

## London Borough of Hammersmith and Fulham

**Report to:** Cabinet

**Date:** 3 February 2020

**Subject:** Treasury Management Strategy Mid-Year Review Report 2019/20

**Report of:** Cabinet Member for Finance and Commercial Services – Councillor Max Schmid

**Responsible Director:** Hitesh Jolapara - Strategic Director of Finance and Governance

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### Summary

This report provides an update on the delivery (six-month point to 30 September 2019) of the 2019/20 Treasury Management Strategy approved by Council on 27 February 2019 and presents the Treasury Management Strategy 2019-20 mid-year review. Treasury management comprises of managing the Council's borrowing to ensure that funding of the Council's future capital programme is at optimal cost and investing surplus cash balances arising from the day-to-day operations of the Council to obtain an optimal return, while ensuring security and liquidity.

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

- a review of the Council's investment portfolio for 2019/20 to include the treasury position as at 30 September 2019;
- a review of the Council's borrowing strategy for 2019/20;
- a review of compliance with Treasury and Prudential Limits for the first six months of 2019/20;
- an economic update for the first part of the 2019/20 financial year.

### Recommendations

The Committee is asked to note the Treasury Management Strategy 2019/20 mid-year review.

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**Wards Affected:** All

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## H&F Priorities

<b>Our Priorities</b>	<b>Summary of how this report aligns to the H&amp;F Priorities</b>
<ul style="list-style-type: none"><li>• Building shared prosperity</li></ul>	Achieve best value for money in investment and borrowing decisions.
<ul style="list-style-type: none"><li>• Being ruthlessly financially efficient</li></ul>	Effective management of the Council's cash flow resources.

## Financial Impact

This report is wholly of a financial nature.

## Legal Implications

There are no legal implications arising from this report.

Implications verified by: Rhian Davies, Assistant Director of Legal and Democratic Services

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## Background Papers Used in Preparing This Report

<b>No.</b>	<b>Description of Background Papers</b>	<b>Name/Ext of holder of file/copy</b>	<b>Department/ Location</b>
	Treasury Management Strategy Statement 2019/20	Phil Triggs	Tri-Borough Treasury and Pensions

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## 1. TREASURY POSITION AS AT 30 SEPTEMBER 2019

- 1.1 As at 30 September 2019, net cash invested was £135m, an increase of £22m on the position at 31 March 2019 as shown below:

	30 September 2019	31 March 2019	31 March 2018
	£m	£m	£m
Total borrowing	213	213	217
Total cash invested	(348)	(326)	(339)
<b>Net cash invested</b>	<b>(135)</b>	<b>(113)</b>	<b>(122)</b>

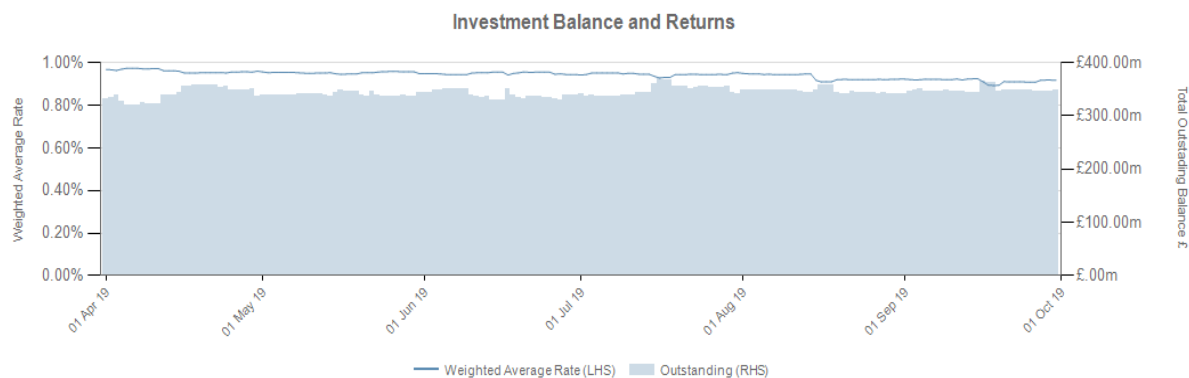
- 1.2 The increase in net cash reflects the forecast pattern of the Council's cash flows and largely relates to the timing of grants, council tax and business rates received.

