London Borough of Hammersmith & Fulham CABINET 14 JANUARY 2019	
TREASURY MANAGEMENT STRATEGY MID-YEAR REVIEW REPORT 2018/19	
Report of the Cabinet Member for Finance and Commercial Services: Councillor Max Schmid	
Open Report	
Classification – For decision **Key Decision: Yes**	
Consultation	
Wards Affected: ALL	
Accountable Director: Hitesh Jolapara, Strategic Director of Finance and Governance Phil Triggs, Director of Treasury and Pensions	
Report Author: Phil Triggs, Director of Treasury and Pensions	**Contact Details:** Tel: 0207 641 4136 E-mail: ptriggs@westminster.gov.uk

1. EXECUTIVE SUMMARY

1.1. The purpose of this report is to:

- update Members on the delivery (six-month point to 30 September 2018) of the 2018/19 Treasury Management Strategy approved by Council on 5 February 2018; and

- note the Annual Treasury Management Strategy 2018-19 mid-year review.

1.2. Treasury management comprises:

- managing the 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 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).

2. RECOMMENDATIONS

2.1. To note the Annual Treasury Management Strategy 2018/19 mid-year review.

3. REASONS FOR DECISION

3.1. This report presents the Council's mid-year Treasury Management Strategy half-year review for 2018/19 in accordance with the Council's Treasury Management Practices. It is a regulatory requirement for this report to be presented to the Council.

4. TREASURY POSITION AS AT 30 SEPTEMBER 2018

4.1. As at 30 September 2018, net cash invested was £94m, a decrease of £28m on the position at 31 March 2018 as shown below:

	30 September 2018 £m	31 March 2018 £m	31 March 2017 £m
Total borrowing	217	217	225
Total cash invested	(311)	(339)	(327)
Net cash invested	**(94)**	**(122)**	**(102)**

4.2. The decrease 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

4.3. 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 the 5 February 2018. 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.

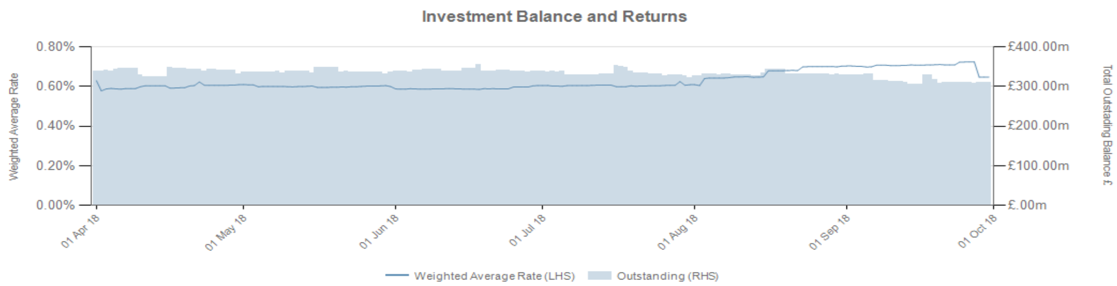
4.4. The table below provides a breakdown of investments, together with comparisons for the previous two financial year ends.

	30 September 2018 £m	31 March 2018 £m	31 March 2017 £m
Money Market Funds	65	84	38
Call Accounts	2	0	3
Notice Accounts	50	70	33
Term Deposits	82	115	45
Bonds	52	30	208
Enhanced Cash Funds	60	40	0
Total cash invested	**311**	**339**	**327**

4.5. Liquidity is managed through the use of Call Accounts and Money Market Funds providing same day liquidity. The average level of funds available for investment in the first six months of 2018/19 was £334m.

4.6. Daily investment balances have varied from a high of £352m in mid-July 2018 to a low of £307m in mid-September 2018 as shown on the shaded area in the chart below.

