City of Westminster

Audit & Performance Committee

Date:	2 May 2019
Classification:	General Release
Title:	Treasury Management Strategy Outturn 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 and final outturn position
Report of:	Gerald Almeroth Executive Director for Finance and Resources

1. EXECUTIVE SUMMARY

1.1. The purpose of this report is to:

- Present the Council's Annual Treasury Management Outturn Report for 2018/19 in accordance with the Council's treasury management practices. It is a regulatory requirement for this outturn report to be presented to Council by the 30 September each year.

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 of capital and liquidity.

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

- Review of the Council's investment portfolio for 2018/19 to include the treasury position as at 31 March 2019.
- Review of the Council's borrowing strategy for 2018/19.
- Review of compliance with Treasury and Prudential Limits for year to 2018/19.
- Economic update for 2018/19.

1.4. The Council has complied with all elements of the Treasury Management Strategy Statement (TMSS) apart from two instances (already reported in the 2018/19 mid-year review) 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. This resulted in funds in excess of the strategy limit set for the Council's current bank account on two occasions:

- £1.171m on 3rd April 2018.
- £23.686m on 25th May 2018.

2. RECOMMENDATIONS

2.1. Cabinet is asked to note the annual treasury strategy final outturn 2018/19, noting the cases of non-compliance.

3. TREASURY POSITION AS AT 31 MARCH 2019

3.1. As at 31 March 2019, net cash invested was £506m, an decrease of £235m on the position at 31 March 2018 as shown below:

	31 March 2019 (£m)	31 March 2018 (£m)
Total Borrowing	(223)	(251)
Total Cash Invested	729	992
Net Cash Invested	**506**	**741**

Investments

3.2. 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.

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

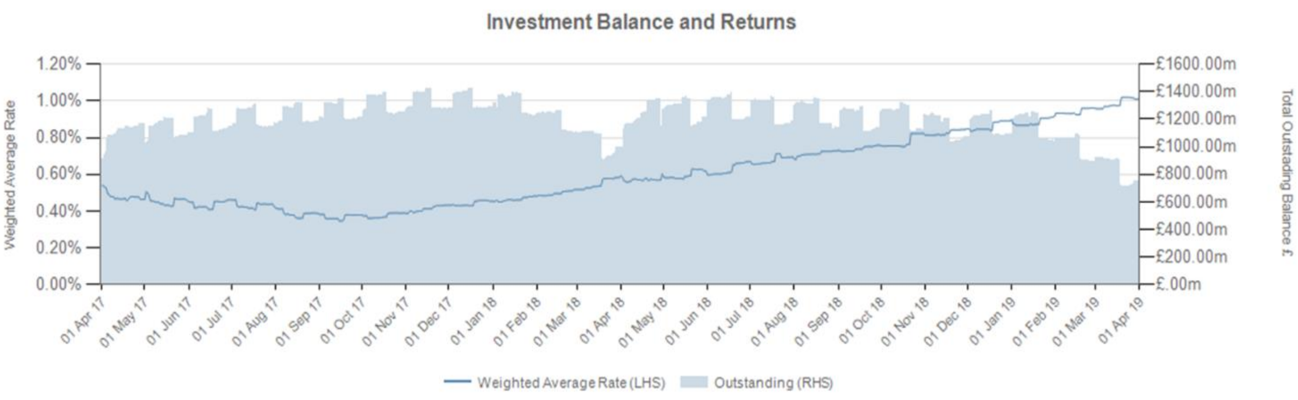
	Investment Balance 31 March 2019 (£m)	Investment Balance 31 March 2018 (£m)	Movement
Money Market Funds	59.7	129.6	-69.9
Notice Accounts	89.5	89.3	0.2
Term Deposits	465.0	385.0	80.0
Tradeable Securities	114.8	336.1	-221.3
Enhanced Cash Funds	0.0	52.2	-52.2
Total:	**729.0**	**992.2**	**-263.2**

3.4. 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 2018/19 was £1,172m.

3.5. Daily investment balances have steadily decreased from £992.9m at 1 April 2018 to £729.0m at 31 March 2019.

3.6. The Bank of England reduced the Base Rate in August 2016. However, since the latter half of 2017, rates have steadily improved. This is due to the November 2017 and August 2018 Bank of England base rate increases.

3.7. Although surplus cash for investment has reduced, cash has been invested with higher interest rate paying counterparties. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.



