City of Westminster

Housing, Finance and Customer Services Policy and Scrutiny Committee

Date:	28th November 2018
Classification:	General Release
Title:	Treasury Management Strategy Mid-Year Review 2018-19
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:	Phil Triggs, Tri-Borough Director of Treasury and Pensions

1. EXECUTIVE SUMMARY

1.1. The purpose of this report is to:

- update Members on the delivery of the 2018/19 Treasury Management Strategy approved by Council on 7 March 2018; 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 six-monthly review of the Council's investment portfolio for 2018/19 to include the treasury position as at 30 September 2018;
- a review of the Council's borrowing strategy for 2018/19;
- a review of compliance with Treasury and Prudential Limits for the first six months of 2018/19;
- an economic update for the first part of the 2018/19 financial year.

1.4. The Council has complied with all elements of the Treasury Management Strategy Statement (TMSS) apart from two instances, which arose because of exceptional banking receipts which were received too late in the day to be moved from the bank until the following day:

- £1.171m on 3 April 2018
- £23.686m on 25 May 2018

2. RECOMMENDATIONS

2.1. To note:

- the Treasury Management Strategy 2018-19 mid-year review, noting the cases of non-compliance and the action taken to rectify this.

3. TREASURY POSITION AS AT 30 SEPTEMBER 2018

3.1. As at 30 September 2018 net cash invested was £920m, an increase of £179m on the position at 31 March 2018 as shown below:

	30 September 2018 £m	31 March 2018 £m
Total borrowing	(221)	(251)
Total cash invested	1,141	992
Net cash invested	**920**	**741**

3.2. During the first six months of the year, net cash inflows of £179m have been received. The significant increase reflects the forecast pattern of the Council'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 2018-19 was approved by the Council on 7 March 2018. 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.

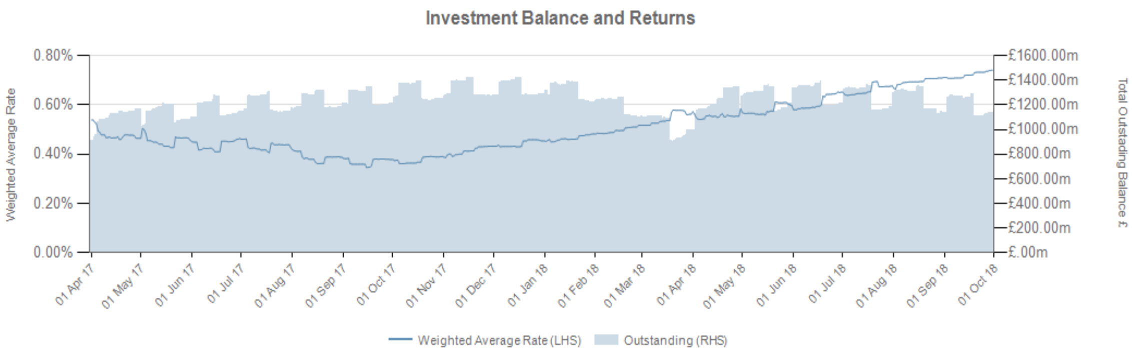
3.4. The table below provides a breakdown of investments, together with comparisons for the last financial year end.

	30 September 2018 £m	31 March 2018 £m
Money Market Funds	142	130
Notice Accounts	90	89
Term Deposits	455	385
Tradable Securities	422	336
Enhanced Cash Funds	32	52
Total cash invested	**1,141**	**992**

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 six months of 2018-19 was £1,252m.

3.6. The shaded area in the chart below shows the daily investment balance from 1 April 2017 to 30 September 2018. The line shows the weighted average return of the investment portfolio, which has fallen during the first half of the 2017/18 financial year, but has then steadily increased since October 2017.

