City of Westminster

Decision Maker:	Audit and Performance Committee
Date:	24 October 2023
Classification:	General Release
Title:	Treasury Management Strategy Mid-Year Review 2023-24
Wards Affected:	All
Policy Context:	To manage the Council’s finances prudently and efficiently
Cabinet Member:	Cabinet Member for Finance and Council Reform
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:	Gerald Almeroth, Executive Director for Finance and Resources
Report Author:	Kelly Martin, Treasury Manager

1. EXECUTIVE SUMMARY

1.1. The purpose of this report is to:

- Update Members on the delivery of the 2023/24 Treasury Management Strategy approved by Council on 8 March 2023; and

- Approve the recommendations in paragraph 2.1.

1.2. Treasury management comprises:

- 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. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensures this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially, before considering optimising investment return.

- Managing the City Council's borrowing to ensure funding of the Council's future capital programme is at optimal cost. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

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 2023/24 to include the treasury position as at 30 September 2023;

- A review of the Council's borrowing strategy for 2023/24;

- A review of compliance with Treasury and Prudential Limits for the first six months of 2023/24; and

- An economic update for the first part of the 2023/24 financial year.

1.4. 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 strategy mid-year review 2023/24.

3. TREASURY POSITION AS AT 30 SEPTEMBER 2023

3.1. As at 30 September 2023, the net cash position was £576.5m, an increase of £138.8m on the position at 31 March 2023 as shown below:

	30 September 2023 (£m)	31 March 2023 (£m)
Total Borrowing	(599.8)	(400.1)
Total Cash Invested	1,176.3	837.8
Net Cash Invested	**576.5**	**437.7**

3.2. The increase of £138.8m reflects the forecast pattern of the Council's cashflows and is mainly dependant on the timing of precept payments, receipt of grants, council tax and business rates, and progress on the capital expenditure programme.

Investments

3.3. The Council's Annual Investment Strategy, which forms part of the annual Treasury Management Strategy Statement (TMSS) for 2023/24, was approved by the Council on 8 March 2023. 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 with comparisons for the previous financial year end.

	Investment Balance 30 September 2023 (£m)	Investment Balance 31 March 2023 (£m)	Movement (£m)
Money Market Funds	276.6	188.3	88.3
Term Deposits	408.1	649.5	-241.4
UK Government Treasury Bills	491.6	0.0	491.6
Total:	**1,176.3**	**837.8**	**338.5**

3.5. Despite a need to appropriately manage short term liquidity needs, there are attractive opportunities in the current economic climate for investments of up to 12 months in financial institutions with high credit ratings.

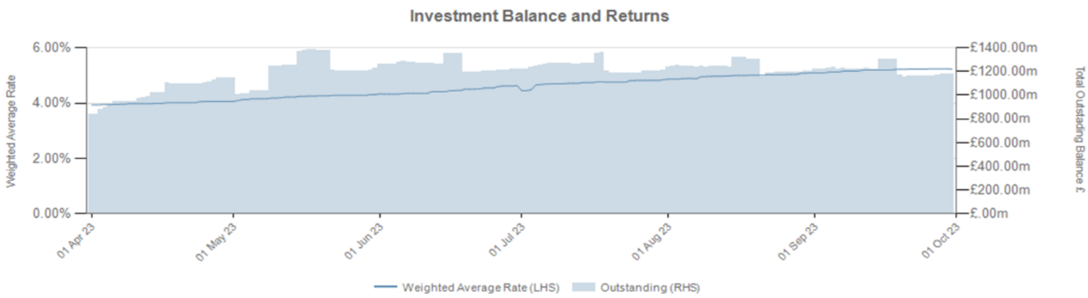
3.6. Liquid balances are managed through Money Market Funds, providing same day liquidity. Cash has been invested in alternative and less liquid instruments, particularly term deposits and UK Government Treasury Bills. The average level of funds available for investment in the first six months of 2023/24 was £1,196.0m.

3.7. The table below provides a more detailed breakdown of the Council's treasury investment position and interest rate generated as at 30 September 2023.

	Investment Balance (£m)	Interest Rate (%)
Money Market Funds	276.6	5.29
UK Banks	80.0	5.31
Non UK Banks	75.0	4.99
UK Government	639.7	5.26
Local Authorities	105.0	5.03
Total:	**1,176.3**	**5.23**

3.8. The shaded area in the chart below shows the daily investment balance from 1 April 2023 to 30 September 2023. The line shows the weighted average return of the investment portfolio, which has increased throughout the first half of 2023/24. The daily investment balance is shown by the grey shaded area. This balance rises and falls over each month but follows a general upwards trend over the period.

