix 1 provides more detail on how the Council's surplus cash investments are to be managed in 2018/19. Approved schedules of specified and non-specified investments will be updated following consideration by Members and Schedules of approved and finalisation of 2018/19 budget plans.

TREASURY MANAGEMENT STRATEGY STATEMENT

5. SECTION 1 - CAPITAL SPENDING

Capital spending plans

5.1 Table 1 summarises the Council's capital expenditure plans, both in terms of those agreed previously, and those forming part of the current budget cycle. The table sets out the Council's current expectations about whether these plans are to be financed by capital or revenue resources.

5.2 Compared with the forecast in the 2017/18 TMSS General Fund capital spend has slipped back by around £69m in 2016/17 to 2017/18 and the reamains an element of further slippage in future years. The HRA capital programme has seen £100m in forecast slippage annum over the period 2019/20 to 2020/21. The risks are that:

- ➢ continued slippage in new starts will push borrowing requirements to later years when interest rates are forecast to be higher than currently;
- ➢ slippage in the programme of capital receipts may increase the need to borrow in the medium-term.

Table 1 Capital spending and funding plans

2016/17		2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	Total
Actual		Forecast	Estimate	Estimate	Estimate	Estimate	Estimate	
£m		£m	£m	£m	£m	£m	£m	£m
	Expenditure							
118	General Fund	278	393	384	306	227	142	1,730
58	HRA	98	175	201	177	96	146	893
176	**TOTAL**	**376**	**568**	**585**	**483**	**323**	**288**	**2,623**
	Funding							
	General Fund							
(63)	Grants & Contributions	(94)	(165)	(185)	(148)	(96)	(59)	(747)
(4)	Capital Receipts Applied	(80)	0	(16)	(21)	(48)	(69)	(234)
	HRA							
(8)	Grants & Contributions	(4)	(24)					(28)
(15)	Capital Receipts Applied	(24)	(76)	(88)	(101)	(43)	(74)	(406)
(23)	Major Repairs Reserve	(21)	(21)	(21)	(21)	(21)	(21)	(126)
(1)	Revenue Financing	(49)	(41)	(45)	(55)	(32)	(51)	(273)
(114)	**TOTAL**	**(272)**	**(327)**	**(355)**	**(346)**	**(240)**	**(274)**	**(1,814)**
62	**Net finacing need for the year**	**104**	**241**	**230**	**137**	**83**	**14**	**809**

Other investment opportunities

5.3 As well as investing in assets owned by the Council and used in the delivery of services, the Council also invests, where appropriate, in:

- Infrastructure projects, such as green energy;
- Loans to third parties;
- Shareholdings in limited companies and joint ventures.

5.4 Such investments are treated as expenditure for treasury management and prudential borrowing purposes even though they do not create physical assets in the Council's accounts. Appropriate budgets in respect of these activities will be agreed as part of the Council's budget setting and ongoing monitoring processes and considered as part of the Investment Strategy.

5.5 In addition the Council has a substantial commercial property portfolio which forms part of the investment strategy. In previous years, the Council has invested in traditional asset classes of offices, retail and industrial/logistics, which meet the Council requirements for the income to be secure and reliable and the investments low risk.

5.6 Following a Cabinet decision in late 2015, the Council allocated funds to invest in commercial property commencing 2016/17. The aim is to diversify the property portfolio into sectors that have historically been considered alternatives but are increasingly being viewed as mainstream. The strategy focuses on increasing the income generated by the Council from its property holdings while also improving the quality of the Council's current portfolio. The Council has investigated a number of potential projects during 2017/18, although none of these have started development as of yet. These will be further progressed in 2018/19 within the overall context of the Council's annual investment strategy.

Capital Financing Requirement (CFR)

5.7 The CFR measures the extent to which capital expenditure has not yet been financed from either revenue or capital resources. Essentially it measures the Council's underlying borrowing need. Each year, the CFR will increase by the amounts of new capital expenditure not immediately financed.

5.8 Table 2 overleaf shows that the CFR will increase over the medium term. Consequently, the capital financing charge to revenue will increase, reflecting the capital spending plans.