3.7. Daily investment balances have steadily increased from £909m at 1 April 2017 to the current level at 30 September 2018 of £1,141m, as shown by the shaded area in the chart overleaf. At the same time, average returns have risen by 0.20% as shown by the solid line in the chart. This reflects the increasing of the base rate by the Bank of England on 2 November 2017 and 2 August 2018.



3.8. All investments limits specified in the 2018/19 investment strategy have been complied with, except for:

- ➢ Two occasions of excess cash balances due to unexpected banking receipts 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 2018.

Borrowing

3.10. At the maximum level of £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 2018/19 of £855m.[1]

3.11. Currently the Council is internally borrowed by £455m because it has used internal cash resources to fund capital expenditure.

3.12. As anticipated in the TMSS for 2018/19, 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 for borrowing at current low rates as future requirements have been identified for the General Fund and the Housing Revenue Account (HRA).

3.13. In order to achieve the best balance, it would be prudent for the Council to lock in affordability by placing some forward borrowing for the amounts it can be relatively certain it will need, whilst maintaining some forward flexibility as projects may or may not get of the ground within the expected timeframes. Such a forward borrowing strategy is currently under consideration.

3.14. The table below shows the details around the Council's external borrowing as at 30 September 2018, split between the General Fund and HRA.

External borrowing	30 September 2018		31 March 2018	
	Balance £m	Rate %	Balance £m	Rate %
HRA	196	4.2%	226	4.9%
General Fund	25	4.1%	25	4.1%
Total borrowing	**221**	**4.2%**	**251**	**4.8%**

3.15. No new borrowing was incurred in the first half of 2018-19. General Fund external borrowing reduced by £20,000 from repaying the principal on General Fund annuity loans. HRA external borrowing reduced by £30m due to the repayment on maturity of a PWLB long term loan.

[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 30 September 2018, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS approved by Council on 7 March 2018 as set out below.

PI ref	Indicator	2018/19 indicator	2018/19 forecast	Indicator met?
1	Capital expenditure	£570m	£393m	Met
2	Capital Financing Requirement (CFR)	£855m	£676m	Met
3	Net debt vs CFR	£634m underborrowing	£455m underborrowed	Met
4	Ratio of financing costs to revenue stream	GF (2.71%) HRA 28.68%	GF (3.38%) HRA 30.31%	Met
5	Incremental impact of new capital investment decisions on council tax	£17.65 decrease in Band D council tax charge per annum	£57.16 decrease	Met
6	Impact of new capital investment decisions on housing rents	£0.64 decrease in average rent per week	£2.40 increase	Met
7a	Authorised limit for external debt	£855m	£221m	Met
7b	Operational debt boundary	£253m	£221m	Met
7c	HRA debt limit	£334m		
8	Working capital balance	£0m	£142m	Met
9	Limit on surplus funds invested for more than 364 days (i.e. non-specified investments)	£450m	£0m	Met
10	Maturity structure of borrowing	Upper limit under 12 months - 40% Lower limit 10 years and above - 35%	0% 75%	Met Met

Capital expenditure and borrowing limits

4.2. Capital expenditure to 30 September 2018 was £142m for both the General Fund and the HRA against a forecast for the whole year of £393m. This relates to a number of large development projects and related acquisitions. The forecast for development projects are contingent on progress by developers which, it 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 £142m capital expenditure incurred to date is well within the forecast use of capital resources of £326m, 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, a thorough risk analysis was determined, the cost of carry was appropriate, then 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.

4.4. The Council currently has substantial cash balances, but these balances are expected to reduce over the next five years, with increased capital spending and the release of surplus collection fund cash, meaning the Council will need to borrow at some point in the future. The Council will need to consider whether it would be prudent to arrange some or all of the required borrowing now and this process is currently underway. This will lock in affordability and protect against interest rate risk.