3.9. Daily investment balances have increased from £837.8m at 1 April 2023 to £1,176.3m at 30 September 2023. Investment returns which had been lower during 2022/23, have increased steadily during 2023/24 and the Council's average return on the portfolio as at 30 September 2023 was 5.23%



3.10. In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The August 2023 CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.

3.11. The Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures then "further tightening in policy would be required". Governor Bailey stated, "[the bank will] be watching closely to see if further increases are needed." The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long."

3.12. This narrative supports the Bank of England's objective in limiting the potential for the market to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could force it to raise rates at the next meeting on 2 November 2023, or pause in November 2023 and raise rates in December 2023.

3.13. Gilt yields and PWLB certainty rates rose throughout the first half of 2023/24. At the beginning of April 2023, the five-year rate was the cheapest part of the curve and touched 4.14% while the 25-year rate was relatively expensive at 4.58%. July 2023 saw short-dated rates peak at their most expensive. The one-year rate spiked to 6.36% and the five-year rate to 5.93%. Although, in due course, short-dated rate expectations fell, the medium dates shifted higher through August 2023 and the ten-year rate pushed higher to 5.51% and the 25-year rate to 5.73%. The 50-year rate was 4.27% on 5 April 2023 but rose to 5.45% on 28 September 2023.

3.14. Rates are forecast to fall back over the next two to three years as inflation dampens. The CPI measure of inflation is expected to fall below 2.0% in the second half of 2024, and 50-year rates to stand at 3.90% by the end of September 2025. However, there are still considerable gilt issuances to be digested by the market over the next couple of years, as a minimum, so there is a high degree of uncertainty as to whether rates will fall that far.

3.15. 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 2023/24 is £26.283m, and performance for the year is expected to be £18.668m above budget. Any additional interest earnings received will mitigate in-year budget pressures as outlined in the quarterly finance monitor as well as being used to support the delivery of the capital programme. The total portfolio weighted average yield performance for the first half of 2023/24 to 30 September 2023 was 4.61%.

	Budget £000	Forecast £000	Variance £000
Investment Income	26,283	44,951	18,668

3.16. Appendix 1 provides a full list of the Council's limits and exposures as at 30 September 2023.

Borrowing

3.17. 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 2023/24 unfinanced capital expenditure, and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.18. At £599.8m, the Council's borrowing was well within the Prudential Indicator for external borrowing, namely, that borrowing should not exceed the CFR for 2023/24 of £1,310m.

3.19. During 2023/24, the Council maintained an under-borrowed position of £698m. This meant that the capital borrowing need (the CFR) was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim funding measure. These reserves are expected to remain part of the Council's balance sheet throughout the remainder of 2023/24.

3.20. The table below shows the details around the Council's external borrowing as at 30 September 2023, split between the General Fund and the Housing Revenue Account (HRA).

Borrowing	30 September 2023 (£m)	31 March 2023 (£m)
HRA	175.6	175.6
General Fund	424.2	224.5
Total Borrowing	**599.8**	**400.1**

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

	Loan Balance 30 September 2023 (£m)	Loan Balance 31 March 2023 (£m)	Movement (£m)
PWLB	130.6	130.6	0.0
LOBO	70.0	70.0	0.0
Private Placement	399.2	199.5	199.7
Total:	**599.8**	**400.1**	**199.7**

3.22. During 2023/24, the Council repaid £0.357m of private placement annuity loans using investment balances. The final advance from the forward borrowing loan portfolio was received in May 2023. This consisted of £200m from Rothesay Life Plc.

3.23. In addition to the above, the Council also received two scheme specific loans to help fund a range of energy efficiency measures. One was the Mayor of London's Energy Efficiency Fund (MEEF), managed by Amber Fund Management Limited, which provided the Council with a £12m loan to finance new electric refuse collection vehicles and charging infrastructure. The other was the partnership with Abundance Investment, where the Council raised £1m from the public and local residents to help finance energy efficiency projects and carbon reduction measures on Council owned buildings.

3.24. The capital programme is being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour. The Council's borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long term.

Forward Borrowing

3.25. As anticipated in the 2023/24 TMSS, the Council took no additional general and council wide 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 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.