Table 2 Capital Financing Requirement forecast

2016/17			2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Actual			Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
£m			£m	£m	£m	£m	£m	£m
	CFR as at 31 March							
260	General Fund		360	580	750	869	932	926
261	HRA		261	274	321	321	321	321
521		**TOTAL**	**621**	**854**	**1,071**	**1,190**	**1,253**	**1,247**
	Annual Charge							
51	General Fund		100	220	170	119	63	(6)
11	HRA		0	13	47	0	0	0
62		**TOTAL**	**100**	**233**	**217**	**119**	**63**	**(6)**
	Reason for Change							
65	Net financing		104	241	230	137	83	14
(3)	Less MRP		(4)	(8)	(13)	(18)	(20)	(20)
0	Less Cap Receipts		0	0	0	0	0	0
62		**TOTAL**	**100**	**233**	**217**	**119**	**63**	**(6)**

5.9 Table 3 below confirms that the Council's gross debt does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for current year and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

Table 3 Borrowing compared to the Capital Financing Requirement

2016/17		2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Actual		Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
£m		£m	£m	£m	£m	£m	£m
251	Gross Projected Debt	251	264	298	519	747	747
521	Capital Financing Requirement	621	854	1,071	1,190	1,253	1,247
270	**Under / (over) borrowing**	**370**	**590**	**773**	**671**	**506**	**500**

Affordability

5.10 The objective of the affordability indicators is to ensure that the level of investment in capital assets proposed remains within sustainable limits, and in particular, the impact on the Council's "bottom line" as reflected in the impact on council tax and rent levels. Table 4 below sets out the expected ratio of capital financing costs to income for both General Fund and HRA activities:

Table 4 Ratio of capital financing costs to income

2016/17		2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Actual		Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
%		%	%	%	%	%	%
0.32	General Fund	0.84	(0.40)	1.92	7.86	12.79	14.40
31.25	HRA	30.11	28.68	29.87	31.17	30.50	29.68

5.11 For 2017/18 and 2018/19, gross capital financing charges (loan interest, MRP and finance and PFI payments) for the General Fund capital programme are largely outweighed or balanced by income from investments and the commercial property portfolio. However, in future years the Council will begin to incur increasing capital financing charges in line with the forecast increase in the General Fund CFR in Table 2.

5.12 The capital financing charges arising from the HRA capital programme increase in line with the forecast increase income, hence capital charges as a proportion of the HRA net revenue stream remain fairly steady.

5.13 Table 5 below sets out the Incremental impact of the capital programme on council tax and housing rents.

Table 5 Impact of capital investment decisions on council tax and housing rents

2016/17		2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Actual		Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
£		£	£	£	£	£	£
(13.63)	Increase / (Decrease) in Council Tax(band D) per annum	11.56	(17.09)	32.11	82.03	68.18	22.25
(1.19)	Increase / (Decrease) in housing rent per week	(2.94)	(0.64)	2.05	4.29	0.31	1.36

5.14 For the General Fund capital programme, although the ratio of capital financing costs to income is relatively low as shown in Table 4 above, there is a much greater impact on council tax as shown in Table 5, because the Council has a very low council taxbase. The decrease in 2018/19 of £5.52 per Band D council tax reflects the reduction in capital financing costs in 2018/19 compared to 2017/18, and the subsequent increase reflects the increase in capital charges as the capital programme progresses.

5.15 The capital charges from the HRA capital programme increase is gradual and therefore there is relatively little impact on weekly housing rents between years as shown in Table 5.

6. SECTION 2 - BORROWING

Overall borrowing strategy

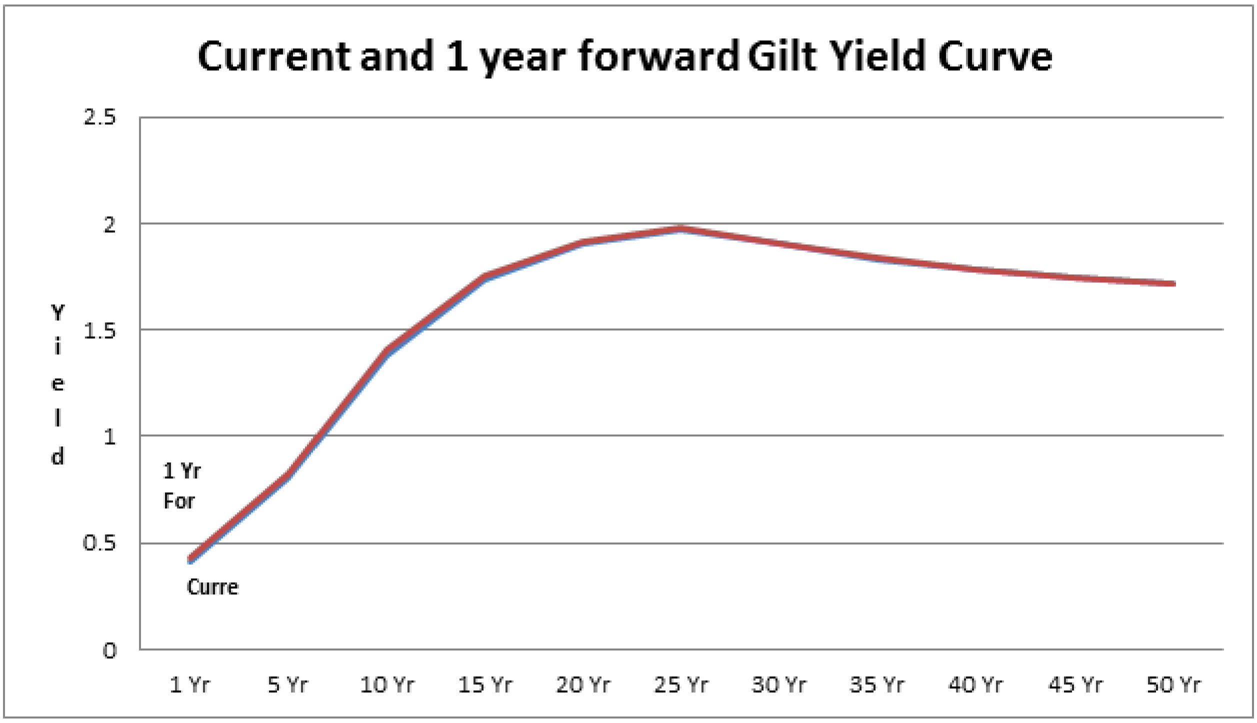
6.1 The Council's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required. Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The key factors influencing the 2018/19 strategy are:

- forecast borrowing requirements,
- the current economic and market environment, and
- interest rate forecasts.

6.2 The Council is currently maintaining an under-borrowed position. This means that capital expenditure has not been fully funded from loan debt as other funding streams (such as government grants and 3rd party contributions, use of Council reserves and cash balances and capital receipts) have been employed where available. This policy has served the Council well over the last few years while investment returns have been low and counterparty risk has been relatively high.

Prospects for Interest Rates

6. 3 However, the borrowing position needs to be kept under review to avoid incurring higher borrowing costs in future years when the Council may not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt. Market commentators are forecasting an increase in interest rates across all maturities (see graph below) – though a limited increase rather than a material change. More detail on their interest rate forecasts is at Appendix 4.



Source: Bloomberg

6.4 Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Treasury Management team will continue to monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances (within their approved remit).

6.5 If it were considered that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

6.6 In the event that interest rates rose beyond the forecast used in the capital programme the revenue interest cost to the Council would increase. A rise of an extra 1% per year during the Council's peak borrowing would cost an additional £32m in interest payments cumulative over the period from 21/22 – 27/28

Limits on external borrowing

6.7 The Prudential Code requires the Council to set two limits on its total external debt, as set out in Table 6 below. The limits have been increased by 10-20% per annum compared with the 2017/18 TMSS to reflect slippage in the capital programme from previous years. The limits are:

- **Authorised Limit for External Debt (Prudential Indicator 7a)** – This is the limit prescribed by section 3(1) of the Local Government Act 2003 representing the maximum level of borrowing which the Council may incur. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term.

- **Operational Boundary (Prudential Indicator 7b)** – This is the limit which external debt is not normally expected to exceed. The boundary is based on current debt plus anticipated net financing need for future years.

Table 6 Overall borrowing limits

2016/17		2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Actual		Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
£		£	£	£	£	£	£
	Authorised Limit for External:						
612	Borrowing and other long term liabilities	621	854	1,071	1,190	1,253	1,247
	Operational Boundary for:						
270	Borrowing	300	320	360	620	900	900
12	Other long term liabilities	11	11	11	10	10	10
282	**Total**	**311**	**331**	**371**	**630**	**910**	**910**

6.8 In addition, borrowing for the HRA has to remain within the HRA Debt Limit (prescribed in the HRA Self-Financing Determinations 2012) as detailed in the table below. Borrowing for the HRA is measured by the HRA CFR.

Table 7 HRA borrowing

2016/17		2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Actual		Forecast	Estimate	Estimate	Estimate	Estimate	Estimate
£		£	£	£	£	£	£
334	HRA Debt Limit	334	334	334	334	334	334
261	HRA CFR	261	274	321	321	321	321
73	**Headroom**	**73**	**60**	**13**	**13**	**13**	**13**

6.9 The City Treasurer reports that the Council complied with these indicators in the current year and does not envisage difficulties for the future.

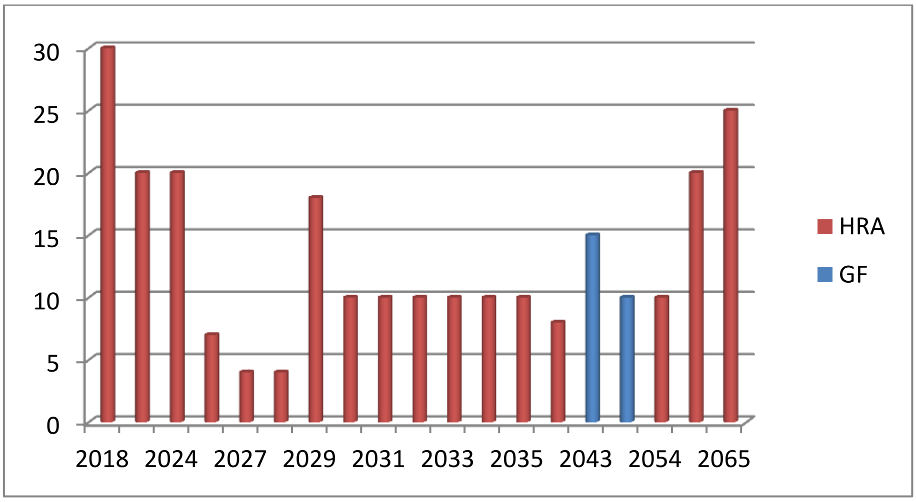
Maturity structure of borrowing (Prudential Indicator 10)

