City of Westminster

Decision Maker:	Audit and Performance Committee
Date:	31 October 2022
Classification:	General Release
Title:	Treasury Management Strategy Outturn 2021/22
Wards Affected:	All
Policy Context:	To manage the Council's finances prudently and efficiently
Cabinet Member:	Cabinet Member for Finance and Smart City
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
Report Author:	Mathew Dawson Strategic Finance Manager

1. EXECUTIVE SUMMARY

1.1. This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2021/22. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2. The purpose of this report is to:

- Present the Council's annual Treasury Management outturn report for 2021/22 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 of each year.

1.3. 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.

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

- ➢ Review of the Council's investment portfolio for 2021/22 to include the treasury position as at 31 March 2022.
- ➢ Review of the Council's borrowing strategy for 2021/22.
- ➢ Review of compliance with Treasury and Prudential Limits for year to 2021/22.
- ➢ Economic update for 2021/22.

1.5. The Council has complied with all elements of the Treasury Management Strategy Statement (TMSS).

2. RECOMMENDATIONS

2.1. The Committee is asked to note the annual treasury management final outturn 2021/22.

3. TREASURY POSITION AS AT 31 MARCH 2022

3.1. The Council's treasury management debt and investment position is organised by the Tri-Borough Treasury team in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting, and through officer activity detailed in the Council's Treasury Management Practices (TMPs).

3.2. As at 31 March 2022, net cash invested was £156.3m, an increase of £29.1m on the position at 31 March 2021 as shown below:

	31 March 2022 (£m)	31 March 2021 (£m)
Total Borrowing	(298.2)	(206.1)
Total Cash Invested	454.5	333.3
Net Cash Invested	**156.3**	**127.2**

Investments

3.3. The Council's Annual Investment Strategy which forms part of the annual Treasury Management Strategy Statement (TMSS) for 2021/22 was approved by the Council on 3 March 2021. 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 previous financial year end.

	Investment Balance 31 March 2022 (£m)	Investment Balance 31 March 2021 (£m)	Movement (£m)
Money Market Funds	71.5	77.8	-6.3
Notice Accounts	30.0	20.0	10.0
Term Deposits	353.0	235.5	117.5
Total:	**454.5**	**333.3**	**121.2**

3.5. Liquid balances are managed through Money Market Funds, providing same day liquidity. Cash has also been invested in less liquid instruments, particularly term deposits. The average level of funds available for investment in 2021/22 was £657.2m.

3.6. Daily investment balances have steadily increased from £333.3m at 31 March 2021 to £454.5m at 31 March 2022.

3.7. The table below provides a more detailed breakdown of the Council's treasury investment position and interest rate received as at 31 March 2022:

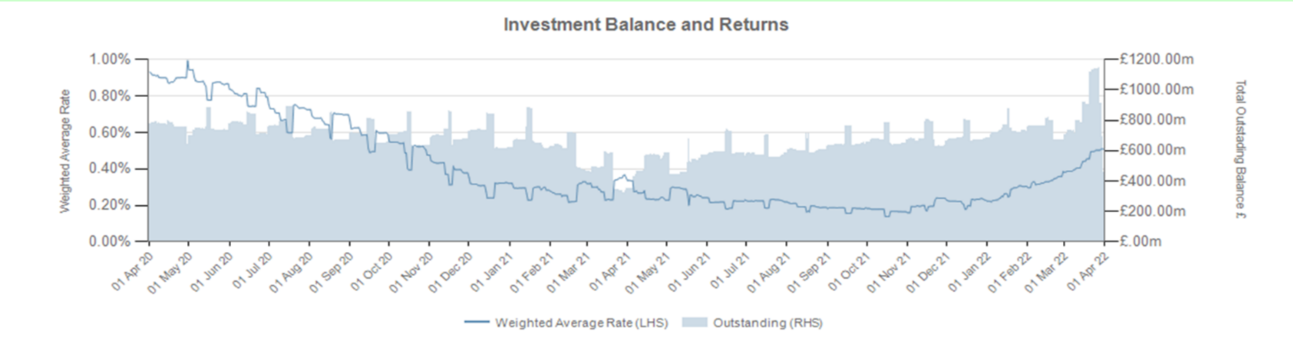
	Investment Balance (£m)	Interest Rate (%)
Money Market Funds	71.5	0.53
UK Banks	170.0	0.45
Non UK Banks	85.0	0.75
UK Government	110.0	0.19
Local Authorities	18.0	1.74
Total:	**454.5**	**0.51**

3.8. Over the last two years, the coronavirus outbreak has caused huge economic damage to the UK and to the global economy. After the Bank of England took emergency action in March 2020 to cut the Bank Rate to 0.10%, it left the Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.