4.7. The Enhanced Cash Funds (ECF) average return as at 30 September 2018 is approximately 0.35%. Portfolio wide average returns have increased from 0.63% to 0.65% as shown by the solid line in the chart.



4.8. There are two non-specified one-year fixed term deposits with the London Borough of Sutton (£7.5m at 1% in January 2018) and Dudley Metropolitan Borough Council (£10m at 1.25% in March 2018) where the interest will be paid on maturity, with the remainder of the investments being specified. All investments complied with the Annual Investment Strategy.

4.9. Appendix 1 provides a full list of the Council's investment limits and exposures as at 30 September 2018.

Borrowing

4.10. At 30 September 2018, the Council's long-term borrowing amounted to £217m and was well within the Prudential Indicator for external borrowing, namely that borrowing should not exceed the Capital Financing Requirement[1] (CFR) for 2018/19 of £305m.

4.11. Currently the Council is internally borrowed by £60m because it has used internal resources to fund capital expenditure.

4.12. The TMSS for 2018/19 stated the Council had no immediate requirement to undertake new borrowing due to the high level of cash holdings. However, 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).

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

External borrowing	30 September 2018		31 March 2018	
	Balance	Rate	Balance	Rate
	£m	%	£m	%
General Fund	37	4.86	37	4.86
HRA	180	4.86	180	4.86
Total borrowing	**217**	**4.86**	**217**	**4.86**

4.14. No new borrowing was undertaken in the first half of 2018/19.

5. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

5.1. During the financial year to 30 September 2018, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS and Budget approved by Council on 5 February 2018 as set out below.

[1] The CFR measures the Council's underlying need to borrow for capital purposes.

PI ref	Indicator	2018/19 indicator	2018/19 actual	Indicator met?
1	Net financing need	£113m	£98m	Met
2	Capital Financing Requirement (CFR)	£322m	£305m	Met
3	Net debt vs CFR	£109m underborrowing	£88m underborrowed	Met
4	Ratio of financing costs to revenue stream	GF 0.14% HRA 29.25%	GF 0.14% HRA 29.25%	Met
5	Impact of new capital investment decisions on housing rents	£0.00 decrease in average rent per week	£0.00 decrease in average rent per week	Met
6a	Authorised limit for external debt	£345m	£217m	Met
6b	Operational debt boundary	£290m	£217m	Met
6c	HRA debt limit	£255m	£255m removed October 2018	Met
7	Working capital balance	£0m	£0m	Met
8a	Upper limit for fixed interest rate borrowing	£120m	£17.5m	Met
8b	Upper limit for variable rate borrowing	£0m	£0m	Met
8c	Limit on surplus funds invested	£120m	£17.5m	Met
9	Maturity structure of borrowing	Upper limit under 12 months - 15% Lower limit 10 years and above - 100%	Upper limit under 12 months - 15% Lower limit 10 years and above - 100%	Met Met

Capital expenditure and borrowing limits

5.2. Capital expenditure to 30 September 2018 was £29.850m for both the General Fund and the HRA against a latest forecast for the whole year of £91.342m.

5.3. 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. As a result of the significant level of cash balances, it is deemed unlikely that any new borrowing will be required in the foreseeable future.

5.4. 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 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	15	0	2
12 months and within 24 months	15	0	4
24 months and within 5 years	60	0	7
5 years and within 10 years	75	0	14
10 years and above	100	0	73

5.5. 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.

5.6. The average rate on the fixed interest borrowing is 4.86% with an average redemption period of 22 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.

Investment limits

5.7. Specified investments are limited to a maximum maturity of less than one year. Non–specified investment have a maturity of one year and over. Investments in non-specified investments are currently at £17.5 million within the limit of £120m. Officers continue to seek appropriate longer-term investment opportunities.

5.8. 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.

6. THE ECONOMY AND INTEREST RATES

6.1. 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 (9-0) vote to increase the Bank Rate on 2 August 2018 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.