6.10 Managing the profile of when debt matures is essential for ensuring that the Council is not exposed to large fixed rate sums falling due for re-financing within a short period, and thus potentially exposing the Council to additional cost. Table 8 below sets out current upper and lower limits for debt maturity which are unchanged from 2017/18. The chart below shows the principal repayment profile for current council borrowing remains within these limits.

Table 8 Debt maturity profile limits

Actual maturity at 30 Sept 2016		upper limit	lower limit
%		%	%
0	under 12 months	40	0
12	12 months and within 24 months	35	0
8	24 months and within 5 years	35	0
11	5 years and within 10 years	50	0
69	10 years and above	100	35

Maturity profile of long-term borrowing



6.11 The Council has £70 million of LOBO (Lender Option Borrower Option) debt, none of which matures in the near future. Were the lender to exercise their option, officers will consider accepting the new rate of interest or repaying (with no penalty). Repayment of the LOBO may need to be considered for re-financing.

6.12 In the event that there is a much sharper rise in long and short term rates than currently forecast, then the balance of the loan portfolio will be re-visited with a view to taking on longer term fixed rate borrowing in anticipation of future rate rises.

Policy on Borrowing in Advance of Need

6.13 The Council has the power to borrow in advance of need in line with its future borrowing requirements under the Local Authorities (Capital Finance and Accounting)(England) Regulations 2003, as amended. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

6.14 Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt Rescheduling

6.15 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the cost of debt repayment (premiums incurred).

6.16 The reasons for any rescheduling to take place will include:

- generating cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy; and
- enhancing the balance of the portfolio by amending the maturity profile and/or the balance of volatility.

6.17 Consideration will also be given to identifying the potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

6.18 Any rescheduling will be reported.

7. SECTION 3 - MANAGING CASH BALANCES

The current cash position and cash flow forecast

7.1 Table 9 below shows that cash balances have increased by £300m in the past six months which is mainly due to income such as council tax, business rates and grants received in advance.

Table 9 Cash position at 30 September 2017

As at 31 March 2017			As at 30 September 2017	
Principal	Average Rate		Principal	Average Rate
£m	%		£m	%
		Investments		
884	0.54	Specified	1,135	0.42
25	1.52	Non-Specified	74	0.39
909	**2**	**Total**	**1,209**	
		Borrowing		
181	4.75	Public works loan Board	181	4.75
70	5.08	Market Loans	70	5.08
251		**Total**	**251**	

7.2 The medium-term cash flow forecast (see below) shows that the Council has a substantial positive cashflow position with an average cash position fluctuating around £600m for the medium-term. The reason for the high cash balance is largely due to business rates and the amount held pending rating appeals.

Table 10 Medium-term cashflow forecast

	2018/19	2019/20	2020/21	2021/22	2022/23
	£m	£m	£m	£m	£m
Balance at 1 April	**792**	**663**	**572**	**606**	**666**
Movement in Cash					
Capital Receipt	0	16	21	48	69
Grants & Contributions	165	185	148	96	59
Revenue Financing/ MRR					
Cash In	**165**	**201**	**169**	**144**	**128**
Capital Programme	(393)	(384)	(306)	(227)	(142)
Cash Out	**(393)**	**(384)**	**(306)**	**(227)**	**(142)**
Borrowing			221	208	
Repayment of debt	(30)		(15)	(5)	
Balance 31 March	**534**	**480**	**641**	**726**	**652**
Average Balance	**663**	**572**	**606**	**666**	**659**

7.3 The Council aims to manage daily cash flow peaks and troughs to achieve a nil current account balance throughout the year. As such the average yearly surplus cash balances should be fully invested throughout.

Prospects for Investment Returns

7.4 Investment returns on cash-based deposits are likely to remain low during 2018/19 and beyond; despite a potential near term interest rate rise. Borrowing interest rates were on a downward trend during most of 2016; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of August when a new package of quantitative easing purchasing of gilts was announced. As inflationary pressures have mounted in the past year the prospect of an interest rate rise has now increased. The recent prospect of a rate rise from the bank of England has seen the PWLB 25 year loan rate increase by 0.20% from 12 September 2017 to 03 October 017.