3.9. Investment returns remained close to zero for much of 2021/22. The expectation for interest rates within the treasury management strategy for 2021/22 was that the Bank Rate would remain at 0.1% until it was clear to the Bank of England that the emergency level of rates was no longer needed.

3.10. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

3.11. Surplus cash for investment remained high throughout the year and the weighted average rate has increased since the start of April 2021. The level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Council's capital programme.



3.12. The Bank of England and the Government also maintained various monetary and fiscal measures, supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the various lockdowns/negative impact on their cashflow. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that, for most of the year, there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates remained very low until towards the turn of the year when inflation concerns indicated central banks, not just the Bank of England, would need to lift interest rates to combat the effects of growing levels of inflation (CPI was 7.0% in March 2022).

3.13. All investment/overdraft limits specified in the 2021/22 investment strategy have been complied with.

3.14. The table below shows the forecast investment income to be achieved in the year: budget versus actual and the variance. The Council's budgeted investment return for 2020/21 was £2.013m, and performance for the year is £3.779m above budget.

Year 2021/22	Budget £000	Actual £000	Variance £000
Investment Income	2,013	5,792	3,779

3.15. Appendix 1 provides a full list of the Council's limits and exposures as at 31 March 2022.

Borrowing

3.16. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2021/22 unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.17. A key part of the Council's treasury activities is to address the funding requirements for this borrowing need. The treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, such as the Government, through the PWLB, or the money markets, or utilising temporary cash resources within the Council.

3.18. At £298.2m, the Council's borrowing at 31 March 2022 was within the Prudential Indicator for external borrowing, namely, that borrowing should not exceed the estimated CFR for 2021/22 of £1,111m. The final CFR for 2021/22 was £998m.

3.19. During 2021/22, the Council maintained an under-borrowed position of £700m. This meant that the Capital Financing Requirement was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on the placing of treasury investments also needed to be considered.

3.20. The table below shows the details around the Council's external borrowing as at 31 March 2022, split between the General Fund and HRA.

Total Borrowing	31 March 2021 (£m)	31 March 2022 (£m)
HRA	181.0	175.6
General Fund	25.1	122.6
Total Borrowing	**206.1**	**298.2**

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

Borrowing Type	Loan Balance 31 March 2021 (£m)	Loan Balance 31 March 2022 (£m)	Movement (£m)
PWLB	136.0	130.6	-5.4
LOBO	70.0	70.0	0.0
Mortgage Annuity	0.1	0.1	0.0
Private Placement	0.0	37.5	37.5
Local Authority	0.0	60.0	60.0
Total:	**206.1**	**298.2**	**92.1**

3.22. During 2021/22, the Council repaid a £5.4m PWLB loan and £0.048m principle of mortgage annuity loans using investment balances. The first advance from the forward borrowing loans from Phoenix group totalling £37.5m was received in March 2022 and the Council was also required to take £60.0m of short term loans from other local authorities at year end. These loans were for an average duration of 35 days and all were fully repaid by 4th May 2022.

Forward Borrowing

3.23. As anticipated in the TMSS 2021/22, the Council took no additional long-term borrowing for the financial year 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). The monitoring process includes the setting of various trigger points, the breaking of which will require officer consideration of borrowing requirements and market conditions.

3.24. Due to the overall financial position and the underlying need to borrow for capital purposes, it is prudent for the Council to lock in affordability by placing some forward borrowing for the amounts it can be relatively certain it will need, while maintaining some forward flexibility as projects may or may not proceed within the expected timeframes.

3.25. During the financial year 2019/20, the Council arranged forward borrowing loans totalling £400m. These loans have enabled the Council to agree competitive rates in advance of need which eliminates the “cost of carry”, i.e., the difference between loan interest cost and the rate of return on cash investments.