6.2. Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value against both the US dollar and the euro. The Consumer Price Index (CPI) measure of inflation dropped to 2.4% in September 2018 due to increases in volatile components, and 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 the Bank Rate for the second half of 2019.

6.3. 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 the 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.

6.4. There is a degree of uncertainty surrounding the UK's departure from the European Union. Depending on the outcome, 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 weaker pound and concerns around inflation picking up.

7. PRUDENTIAL INDICATORS

7.1. 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.

8. EQUALITY IMPLICATIONS

8.1. The report is for noting so there are no equality implications as a result of this report.

8.2. Implications completed by Peter Smith, Head of Policy & Strategy, tel. 020 8753 2206.

9. LEGAL IMPLICATIONS

9.1. There are no legal implications arising from this report.

9.2. Implications completed by: Rhian Davies, Assistant Director of Legal and Democratic Services, tel 020 8753 2729.

10. FINANCIAL IMPLICATIONS

10.1. This report is wholly of a financial nature.

10.2. Implications verified by Emily Hill – Assistant Director (Corporate Finance), tel. 020 873 3145.

11. IMPLICATIONS FOR BUSINESS

11.1 The Council's borrowing and investment activity is presented to 30 September 2018. This 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.

11.2 Implications verified/completed by: Albena Karameros, Economic Development Team, tel. 07739 316 957.

12. RISK MANAGEMENT

12.1. 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.

12.2. 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 is somewhat uncertain due to this Government's negotiations over the UK's departure from the European Union as expressed in paragraph 6.5 of this report. In adopting a policy of managing risk, an authority is determining its level of risk acceptance.

12.3. 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.

12.4. 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.

12.5. Implications verified by: Michael Sloniowski, Risk Manager, tel. 0208 753 2587.

13. COMMERCIAL IMPLICATIONS

13.1. There are no procurement implications arising from this report.

13.2. Implications verified/completed by: Andra Ulianov, Procurement consultant, tel. 020 8753 2284.

14. IT IMPLICATIONS

14.1. There are no IT implications arising from this report.

14.2. Implications verified/completed by: Tina Akpogheneta, Interim Head of Strategy and Strategic Relationship Manager, te. 020 8753 5748.

15. BACKGROUND PAPERS USED IN PREPARING THIS REPORT

No.	Description of Background Papers	Name/Ext of holder of file/copy	Department/ Location
	Treasury Management Strategy Statement 2018/19 - *published*	Phil Triggs	Shared Services Treasury and Pensions

LIST OF APPENDICES:

Appendix 1: Investment Limits and Exposures at 30 September 2018.

Appendix 1

Limits and exposures as at 30 September 2018

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)
UK Government (Gilts/T- Bills/Repos)	Unlimited	Unlimited	UK Government Treasury Bill	19.3
			UK Government Treasury Bill	5.8
			UK Government Treasury Bill	20.0
			UK Government Treasury Bill	6.8
Rated UK Building Societies (A-/A3/A)	£30m	3 years	Coventry Building Society	20.0
UK Local Authorities	£20m per local authority; £100m in aggregate	3 years	Fife Council	5.0
			London Borough of Sutton	7.5
			Stockport Metropolitan Borough Council	20.0
			Dudley Metropolitan Borough Council	10.0
Money Market Funds	£30m per fund. £200m Total	Up to three day notice	Federated Sterling Liquidity Fund	30.0
			Morgan Stanley Liqiudity 3	30.0
			BlackRock ICS Institutional Liquidity Hertitage Dis	4.7
Enhanced Cash Funds	£20m per fund. £60m in total	Up to seven day notice	Payden & Rygel Sterling Reserve	19.9
			Royal London Asset Mgmt Cash Plus	20.0
			Federated Prime Rate Cash Plus	20.0
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	1.8
Non-UK Banks (AA-/ Aa2/ AA-)	£50m	3 years	Svenska Handelsbanken	25.0
Total				**310.8**