7.5 Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The Council is therefore committed to investigating and pursuing alternatives to cash-based investments where it is considered prudent to do so.

Council policy on investing and managing risk

7.6 The aim is to manage risk and reduce the impact of any adverse movement in interest rates on the one hand but at the same time not setting the limits to be so restrictive that they impair opportunities to reduce costs or improve performance.

Balancing short and longer term investments

7.7 During the first half of 2017/18 investment of surplus funds for more than 364 days totalled £73m which was well within the upper limit for such investments of £450m.

Table 11 Investment limits

2016/17 Actual £		2017/18 Forecast £	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £	2021/22 Estimate £	2022/23 Estimate £
	Upper limit for fixed interest rate exposure						
251	Net principal re fixed rate borrowing	251	264	298	519	747	747
	Upper Limit for variable rate exposure						
0	Net Principal for variable rate borrowing	0	0	0	0	0	0
73	Upper Limit for principal sums invested for more the 364 days	450	450	450	450	450	450

8. SUMMARY OF PRUDENTIAL INDICATORS (PIs)

8.1 The purpose of prudential indicators (PIs) is to provide a reference point or "dashboard" so that senior officers and Members can:

- easily identify whether approved treasury management policies are being applied correctly in practice and
- take corrective action as required.

8.2 As the Council's s151 officer, the City Treasurer has a responsibility to ensure that appropriate PIs are set and monitored and that any breaches are reported to Members.

8.3 The City Treasurer has confirmed that the PIs set out below are all expected to be complied with in 2017/18 and he does not envisage at this stage that there will be any difficulty in achieving compliance with the suggested indicators for 2018/19.

PI ref	Para ref		2016/17 actual	2017/18 forecast	2018/19 proposed
1	5.2	Capital expenditure	£176m	£376m	£568m
2	5.8	Capital Financing Requirement (CFR)	£521m	£621m	£854m
3	5.9	Net debt vs CFR	£270m underborrowing	£370m underborrowing	£590m underborrowing
4	5.10	Ratio of financing costs to revenue stream	GF 0.32% HRA 31.25%	GF 0.84% HRA 30.11%	GF (0.4%) HRA 28.68%
5	5.12	Incremental impact of new capital investment decisions on council tax	£11.56 decrease in Band D council tax charge per annum	£11.57 increase in Band D council tax charge per annum	£1.40 decrease in Band D council tax charge per annum
6	5.12	Impact of new capital investment decisions on housing rents	£13.63 decrease in average rent per week	£2.94 decrease in average rent per week	£0.64 decrease in average rent per week
7a	6.7	Authorised limit for external debt	£612m	£621m	£854m
7b	6.7	Operational debt boundary	£282m	£311m	£331m
7c	6.8	HRA debt limit	£334m	£334m	£334m
8	7.3	Working capital balance	£150m	£0m	£0m
9	7.7	Limit on surplus funds invested for more than 364 days (i.e. non-specified investments)	£25m	£100m	£450m
10	6.10	Maturity structure of borrowing	Upper limit under 12 months - 40% Lower limit 10 years and above - 35%	Upper limit under 12 months - 40% Lower limit 10 years and above - 35%	Upper limit under 12 months - 40% Lower limit 10 years and above - 35%

9. LEGAL IMPLICATIONS

9.1 The Director of Law comments that the legal requirements are set out in the 2003 Act, and in the subordinate legislation. The City Treasurer as section 151 officer, has confirmed (paragraph 8.2) that the PIs are expected to be met in the current year.

Legal comments added by David Walker, Principal Solicitor, 020 7361 2211

10. APPENDICES

1 Annual Investment Strategy

2 Minimum Revenue Provision (MRP) Policy

3 CIPFA Requirements

4 Prospect for Interest Rates/ Economic Update

BACKGROUND PAPERS

Treasury Management Strategy Statement 2017/18 (Approved by Council March 2017)

1. Section 3 Local Government Act 2003
2. Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended
3. DCLG Guidance on Minimum Revenue Provision 2012
4. DCLG Guidance on Local Government Investments – March 2010
5. CIPFA Prudential Code for Capital Finance in Local Authorities, 2011
6. CIPFA Treasury Management Code of Practice, 2011

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

ANNUAL INVESTMENT STRATEGY

1. The Council holds significant invested funds, representing income received in advance of expenditure, balances and reserves. During the first half of the current year, the Council's average investment balance has been around £1,184m and the cash flow projections shows this pattern is expected to continue in the forthcoming year. Investments are made with reference to the core balance, future cash flow requirements and the outlook for interest rates.