3.26. Due to the overall financial position and the underlying need to borrow for capital purposes, it is prudent for the Council to continually monitor its borrowing options.

3.27. 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. The loans for 2022 and 2023 have all been received and are included in the borrowing figures detailed above.

3.28. 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**	

4. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

4.1. During the financial year to 30 September 2023, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS approved by Council on 8 March 2023 as set out below.

4.2. It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the half year ended 30 September 2023, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023. The Executive Director of Finance and Resources reports that no difficulties are envisaged for the current or future years in complying with these indicators.

PI Ref		2023/24 Indicator	2023/24 Forecast
1	Capital expenditure	£438m	£603m
2	Capital Financing Requirement (CFR)	£1,310m	£1,285m
3	Net debt vs CFR	£723m underborrowing	£698m underborrowing
4	Ratio of financing costs to revenue stream	GF 12.24% HRA 34.59%	GF 38.13% HRA 38.99%
5a	Authorised limit for external debt	£1,359m	£1,336m
5b	Operational debt boundary	£636m	£638m
6	Working Capital Balance	£0m	£0m
7	Limit on surplus funds invested for more than 364 days (i.e. non specified investments)	£450m	£0m
8	Maturity structure of borrowing	Upper limit under 12 months: 40% Lower limit 10 years and above: 35%	Upper limit under 12 months: 4% Lower limit 10 years and above: 75%

Capital expenditure and borrowing limits

4.3. The capital expenditure forecast to 31 March 2024 totals £603m for both the General Fund and the HRA. The initial capital expenditure budget at the time of the approval of the annual Treasury Management Strategy Statement 2023/24 was £438m.

4.4. The long-term capital investment plan is underpinned by the Council's policy objectives. Capital proposals are considered within the Council's overall medium to long-term priorities, and the preparation of the capital programme is an integral part of the financial planning process. This includes taking account of the revenue implications of the projects as part of the revenue budget setting process.

4.5. The Council continues to set aside additional revenue funding each year to cover the financing costs of the programme in accordance with previously stated plans. Earmarked reserves are also maintained to support the financing of the capital programme and provide a sustainable approach to funding through the Medium Term Financial Plan.

4.6. 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 if the planned capital programme required new borrowing to be raised over the medium term, interest rates were deemed favourable and 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.

4.7. 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 2023 was within the limits set and does not highlight any significant issues.

Actual Maturity at 30 September 2023	Duration	Upper Limit	Lower Limit
4	Under 12 Months	40	0
1	12 Months and within 24 Months	35	0
5	24 Months and within 5 Years	35	0
15	5 Years and within 10 Years	50	0
75	10 Years and Above	100	35

4.8. The Council is not subject to any adverse movement in interest rates in its current loans portfolio as it only holds fixed interest borrowing.

4.9. The average rate on the fixed interest borrowing is 3.09% with an average redemption period of 21 years. This reflects the historical legacy of borrowing taken out some years ago. Debt rescheduling opportunities have become more common in the current economic climate. No debt rescheduling has been undertaken to date in the current financial year. Debt rescheduling opportunities have increased over the course of the past six months and will be considered if giving rise to long-term savings. However, no debt rescheduling has been undertaken to date in the current financial year.

4.10. 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

4.11. Investment in non-specified investments at £0m does not break into the limit of £450.0m for such investments. This reflects the fact that 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 £0m.

4.12. 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 generates from its investments.

5. THE ECONOMY AND INTEREST RATES

5.1. The first half of 2023/24 saw:

- Interest rates rise by a further 100bps, taking the Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
- Short, medium and long-dated gilts remain elevated as inflation remains persistent.
- A 0.5% month on month (m/m) decline in real GDP in July 2023, mainly due to more strikes.
- CPI inflation falling from 8.7% in April 2023 to 6.7% in August 2023, its lowest rate since February 2022, but still the highest in the G7.
- Core CPI inflation declining to 6.2% in August 2023 from 7.1% in April 2023 and May 2023, a then 31 years high.
- A cooling in labour market conditions, but no evidence that it has led to an easing in wage growth (as the three-month year on year growth of average earnings rose to 7.8% in August 2023, excluding bonuses).

5.2. The 0.5% m/m fall in GDP in July 2023 suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July 2023 was due to there being almost twice as many working days lost to strikes in July 2023 (281,000) than in June 2023 (160,000). However, with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.