3.26. An analysis of these loans can be found in the table below.

Counterparty	Amount (£m)	Start Date	Maturity Date	Rate (%)	Profile
Phoenix Group	37.5	15 March 2022	15 March 2062	2.706	Annuity
Barings LLC	150.0	15 August 2022	15 August 2052	1.970	Maturity
Phoenix Group	12.5	15 March 2023	15 March 2063	2.751	Annuity
Rothesay Life Plc	200.0	08 May 2023	08 May 2063	2.887	Equal Instalment of Principal
Weighted average interest rate	**400.0**			**2.579**	

Compliance with Treasury Limits and Prudential Indicators

3.27. During the financial year to 31 March 2022, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS approved by Council on 3 March 2021 as set out below.

PI Ref		2021/22 Forecast	2021/22 Actual	Indicator Met?
1	Capital expenditure	£436m	£351m	Met
2	Capital Financing Requirement (CFR)	£1,111m	£998m	Met
3	Net debt vs CFR	£873m underborrowing	£700m underborrowing	Met
4	Ratio of financing costs to revenue stream	GF (10.33)% HRA 45.15%	GF 1.57% HRA 45.15%	Met
5a	Authorised limit for external debt	£1,162m	£1,050m	Met
5b	Operational debt boundary	£289m	£298m	Met
6	Working Capital Balance	£0m	£0m	Met
7	Limit on surplus funds invested for more than 364 days (i.e. non specified investments)	£18m	£18m	Met
8	Maturity structure of borrowing	Upper limit under 12 months: 40% Forecast: 0% Lower limit 10 years and above: 35% Forecast: 64%	Upper limit under 12 months: 20% Lower limit 10 years and above: 53%	Met

Capital Expenditure and Borrowing Limits

3.28. Capital expenditure to 31 March 2022 totalled £351m for the General Fund and the HRA against a forecast for the whole year of £436m. The Council has embarked on an ambitious capital programme with a plan to invest up to £2.862bn (general fund) over the next 15 years.

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

	2021/22 Indicator (£m)	2021/22 Actual (£m)
General Fund Capital Expenditure	271	187
HRA Capital Expenditure	165	164
Total Capital Expenditure	**436**	**351**
Financed by:		
Capital Receipts	37	59
Capital Grants	156	131
Funded from Revenue	0	6
Major Repairs Allowance	24	20
Prudential Borrowing	219	135
Total Finance	**436**	**351**

	General Fund £m	Housing Revenue Account £m	Total £m
Adjusted Opening CFR 31/03/2021	583	300	883
Prudential Borrowing in 2021/22	128	64	192
Capital Receipts applied to reduce CFR	-21	-38	-59
Minimum Revenue Provision	-18	0	-18
MRP in respect of Other Long Term Liabilities	0	0	0
Closing CFR	**672**	**326**	**998**

3.30. 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. Officers are monitoring the need for new borrowing in the short/medium term.

3.31. 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 31 March 2022 was within the limits set and does not highlight any significant issues.

Actual Maturity at 31 March 2022	Duration	Upper Limit	Lower Limit
20	Under 12 Months	40	0
4	12 Months and within 24 Months	35	0
8	24 Months and within 5 Years	35	0
15	5 Years and within 10 Years	50	0
53	10 Years and Above	100	35

3.32. 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 3.26 shows that the Council is not subject to any adverse movement in interest rates as it only holds fixed interest borrowing.

3.33. The average rate on the fixed interest borrowing is 3.26% 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 current PWLB interest rates for comparable loans if they were taken out at today's levels. Officers have considered loan refinancing but premia for premature redemptions are prohibitively high, making this option poor value for money.

3.34. 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 were 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 redeem. 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

3.35. There are no deposits in non-specified investments as at 31 March 2022 as all of the Council's investments have a life of less than 12 months. The highest level of non-specified investments during the year was £18.0m, which is well within the limit of £450.0m for such investments.