3.8. All investment limits specified in the 2018/19 investment strategy have been complied with except for two instances of cash balances received after close of banking business:

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

3.9. The original/ budgeted average balance for 2018/19 was £1.2 billion, while the actual outturn average investment balance for the year was £1.172 billion. The average investment balance peaked in June 2018, reaching £1.294 billion.

3.10. The table below shows the actual investment income and expenditure achieved in the year: budget versus actual and the variance.

	Budget £000	Actual £000	Variance £000
Investment Income	-5,575	-11,148	-5,573
Interest Payable	12,293	10,626	-1,667

3.11. Appendix 1 provides a full list of the Council's limits and exposures as at 31 March 2019.

Borrowing

3.12. At £223m, the Council's borrowing was well within the Prudential Indicator for external borrowing, namely, that borrowing should not exceed the estimated capital financing requirement (CFR) for 2018/19 of £724m. The final CFR for 2018/19 was £746m.

3.13. Currently, the Council is "under borrowed" by £523m because it has used internal funding resources to fund capital expenditure.

3.14. The table below shows the details around the Council's external borrowing as at 31 March 2019, split between the General Fund and HRA.

Total Borrowing	31 March 2018 (£m)	31 March 2019 (£m)
HRA	226	196
General Fund	25	27
Total Borrowing	**251**	**223**

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

Borrowing Type	Loan Balance 31 March 2018 (£m)	Loan Balance 31 March 2019 (£m)	Movement
PWLB	181.04	151.04	-30.00
LOBO	70.00	70.00	0.00
Mortgage Annuity	0.23	0.19	-0.04
Greater London Authority	0.00	2.00	2.00
Total:	**251.27**	**223.23**	**-28.04**

3.16. A HRA loan of £30m has matured in August 2018 which was costing 9.75% interest per annum.

Forward Borrowing

3.17. As anticipated in the 2018/19 TMSS, 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).

3.18. Officers have also investigated the use of forward borrowing deals. On 12 March, the Council undertook two forward borrowing deals: £37.5m with a start date 15/3/22 and end date 15/3/62, and £12.5m with a start date 15/3/23 and end date 15/3/66.

3.19. A further £200m is currently being negotiated with a separate provider with a view to a similar forty-year loan to be transacted around end-April 2019 to commence in four years' time.

COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

3.20. During the financial year to 31 March 2019, 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		2018/19 Forecast	2018/19 Actual	Indicator Met?
1	Capital expenditure	£389m	£325m	Met
2	Capital Financing Requirement (CFR)	£724m	£746m	Met
3	Net debt vs CFR	£503m underborrowing	£523m underborrowing	Met
4	Ratio of financing costs to revenue stream	GF (3.06)% HRA 30.11%	GF (2.35)% HRA 28.68%	Met
5a	Authorised limit for external debt	£724m	£746m	Met
5b	Operational debt boundary	£275m	£255m	Met
6	Working Capital Balance	£0m	£4m	Met
7a	Upper limit for variable interest rate borrowing	£0m	£0m	Met
7b	Upper limit for fixed interest rate borrowing	£724m	£746m	Met
7c	Limit on surplus funds invested for more than 364 days (i.e. non specified investments)	£450m	£0m	Met
8	Maturity structure of borrowing	Upper limit under 12 months: 40% Forecast: 0% Lower limit 10 years and above: 35% Forecast: 75%	Upper limit under 12 months: 0% Lower limit 10 years and above: 73%	Met

Capital expenditure and borrowing limits

3.21. Capital expenditure to 31 March 2019 totalled £325m for the General Fund and the HRA against a forecast for the whole year of £570m. 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.

	2018/19 Indicator (£m)	2018/19 Actual (£m)
General Fund Capital Expenditure	279	224
HRA Capital Expenditure	110	101
Total Capital Expenditure	**389**	**325**
Financed by:		
Capital Receipts	130	46
Capital Grants	128	112
Funded from Revenue	18	22
Major Repairs Allowance	23	24
Prudential Borrowing	90	121
Total Finance	**389**	**325**

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

	General Fund £m	Housing Revenue Account £m	Total £m
Adjusted Opening CFR 31/03/2018	373	261	634
Prudential Borrowing in 2018/19	109	12	121
Capital Receipts applied to reduce CFR	0	0	0
Minimum Revenue Provision	-7	0	-7
MRP in respect of Other Long Term Liabilities	-2	0	-2
Closing CFR	**473**	**273**	**746**

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

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

3.24. 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 31 March 2019 was within the limits set and does not highlight any significant issues.