5.3. The fall in the composite Purchasing Managers Index from 48.6 in August 2023 to 46.8 in September 2023 left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% quarter on quarter rise in real GDP in the period April 2023 to June 2023, being followed by a contraction of up to 1% in the second half of 2023.

5.4. The 0.4% m/m rebound in retail sales volumes in August 2023 is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July 2023. Sales volumes in August 2023 were 0.2% below their level in May 2023, suggesting much of the resilience in retail activity in the first half of the year has faded.

5.5. As the growing drag from higher interest rates intensifies over the next six months, it is forecast that the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has so far succeeded in weathering the cost-of-living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. It is expected the Bank of England will keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.

5.6. The tightness of the labour market continued to ease, with employment in the three months to July 2023 falling by 207,000. The further decline in the number of job vacancies from 1.017m in July 2023 to 0.989m in August 2023 suggests that the labour market has loosened a bit further since July 2023. That is the first time it has fallen below 1m since July 2021. At 3.0% in July 2023, and likely to have fallen to 2.9% in August 2023, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July 2023 offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July 2023 as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.

5.7. But the cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June 2023 to -0.9% in July 2023, a lot of that was due to the one-off bonus payments for NHS staff in June 2023 not being repeated in July. The headline three-month year on year rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July 2023, from 8.2% three-month year on year in June 2023 to 8.1% three-month year on year, it is still well above the Bank of England's prediction for it to fall to 6.9% in September 2023.

5.8. CPI inflation declined from 6.8% in July 2023 to 6.7% in August 2023, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the inflationary increases since March 2023 and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July 2023 to a 29-month low of 1.5% in August 2023, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March 2023 and takes it below the forecast of 7.2% the Bank of England published in early August 2023.

6. BACKGROUND

6.1. The Local Government Act 2003 ("the Act") and the Local Authorities (Capital Financing and Accounting) (England) Regulations 2003 require the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. These are contained within this report.

7. FINANCIAL IMPLICATIONS

7.1. Financial implications are contained in the body of this report.

8. LEGAL IMPLICATIONS

8.1. The legislation above 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 monior its borrowing and investment activities.

9. BACKGROUND PAPERS

Full Council Report

Treasury Management – Annual Strategy for 2023/24, including Prudential Indicators and Statutory Borrowing Determinations – 8 March 2023.

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 30 September 2023 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	Bradford Borough Council	15.0	4.58
			Central Bedfordshire Council	20.0	5.50
			East Ayrshire Council	10.0	4.55
			London Borough of Lambeth	20.0	4.65
			Suffolk County Council	10.0	5.64
			Suffolk County Council	10.0	5.65
			Worcestershire County Council	10.0	4.00
			Wrexham County Council	10.0	5.85
Money Market Funds	£70m per fund. £300m in aggregate.	Three day notice	Aberdeen Sterling Liquidity Fund	67.2	
			Federated Sterling Liquidity Fund	70.0	
			JP Morgan Sterling Liquidity Fund	69.4	
			Morgan Stanley Sterling Liquidity Fund	70.0	
UK Government	Unlimited	Unlimited	Debt Management Office	8.1	5.17
			Debt Management Office	20.0	5.20
			Debt Management Office	50.0	5.24
			Debt Management Office	70.0	5.32
			Treasury Bill	29.3	4.52
			Treasury Bill	29.3	4.74
			Treasury Bill	29.3	4.76
			Treasury Bill	29.3	4.77
			Treasury Bill	39.1	4.80
			Treasury Bill	39.0	5.12
			Treasury Bill	39.0	5.22
			Treasury Bill	39.5	5.44
			Treasury Bill	39.5	5.52
			Treasury Bill	38.9	5.59
			Treasury Bill	38.9	5.62
			Treasury Bill	22.7	5.63
			Treasury Bill	38.9	5.72
			Treasury Bill	38.9	5.72
UK Banks (A-/A3/A)	£50m	3 years	Goldman Sachs International	25.0	5.85
			National Westminster Bank	20.0	4.25
				10.0	4.45
			Santander UK Plc	25.0	5.95

			Svenska Handelsbanken	25.0	4.21
Non-UK Banks (AA-/Aa2/ AA-)	£50m	5 years	Toronto Dominion Bank	10.0	4.50
				25.0	6.15
Non-UK Banks (A/A2/A)	£35m	3 years	Australia & New Zealand Banking Group	15.0	4.69
TOTAL				**1,176.3**	**5.24**