### Investments

- 1.3 The Council's Annual Investment Strategy, which forms part of the annual Treasury Management Strategy Statement (TMSS) for 2019/20, was approved by the Council on the 27 February 2019. The Council's policy objective is the prudent investment of cash 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.
- 1.4 The table below provides a breakdown of investments at 30 September 2019, together with comparisons for the previous two financial year ends.

	30 September 2019	31 March 2019	31 March 2018
	£m	£m	£m
Money Market Funds	102	58	84
Call Accounts	0	0	0
Notice Accounts	56	56	70
Term Deposits	190	212	115
Bonds	0	0	30
Enhanced Cash Funds	0	0	40
<b>Total cash invested</b>	<b>348</b>	<b>326</b>	<b>339</b>

- 1.5 Liquidity is managed using Money Market Funds, providing same day liquidity. The average level of funds available for investment in the first six months of 2019/20 was £344m.
- 1.6 Monthly investment balances have varied from a high of £348m in July 2019 to a low of £339m in June 2019 as shown on the shaded area in the chart below. Average returns have decreased from 0.96% in April 2019 to 0.91% in September 2019 as shown by the solid line in the chart.



1.6 All investments complied with the Annual Investment Strategy.

1.7 Appendix 1 provides a full list of the Council's investment limits and exposures as at 30 September 2019.

## 2. Borrowing

2.1 At 30 September 2019, the Council's long-term borrowing amounted to £213m and was well within the Prudential Indicator for external borrowing, namely that borrowing should not exceed the Capital Financing Requirement<sup>1</sup> (CFR) for 2019/20 of £338m<sup>2</sup>.

2.2 Currently, the Council is internally borrowed by £125m as a result of the internal cash resources to fund capital expenditure.

2.3 The TMSS 2019/20 stated that 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 Council's resources available for internal borrowing are expected to reduce as capital spending intensifies, the Council needs to maintain flexibility to borrow at opportune moments in line with the Prudential indicators.

2.4 The table below shows the Council's external borrowing as at 30 September 2019, split between the General Fund and HRA.

External borrowing	30 September 2019		31 March 2019	
	Balance	Rate	Balance	Rate
	£m	%	£m	%
General Fund	36	4.77	36	4.77
HRA	177	4.77	177	4.77
<b>Total borrowing</b>	<b>213</b>	<b>4.77</b>	<b>213</b>	<b>4.77</b>

<sup>1</sup> The CFR measures the Council's underlying need to borrow for capital purposes.

<sup>2</sup> CFR figure based on Capital Programme Monitor & Budget Variations Q2 2019/20 Report

2.5 No new borrowing was undertaken in the first half of 2019/20.

### 3. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

3.1 During the financial year to 30 September 2019, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS and Budget approved by Council on 27 February 2019 as set out below.

PI ref	Indicator	2019/20 indicator	2019/20 forecast	Indicator met?
1	Capital Expenditure	£121m	£115m	Met
2	Capital Financing Requirement (CFR)	£359m	£338m	Met
3	Net debt vs CFR	£156m under-borrowing	£125m under-borrowed	Met
4	Ratio of financing costs to revenue stream	GF 0.65% HRA 32.25%	GF 0.65% HRA 32.25%	Met
5a	Authorised limit for external debt	£400m	£213m	Met
5b	Operational debt boundary	£340m	£213m	Met
6	Working capital balance	£0m	£0m	Met
8c	Limit on surplus funds invested for more than 364 days (i.e. non-specified investments)	£120m	£7m	Met
9	Maturity structure of borrowing	Upper limit under 12 months - 15% Lower limit 10 years and above - 100%	Upper limit under 12 months - 5% Lower limit 10 years and above - 71%	Met Met

#### Capital expenditure and borrowing limits

3.2 Capital expenditure is forecast to be £114.65m for 2019/20.

3.3 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 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.