2. The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Investment Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

3. In accordance with the above guidance and to minimise the risk to investments, the Council applies minimum acceptable credit criteria to generate a list of highly creditworthy counterparties which will provide security of investments, enable diversification and minimise risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Investment returns expectations

4. Bank Rate was cut in August 2016 from 0.50% to 0.25%. The risk of the MPC raising Bank Rate by 0.25% in November 2017, the quarterly Inflation Report month, is now greater than them doing nothing. The question then remains as to whether or not they will stop at this point for a lengthy pause, or will launch into a series of further rate increases in 2018. Bank Rate forecasts for financial year ends (March) are:

2018/19	0.25%
2019/20	0.75%
2020/21	1.00%
2021/22	1.25%
2022/23	1.50%

5. The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows

2018/19	0.50%
2019/20	0.75%
2020/21	1.00%
2021/22	1.25%
2022/23	1.50%

Investment time limits

6. This limit is set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment. For the year 2018/19, the proposed limit of investments for over 364 days is £450m as set out in table 11 of the TMSS.

Investment Policy

7. The Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to assess continually and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

8. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Creditworthiness Policy

9. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

   - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security; and
   - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

10. The City Treasurer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

11. The Council takes into account the following relevant matters when proposing counterparties:

   - the financial position and jurisdiction of the institution;
   - the market pricing of credit default swaps[1] for the institution;
   - any implicit or explicit Government support for the institution;
   - Standard & Poor's, Moody's and Fitch's short and long term credit ratings;
   - Sovereign ratings to select counterparties from only the most creditworthy countries; and
   - Core Tier 1 capital ratios[2].

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[1] Credit Default Swaps (CDS) are tradable instruments where the buyer receives a pay-out from the seller if the party to whom the CDS refers (often a financial institution) has a "credit event" (e.g. default, bankruptcy, etc.). The price of the CDS gives an indication to the market's view of likelihood – the higher the price the more likely the credit event.

[2] The Tier 1 capital ratio is the ratio of a bank's core equity capital to its total risk-weighted assets (RWA). Risk-weighted assets are the total of all assets held by the bank weighted by credit risk according to a formula

12. Changes to the credit rating will be monitored and in the event that a counter party is downgraded and does not meet the minimum criteria specified in Appendix 1, the following action will be taken immediately:

- no new investments will be made;

- existing investments will be recalled if there are no penalties; and

- full consideration will be given to recall or sale existing investments which would be liable to penalty clause.

Specified and Non-specified investments

13. The DCLG Guidance on Local Government Investments made under section 15(1) of the Local Government Act 2003, places restrictions on Local authorities around the use of specified and non-specified investments. A specified investment is defined as an investment which satisfies all of the conditions below:

- The investment and any associated cash flows are denominated in sterling;
- The investment has a maximum maturity of one year;
- The investment is not defined as capital expenditure; and
- The investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or parish/community council.

14. A non-specified investment is any investment that does not meet all the conditions above. In addition to the long-term investments listed in the table at the end of Appendix 1, the following non-specified investments that the Council may make include:

- **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.

- **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. The Council would expect a return commensurate with the type and duration of the loan. A limit of £50 million for this type of investment is proposed with a duration of over the life of the asset and Council's cash flow requirements. 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. All loans would need to be in line with the Council's Scheme of Delegation and Key Decision thresholds levels

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determined by the Regulator (usually the country's central bank). Most central banks follow the Basel Committee on Banking Supervision (BCBS) guidelines in setting formulae for asset risk weights.
The Core Tier 1 ratios for the four UK banks that WCC uses are: Barclays: 10.2%, HSBC: 11.2%, Lloyds: 12.0% and RBS: 10.8%.

- **Shareholdings in limited companies and joint ventures** – The Council invests in three forms of company:

  - Small scale businesses funded through the Civic Enterprise Fund aimed at promoting economic growth in the area. Individual investments are no more than £0.5m and the aim is for the Fund to be self-financing over the medium-term

  - Trading vehicles which the Council has set up to undertake particular functions. These are not held primarily as investments but to fulfil Council service objectives. For example, CityWest Homes is a company limited by guarantee to run the housing arms-length management organisation. Any new proposals will be subject to due diligence as part of the initial business case. As these are not to be held primarily as investment vehicles, then there is an expectation that they will break-even.

  - Trading vehicles held for a commercial purpose where the Council is obliged to undertake transactions via a company vehicle. These will be wholly owned subsidiaries of the Council with the aim of diversifying the investment portfolio risk.

15. For any such investments, specific proposals will be considered by the Director of Treasury and Pensions, and approved by the s151 Officer after taking into account:

    - cash flow requirements
    - investment period
    - expected return
    - the general outlook for short to medium term interest rates
    - creditworthiness of the proposed investment counterparty
    - other investment risks.

16. The value of non-specified investments will not exceed their Investment allocation. The Council must now formulate a strategy that allocates it's cash in the most effective manner to short, medium and long term non-specified investments.