3.36. While 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.

3.37. There is likely to be a further rise in short dated gilt yields and PWLB rates over the next three years. The Bank of England is embarking on a process of Quantitative Tightening, whereby the Bank's £895bn stock of gilt and corporate bonds will be sold back into the market over several years. The impact this policy will have on the market pricing of gilts, while issuance is markedly increasing, is an unknown at the time of writing.

4. THE ECONOMY AND INTEREST RATES

4.1. The UK economy has endured several false dawns through 2021/22, but with most of the economy now opened up and nearly back to business-as-usual, the GDP numbers have been robust (9% y/y Q1 2022) and sufficient for the MPC to focus on tackling the second-round effects of inflation.

4.2. Gilt yields fell towards the back end of 2021 but, despite the war in Ukraine, gilt yields have shot higher in early 2022. These rises have been part of a global trend as central banks have suggested they will continue to raise interest rates to contain inflation.

4.3. Historically, a further rise in US Treasury yields will probably drag UK gilt yields higher. There is a strong correlation between the two factors. However, the squeeze on real household disposable incomes arising from the 54% leap in April 2022 utilities prices, as well as rises in council tax, water prices and many phone contract prices, are strong headwinds for any economy to deal with. In addition, from 1 April 2022, employees also pay 1.25% more in National Insurance tax. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

4.4. Average inflation targeting was the major change in 2020/21 adopted by the Bank of England in terms of implementing its inflation target of 2.0%. The key addition to the Bank's forward guidance in August 2020 was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2.0% target sustainably." That mantra now seems very dated. Inflation is a threat and a perfect storm of supply side shortages, labour shortages, commodity price inflation, the impact of Russia's invasion of Ukraine and subsequent Western sanctions all point to inflation being at elevated levels until well into 2023.

4.5. Until recent years, global growth has been boosted by increasing globalisation, i.e., countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for 18% of total world GDP (the USA accounts for 24%), and Russia's recent invasion of Ukraine, has unbalanced the world economy.

4.6. In addition, after the pandemic exposed how frail extended supply lines were around the world, it is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China (and to a much lesser extent Russia) to supply products and vice versa. This is likely to reduce world growth rates.

5. BACKGROUND

5.1. The Local Government Act 2003 ("the Act") 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.

6. FINANCIAL IMPLICATIONS

6.1. Financial implications are 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 Act to monitor its borrowing and investment activities.

7.2. Legal implications verified by Michael Carson, Principal Solicitor Employment, Criminal and Commercial Litigation.

8. BACKGROUND PAPERS

Full Council Report

Treasury Management Strategy Statement 2021/22, including Prudential Indicators and Statutory Borrowing Determinations: 3 March 2021.

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

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Limits and exposures as at 31st March 2022 **Appendix 1**

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)	Interest Rate (%)
UK Local Authorities	£100m per Local Authority; £500m in aggregate	3 years	Cardiff Council	8.0	1.80
			Dudley Metropolitan Borough Council	10.0	1.70
DMO Deposits	Unlimited	6 months	DMADF	30.0	0.05
			DMADF	30.0	0.03
			DMADF	30.0	0.26
			DMADF	20.0	0.55
Money Market Funds	£70m per fund. £300m in aggregate.	Three day notice	Aberdeen Sterling Liquidity Fund	26.0	
			JP Morgan Sterling Liquidity Fund	45.5	
UK Banks (A-/A3/A)	£50m	3 years	Goldman Sachs International	20.0	0.34
			Goldman Sachs International	20.0	0.65

	£50m	3 years	National Westminster Bank	20.0	0.36
			National Westminster Bank	20.0	0.62
			National Westminster Bank	10.0	0.82
	£50m	3 years	Santander UK Bank	20.0	0.20
			Santander UK Bank	10.0	0.20
	£50m	3 years	Standard Chartered Bank	30.0	0.50
			Standard Chartered Bank	20.0	0.38
Non-UK Banks (AA-/Aa2/ AA-)	£50m	5 years	Toronto Dominion Bank	20.0	0.75
			Toronto Dominion Bank	20.0	0.40
			Toronto Dominion Bank	10.0	0.86
Non-UK Banks (A/A2/A)	£35m	3 years	Australia and New Zealand Banking Group	30.0	0.93
			Australia and New Zealand Banking Group	5.0	0.86
TOTAL				**454.5**	**0.51**