3.4 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 2019 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 2019 (%)
Under 12 months	15	0	5
12 months and within 24 months	15	0	5
24 months and within 5 years	60	0	4
5 years and within 10 years	75	0	15
10 years and above	100	0	71

3.5 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 5.1 shows that the Council is not subject to any adverse movement in interest rates as it only holds fixed interest borrowing.

3.6 The average rate on the fixed interest borrowing is 4.77% with an average redemption period of 21 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 the premiums for early redemption are prohibitively high, making this option poor value for money.

### Investment limits

3.7 Specified investments are limited to a maximum maturity of less than one year. Non-specified investments have a maturity of one year and over. Currently, all investments are specified.

3.8 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 possibly marginally lower credit ratings is likely to increase the yield of the investment portfolio.

## THE ECONOMY AND INTEREST RATES

4.1 The Monetary Policy Committee (MPC) has left the Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its meeting on 1 August 2019, the MPC became more dovish as it was more concerned about the outlook for both the global and domestic economies. That is shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise

at a “gradual pace and to a limited extent” is now also conditional on “some recovery in global growth”. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. Inflation (CPI) has been hovering around the Bank of England’s target of 2% during 2019 and is likely to shift only a little upwards over the rest of 2019/20. It does not therefore pose any immediate concern to the MPC at the current time.

- 4.2 The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August 2019, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. This mirrored investor confidence around the world which is now expecting a significant downturn or possibly even a recession in some developed economies.
- 4.3 If the UK does achieve an agreed deal on Brexit, then it is possible that growth could recover quickly. The MPC would then need to address the issue of whether to raise the Bank Rate when there is very little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there is a no deal Brexit and there is a significant level of disruption to the economy, then growth could falter and the MPC would be likely to cut Bank Rate in order to support growth. However, with the Bank Rate still only at 0.75%, it has relatively little room to make a meaningful impact and the MPC would probably suggest that it would be up to the Chancellor to provide additional help to support growth by way of a fiscal boost, including tax cuts and / or expenditure on infrastructure projects, to boost the economy.
- 4.4 Despite the contraction in GDP growth of -0.2% in quarter 2, employment rose by 115,000 in the same quarter: this suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Unemployment has continued near to a 44-year low, edging up from 3.8% to 3.9% on the Independent Labour Organisation measure in June 2019; however, that was caused by a rise in the participation rate to an all-time high. Job vacancies fell for a sixth consecutive month, hitting record levels, and indicating that employers are having major difficulties filling job vacancies with suitable staff.
- 4.5 It was therefore unsurprising that wage inflation picked up to a high point of 3.9% (3-month average regular pay, excluding bonuses). This meant that, in real terms (i.e. wage rates higher than CPI inflation) earnings grew by about 1.8%. As 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 could mean that the MPC will need to take action to raise the Bank Rate if there is an agreed Brexit deal as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.
- 4.6 On 9 October, the Treasury announced an additional 1% margin to be applied to PWLB interest rates for new loan advances. This will increase the cost of any future borrowing by the Council from the PWLB and the Council may consider other lenders should borrowing be required.

#### **4. PRUDENTIAL INDICATORS**

- 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. Reasons for Decision**

- 6.1 This report presents the Council's mid-year Treasury Management Strategy half-year review for 2019/20 in accordance with the Council's Treasury Management Practices. It is a regulatory requirement for this report to be presented to the Council.
- 6.2 The Council has, within its Constitution, nominated the Audit, Pensions and Standards Committee to be responsible for the effective scrutiny of the Treasury Management Strategy and policies.
- 6.2 The report notes that the Council has complied with all elements of the Treasury Management Strategy Statement (TMSS).

#### **7. Equality Implications**

- 7.1 The report is for noting so there are no equality implications for groups with protected characteristics (under the Equality Act 2010) as a result of this report.
- 7.2 Implications verified by Fawad Bhatti, Public Services Reform, tel. 07500 103617.