Country of Domicile

17. The current TMSS allows deposits / investments with financial entities domiciled in the following countries: Australia, Canada, Denmark, Finland, France, Germany, Japan, Luxembourg, Netherlands, Norway, Singapore, Spain, Sweden, Switzerland, UK and USA. This list will kept under review and any proposed changes to the policy reported to the next meeting

Schedule of investments

18. The criteria for providing a pool of high quality short, medium and long-term, cash-based investment counterparties along with the time and monetary limits for institutions on the Council's counterparty list are in the table overleaf:

All investments listed below must be sterling denominated

Investments	Minimum Credit Rating Required (S&P/Moody's/Fitch)	Maximum Individual Counterparty Investment Limit (£m)	Maximum tenor
DMO Deposits	Government Backed	Unlimited	6 months
UK Government (Gilts/T-Bills/Repos)	Government Backed	Unlimited	Unlimited
Supra-national Banks, European Agencies	LT: AA/Aa/AA	£200m	5 years
Covered Bonds	LT: AA/Aa/AA	£300m	10 years
Network Rail	Government guarantee	Unlimited	Oct 2052
TfL	LT: AA/Aa/AA	£100m	5 years
GLA UK Local Authorities (LA) Local Government Association (LGA)	N/A	GLA : £100M	5 years
		LA : £100m per LA, per criteria £200m in aggregate	3 years
		LGA : £20m	15 years
Commercial Paper issued by UK and European Corporates	ST: A-1/P-1/F-1	£40m per name, £200m in aggregate	6 months
Money Market Funds (MMF)	LT: AAA/Aaa/AAA By at least two of the main credit agencies	£70m per Fund Manager £300m in aggregate	3 day notice
Enhanced Money Funds (EMF)	LT: AAA/Aaa/AAA By at least one of the main credit agencies	£25m per fund manager, £75m in aggregate	Up to 7 day notice
Collateralised Deposits	Collateralised against loan	£100m	50 years
UK Bank (Deposit or Certificates of Deposit)	LT: AA-/Aa3/AA- ST: F1+	£75m	5 years
UK Bank (Deposit or Certificates of Deposit)	LT: A-/A3/A ST: F1	£50m	3 years
Non-UK Bank (Deposit or Certificates of Deposit)	LT: AA-/Aa2/AA- ST: F1+	£50m	5 years
	LT: A/A2/A ST: F1	£35m	3 years
Green Energy Bonds	Internal and External due diligence	Less than 25% of the total project investment or maximum of £20m per bond. £50m in aggregate	10 years
Rated UK Building Societies	LT: A-/A3/A ST: F1	£10m per Building Society, £50m in aggregate	1 year
Loans to organisations delivering services for the Council	Due diligence	£50m in aggregate	Over the life of the asset
Sovereign approved list: Australia, Canada, Denmark, Finland, France, Germany, Japan, Luxembourg, Netherlands, Norway, Singapore, Spain, Sweden, Switzerland, UK and USA			

APPENDIX 2

Minimum Revenue Provision (MRP) Policy

1. Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year. The accounting approach is to spread the cost over the estimated useful life of the asset. The mechanism for spreading these costs is through an annual MRP. The MRP is the means by which capital expenditure, which is financed by borrowing or credit arrangements, is funded by Council Tax.

2. Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended (Statutory Instrument (SI) 3146/2003) requires full Council to approve a Minimum Revenue Provision (MRP) Statement setting out the policy for making MRP and the amount of MRP to be calculated which the Council considers to be prudent. In setting a level which the Council considers to be prudent, the Guidance states that the broad aim is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits to the Council.

3. The Council is recommended to approve the following MRP Statement:

    - For capital expenditure incurred before 1 April 2007, MRP will be calculated using Option 1 (the 'Regulatory Method') of the CLG Guidance on MRP. Under this option MRP will be 4% of the closing non-HRA CFR for the preceding financial year.

    - For all capital expenditure incurred after 1 April 2007 financed from unsupported (prudential) borrowing (including PFI and finance leases), MRP will be based upon the asset life method under Option 3 of the DCLG Guidance.

    - In some cases where a scheme is financed by prudential borrowing it may be appropriate to vary the profile of the MRP charge to reflect the future income streams associated with the asset, whilst retaining the principle that the full amount of borrowing will be charged as MRP over the asset's estimated useful life.

    - A voluntary MRP may be made from either revenue or voluntarily set aside capital receipts.

    - Estimated life periods and amortisation methodologies will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

    - As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

- Charges included in annual PFI or finance leases to write down the balance sheet liability shall be applied as MRP.

- Where borrowing is undertaken for the construction of new assets, MRP will only become chargeable once such assets are completed and operational.

- If property investments are short-term (i.e. no more than 4 years) and for capital appreciation, the Council will not charge MRP as these will be funded by the capital receipt on disposal.

4. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made. For the Council this is componentised based on the life of component and the gross replacement cost within the overall existing use value – social housing of the HRA stock.

CIPFA requirements

The Council has formally adopted CIPFA's Code of Practice on Treasury Management (updated November 2011) and complies with the requirements of the Code as detailed below:

- Maintaining a Treasury Management Policy Statement setting out the policies and objectives of the Council's treasury management activities

- Maintaining a statement of Treasury Management Practices that sets out the manner in which the Council will seek to achieve these policies and objectives

- Presenting the Full Council with an annual TMSS statement, including an annual investment strategy and Minimum Revenue Provision policy for the year ahead (this report) a half year review report and an annual report (stewardship report) covering compliance during the previous year

- A statement of delegation for treasury management functions and for the execution and administration of statement treasury management decisions. (see below).

- Delegation of the role of scrutiny of treasury management activities and reports to a specific named body. At Westminster City Council this role is undertaken by the Housing, Finance and Corporate Services Policy and Scrutiny Committee.

Treasury Management Delegations and Responsibilities

The respective roles of the Council, Cabinet, Housing, Finance and Corporate Services Policy and Scrutiny committee and Section 151 officer are summarised below. Further details are set out in the Treasury Management Practices.

<u>Council</u>

Council will approve the annual treasury strategy, including borrowing and investment strategies. In doing so Council will establish and communicate their appetite for risk within treasury management having regard to the Prudential Code

<u>Cabinet</u>

Cabinet will recommend to Council the annual treasury strategy, including borrowing and investment strategies and receive a half-year report and annual out-turn report on treasury activities.

Cabinet also approves revenue budgets, including those for treasury activities.

<u>Housing, Finance and Corporate Services Policy and Scrutiny Committee</u>

This committee is responsible for ensuring effective scrutiny of the Treasury strategy and policies.

<u>Section 151 Officer</u>

Council has delegated responsibility for the implementation and monitoring of treasury management decisions to the Section 151 Officer to act in accordance with approved policy and practices. The s151 Officer has full delegated powers from the Council and is responsible for the following activities:

- Investment management arrangements and strategy;
- Borrowing and debt strategy;
- Monitoring investment activity and performance;
- Overseeing administrative activities;
- Ensuring compliance with relevant laws and regulations;
- Provision of guidance to officers and members in exercising delegated powers.

Director of Treasury and Pension Fund

Has responsibility for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Policy Statement and CIPFA's 'Standard of Professional Practice on Treasury Management'.

Treasury Team

Undertakes day to day treasury investment and borrowing activity in accordance with strategy, policy, practices and procedures.

Training

The CIPFA code requires the s151 officer to ensure that Members with responsibility for making treasury management decisions and for scrutinising treasury functions to receive adequate training. The training needs of all officers are reviewed periodically as part of the Learning and Development programme. Officers attend various seminars, training sessions and conferences during the year and appropriate Member training is offered as and when needs, and suitable opportunities, are identified.

APPENDIX 4

Prospects for Interest Rates

1. The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

2. Capita Asset Services undertook its last review of interest rate forecasts on 9 August after the quarterly Bank of England Inflation Report. There was no change in MPC policy at that meeting. However, the MPC meeting of 14 September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate "over the coming months". It is therefore possible that there will be an increase to 0.5% at the November MPC meeting. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018.

3. The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include just what final form Brexit will take, when finally agreed with the EU, and when.

4. Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:
   - UK economic growth and increases in inflation are weaker than we currently anticipate.
   - Weak growth or recession in the UK's main trading partners - the EU and US.
   - Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
   - A resurgence of the Eurozone sovereign debt crisis.
   - Weak capitalisation of some European banks.
   - Monetary policy action failing to stimulate sustainable growth and to get inflation up consistently to around monetary policy target levels.

5. The potential for upside risks to current forecast for UK gilt yields and PWLB rates, especially for longer term PWLB rates include;

- The pace and timing of increases in the Fed. Funds Rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.

- UK inflation returning to significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Economic Update

6. **UK.** After the UK economy surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y) which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. . The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

7. The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. This marginal revision can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work

to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

8. It therefore looks very likely that the MPC will increase Bank Rate to 0.5% in November or, if not, in February 2018. The big question after that will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at the start of October, short sterling rates are indicating that financial markets do not expect a second increase until May 2018 with a third increase in November 2019. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth. If this scenario were to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

9. **EU.** Economic growth in the EU, (the UK's biggest trading partner), has been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter (2.3% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

10. **USA.** Growth in the American economy has been volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1%, resulting in an overall annualised figure of 2.1% for the first half year. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.4%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with three increases since December 2016; and there could be one more rate rise in 2017 which would then lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. At its June meeting, the Fed strongly hinted that it would soon begin to unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

11. **Chinese economic growth** has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial

capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

12. **Japan** is struggling to stimulate consistent significant growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.