Actual Maturity at 31 March 2019	Duration	Upper Limit	Lower Limit
0	Under 12 Months	40	0
7	12 Months and within 24 Months	35	0
7	24 Months and within 5 Years	35	0
13	5 Years and within 10 Years	50	0
73	10 Years and Above	100	35

3.25. 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.

3.26. The average rate on the fixed interest borrowing is 4.24% with an average redemption period of 18 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.

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

Investment limits

3.28. Investment in non-specified investments at £20m 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. The highest level of non-specified investments during the year was £20m.

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

4. THE ECONOMY AND INTEREST RATES

4.1. After weak economic growth of only 0.2% in quarter one of 2018, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given all the uncertainties over the UK’s departure from the Euopean Union, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% y/y, confirming that the UK was the third fastest growing individual country in the G7 in quarter 4.

4.2. After the Bank of England Monetary Policy Committee (MPC) raised the Bank Rate from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit are clear. If a disorderly exit resulted, it is likely that the Bank Rate would be cut to support growth.

4.3. Nevertheless, the MPC does have concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.5% (excluding bonuses) in the three months to December 2018 before falling marginally to 3.4% in the three months to January 2019. UK employers ramped up their hiring at the fastest pace in more than three years in the three months to January 2019 as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9%, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

4.4. As for CPI inflation, this has been on a falling trend, reaching 1.8% in January 2019 before rising marginally to 1.9% in February 2019. However, in the February 2019 Bank of England Inflation Report, the latest forecast for inflation over both the two and three-year time horizons remained marginally above the MPC’s target of 2%.

4.5. The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario as the difference between the two figures is now around 1.5%, i.e., a real terms wage increase. 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.

4.6. The EU has now set a Brexit deadline of 31 October 2019. It appears unlikely that there would be a Commons majority supporting no deal or revoking Article 50. The probability of a General Election in 2019 has increased over recent weeks and this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of weak Sterling and concerns around inflation picking up.

5. BACKGROUND

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

6. FINANCIAL IMPLICATIONS

6.1 Financial implications contained in the body of this report.

7. LEGAL IMPLICATIONS

7.1 The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. This report assists the Council in fulfilling its statutory obligation under the Local Government Act 2003 to monitor its borrowing and investment activities.

If you have any queries about this Report or wish to inspect any of the Background Papers please contact:

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BACKGROUND PAPERS:

Full Council Report: Treasury Management – Annual Strategy for 2018/19, including Prudential Indicators and Statutory Borrowing Determinations – 7 March 2018.

Appendix 1 – Limits and exposures as at 31st March 2019

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)
UK Government (Gilts/ T-Bills/ Repos)	Unlimited	Unlimited	Treasury Bills	59.8
UK Local Authorities	£100m per local authority; £500m in aggregate	3 years	Cambridgeshire County Council	20.0
			Isle of Wight Council	10.0
			Leeds City Council	40.0
			London Borough of Barnet	20.0
			London Borough of Croydon	10.0
			London Borough of Enfield	30.0
			London Borough of Hackney	15.0
			London Borough of Hillingdon	20.0
			London Borough of Southwark	20.0
			North Lanarkshire Council	25.0
			Redcar & Cleveland Borough Council	30.0
			South Ayrshire Council	10.0
			Surrey County Council	10.0
Money Market Funds	£70m per fund. £300m in aggregate.	Three day notice	Aberdeen Sterling Fund	11.8
			Federated Sterling Liquidity Fund	10.1
			JP Morgan Sterling Liquidity Fund	1.0
			Morgan Stanley Sterling Liquidity Fund	36.8
UK Banks (AA-/Aa3/ AA-)	£75m	5 years	HSBC	49.2
UK Banks (A-/A3/A)	£50m	3 years	Goldman Sachs International	45.0
			Lloyds Bank	30.0
			Santander UK Plc	50.0
			Standard Chartered Bank	30.0
Non-UK Banks (AA-/ Aa2/ AA-)	£50m	5 years	Svenska Handelsbanken	40.3
			Toronto Dominion Bank	40.0
Non-UK Banks (A/A2/ A)	£35m	3 years	Commonwealth Bank of Australia	35.0
			Helaba	15.0
			Rabobank Nederland	15.0
TOTAL				**729.0**