#### **8. Risk Management Implications**

- 8.1 Treasury Management contributes to all the Council Values and Delivery of Objectives. Management of treasury risks are commensurate to the risk appetite of the Council. The effective understanding, control and management of the many aspects of risk associated with treasury management are essential to achieving an authority's objectives. Risk management is therefore embedded throughout treasury guidance, policies and practices. In adopting a policy of managing risk, an authority is determining its level of risk acceptance.
- 8.2 Treasury risks present themselves in many forms, from failure to optimise performance by not taking advantage of opportunities, to managing exposure to changing economic circumstances, most recently the situation has been somewhat uncertain due to negotiations over the UK's departure from the European Union.
- 8.3 The key challenge is to understand, identify, monitor and manage risks in a planned and effective way. Local authorities are required to report annually to full council on their treasury management strategy (TMS) before the start of



the year, which sets the objectives and boundaries for the approach to treasury activity.

- 8.4 The authority supplements this with treasury management practice schedules (TMPs), which set out the practical arrangement to achieve those objectives. The TMPs inform the day-to-day practices applied to manage and control treasury activities. Local authorities are typically financially risk averse and greatly value stability in order to form council tax and housing rent levels, through to general fund and HRA budgets.
- 8.5 Implications verified by: Michael Sloniowski, Risk Manager, tel. 0208 753 2587.

## **9. Other Implications**

- 9.1 The Council's borrowing and investment activity presented to 30 September 2019. The capital programme represents significant expenditure within the Borough and, consequently, where supplies are sourced locally, changes in borrowing or investment may impact either positively or negatively on local contractors and sub-contractors. Where capital expenditure increases, or is brought forward, this may have a beneficial impact on local businesses; conversely, where expenditure decreases, or is slipped, there may be an adverse impact on local businesses.
- 9.2 Implications verified/completed by: Albena Karameros, Economic Development Team, tel. 07739 316 957.

## **10. Consultation**

- 10.1 Consultation took place with the Council's investment advisor, Link Asset Services, in respect of the Economic and Interest Rate update.

### **List of Appendices:**

Appendix 1: Investment Limits and Exposures at 30 September 2019.

**Limits and exposures as at 30 September 2019**

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)
UK Local Authorities	£30m per local authority; £200m in aggregate	3 years	London Borough of Sutton	7.5
			Dudley Metropolitan Borough Council	10.0
			Canterbury City Council	10.0
			London Borough of Croydon	30.0
			London Borough of Enfield	10.0
			Swale Borough Council	5.0
			Falkirk Council	5.0
			Cheshire West and Chester Council	7.0
			Stockport Metropolitan Borough Council	10.0
			Fife Council	10.0
			London Borough of Southwark	10.0
			Rotherham Metropolitan Borough Council	25.0
			North Tyneside Metropolitan Borough Council	5.0
			Blackpool Council	25.0
Money Market Funds	£30m per fund. £200m Total	Up to three day notice	GS Sterling Liquid Reserve Institutional Inc	3.8
			BlackRock ICS Institutional Sterling Liquidity Heritage Dis	3.7
			Insight Liquidity Sterling C5	0.1
			Federated Prime Rate Sterling Liquidity 3	30.0
			Aberdeen Sterling Fund Flexible Income F130 Fund	24.6
			BNP Paribas InstiCash GBP I Dis GBP	11.0
			Morg Stnly Sterling Liquidity Inst	29.2
UK Banks (A-/A3/A-)	£50m	3 years	Lloyds Bank	25.0
			Goldman Sachs Intl Bank	20.0
UK Banks (AA-/Aa3/ AA-) or UK Government ownership greater than 25%	£70m	5 years	National Westminster Bank	1.0
Non-UK Banks (AA-/Aa2/ AA-)	£50m	3 years	Svenska Handelsbanken	30.0
<b>Total</b>				<b>347.9</b>