4.5. The purpose of the maturity structure of borrowing indicator is to highlight any potential refinancing risk that the Council may be facing if, in any one particular period, there was a disproportionate level of loans maturing. The table below shows that the maturity structure of the Council's borrowing as at 30 September 2018 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 2018 (%)
Under 12 months	40	0	0
12 months and within 24 months	35	0	0
24 months and within 5 years	35	0	9
5 years and within 10 years	50	0	16
10 years and above	100	35	75

4.6. 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 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.

4.7. The average rate on the fixed interest borrowing is 4.24% with an average redemption period of 19 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 refinancing but premiums for premature redemption are prohibitively high, making this option poor value for money.

4.8. The Council's borrowing portfolio contains £70m of Lender Option Borrower Option loans (LOBOs). There are long-term loans of up to 48 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

4.9. Investment in non-specified investments of nil compares with the limit of £450m for such investments. This reflects the fact that all of the Council's investments have a life of less than 12 months.

5. THE ECONOMY AND INTEREST RATES

5.1. The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee (MPC) to unanimously increase the Bank Rate on 2 August from 0.50% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August 2018 Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union on 29 March 2019.

5.2. Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly to 2.7% in August 2018 due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in the Bank Rate. The MPC has indicated that the Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

5.3. As for the labour market, unemployment has continued at a 43-year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July 2018, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9% (3-month average regular pay, excluding bonuses) and to a one-month figure in July 2018 of 3.1%. This meant that in real terms i.e., wage rates higher than CPI inflation, earnings grew by about 0.4%, near to the joint high of 0.5% since 2009 the previous high point was in July 2015).

5.4. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August 2018 as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing the Bank Rate again, especially given all the uncertainties around Brexit.

5.5. In the political arena, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, the central position is that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

6. PRUDENTIAL INDICATORS

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 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.

9. BACKGROUND PAPERS

Full Council Report

Treasury Management Strategy Statement for 2018/19 to 2022/23 on 7 March 2018

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 September 2018

Category	Maximim Individual Counterparty Investment Limit (£m)	Maximum Tenor	Counterparty Name	Current Exposure (£m)
UK Government (Gilts/ T-Bills/ Repos)	Unlimited	Unlimited	UK Treasury Bills	259.3
European Agencies	£200m	5 years	European Investment Bank	72.7
UK Local Authorities	£100m per local authority; £500m in aggregate	3 years	Canterbury City Council	25.0
			Leeds City Council	40.0
			London Borough of Croydon	10.0
			London Borough of Enfield	20.0
			London Borough of Hackney	15.0
			London Borough of Southwark	20.0
			Medway Council	10.0
			North Lanarkshire Council	5.0
			Reading Borough Council	10.0
			Rhondda Cynon Taff Council	15.0
			South Ayrshire Council	10.0

			Stockport Borough Council	15.0
			Surrey County Council	10.0
Money Market Funds	£70m per fund. £300m Total	Three day notice	Federated Sterling Liquidity Fund	65.5
			HSBC Global Liquidity Fund	5.0
			JP Morgan Sterling Liquidity Fund	5.0
			Morgan Stanley Sterling Liquidity Fund	66.7
Enhanced Cash Funds	£25m per fund £75m Total	Up to seven day notice	Payden & Rygel Sterling Reserve	16.8
			Federated Prime Rate Cash Plus	15.4
UK Banks (AA- / Aa3/ AA-)	£75m	5 years	HSBC Bank	49.2
UK Banks (A- /A3/A)	£50m	3 years	Goldman Sachs International Bank	50.0
			Lloyds Bank	30.0
			Santander UK Plc	50.0
			Standard Chartered	50.0
Non-UK Banks (AA-/ Aa2/ AA-)	£50m	5 years	Svenska Handelsbanken	40.1
			Toronto Dominion Bank	30.0
Non-UK Banks (A/ A2/ A)	£35m	3 years	Canadian Imperial Bank of Commerce	25.0
			Commonwealth Bank of Australia	35.0
			Cooperatieve Rabobank	35.0
			Hessen-Thueringen Girozentrale	35.0
TOTAL				**1140.7**