London Borough of Hammersmith and Fulham

Report to: Audit and Pensions Committee

Date: 1 December 2020

Subject: TREASURY MANAGEMENT STRATEGY: MID-YEAR REVIEW REPORT 2020/21

Report of: Phil Triggs, Director of Treasury and Pensions

Summary

This report provides an update on the implementation (six-month point to 30 September 2020) of the 2020/21 Treasury Management Strategy approved by Council on 26 February 2020 and presents the Treasury Management Strategy 2020/21 mid-year review. Treasury management comprises the management of 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 financial operation of the Council to obtain an optimal return, while ensuring security of capital 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 2020/21 to include the treasury position as at 30 September 2020;
- a review of the Council's borrowing strategy for 2020/21;
- a review of compliance with Treasury and Prudential Limits for the first six months of 2020/21;
- an economic update for the first part of the 2020/21 financial year.

Recommendations

The Committee is asked to note the Treasury Management Strategy 2020/21 mid-year review.

Wards Affected: All

H&F Priorities

Our Priorities	Summary of how this report aligns to the H&F Priorities
• Building shared prosperity	Achieve best value for money in investment and borrowing decisions.
• Being ruthlessly financially efficient	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: Janette Mullins Chief Solicitor (litigation)

Contact Officer(s):

Name: Sophie Green
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Verified by Emily Hill, Director of Finance

Name: Janette Mullins
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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 2020/21	Phil Triggs	Tri-Borough Treasury and Pensions

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1. TREASURY POSITION AS AT 30 SEPTEMBER 2020

1.1 As at 30 September 2020, net cash invested was £40.3m, an increase of £6.3m on the position at 31 March 2020 as shown below:

	30-Sep-20 £m	31-Mar-20 £m	31-Mar-19 £m
Total borrowing	283.1	243.1	213.0
Total cash invested	(242.8)	(209.1)	(326.0)
Net cash invested	**40.3**	**34.0**	**(113.0)**

Investments

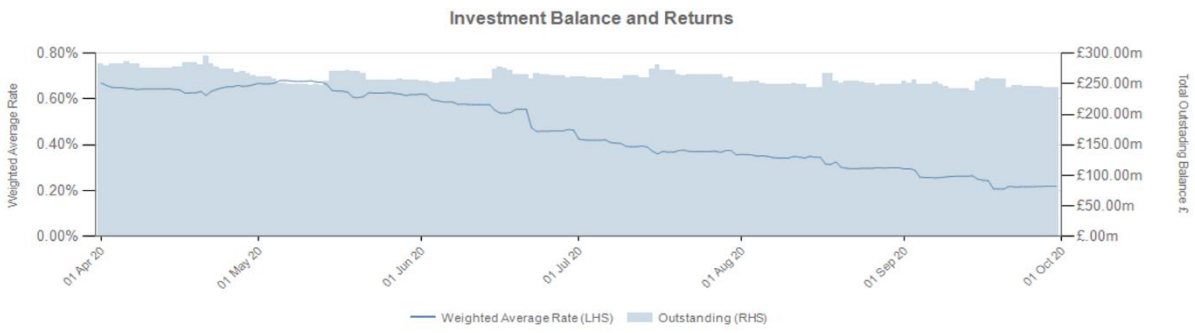
1.2 The Council's Annual Investment Strategy, which forms part of the annual Treasury Management Strategy Statement (TMSS) for 2020/21, was approved by the Council on 26 February 2020. The Council's policy objective is the prudent investment of cash balances to achieve optimum returns on investments, subject to maintaining adequate security of capital and a level of liquidity appropriate to the Council's projected need for funds over time.

1.3 The table below provides a breakdown of investments at 30 September 2020,

	30-Sep-20 £m	31-Mar-20 £m	31-Mar-19 £m
Money Market Funds	185.8	47.1	58.0
Call Accounts	25.0	25.0	0.0
Notice Accounts	0.0	0.0	56.0
Term Deposits	32.0	137.0	212.0
Bonds	0.0	0.0	0.0
Enhanced Cash Funds	0.0	0.0	0.0
Total cash invested	**242.8**	**209.1**	**326.0**

together with comparisons for the previous two financial year ends.

1.4 Liquidity is managed using Money Market Funds (MMFs), providing same day liquidity. The average level of funds available for investment in the first six months of 2020/21 was £263.3m. The Council has chosen to increase the allocation in MMFs during the year to ensure liquidity throughout the COVID-19 pandemic and as a response to the reduced interest rates achievable from term deposits. This is reflective of the wider market where interest rates on investments and borrowings have fallen in the first half of 2020/21 due to the pandemic. 1.5 Monthly investment balances have varied from a high of £278.3m in April 2020 to a low of £248.2m in September 2020 as shown on the shaded area in the chart below. Average returns have decreased from 0.70% in April 2020 to 0.20% in September 2020 as shown by the solid line in the following 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 2020.

2. Borrowing

2.1 At 30 September 2020, the Council's long-term borrowing amounted to £283.1m and was well within the Prudential Indicator for external borrowing, namely that borrowing should not exceed the Capital Financing Requirement[1] (CFR) for 2020/21 of £389.5m[2].

2.2 Currently, the Council is internally borrowed by £106.4m as a result of the internal cash resources to fund capital expenditure.

2.3 The TMSS 2020/21 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

External borrowing	30-Sep-20		31-Mar-20	
	Balance	Rate	Balance	Rate
	£m	%	£m	%
General Fund	54.7	3.7	54.7	3.7
HRA	228.4	3.8	188.4	4.3
Total borrowing	**283.1**	**3.8**	**243.1**	**4.0**

2020 split between the General Fund and HRA.

2.5 Two £20.0m HRA loans were taken out in the first half of 2020/21. The loans were taken out at interest rates of 1.26% and 1.25%, driving the average interest rate down by 0.2% from 31 March 2020.

[1] The CFR measures the Council's underlying need to borrow for capital purposes.
[2] CFR figure based on Capital Programme Monitor & Budget Variations Q2 2019/20 Report

3. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

3.1 During the six months of the financial year to 30 September 2020, the Council operated within the Treasury Limits and Prudential Indicators set out in the TMSS and Budget approved by Council on 26 February 2020 as set out below.

PI ref	Indicator	2020/21 indicator	2020/21 forecast	Indicator met?
1	Capital Expenditure	£103.0m	£100.6m	Met
2	Capital Financing Requirement (CFR)	£402.0m	£389.5m	Met
3	Net debt vs CFR	£95.0m under-borrowing	£106.4m under-borrowing	Met
4	Ratio of financing costs to revenue stream	GF 1.8% HRA 28.9%	GF (0.9%) HRA 6.1%	Met
5a	Authorised limit for external debt	£400.0m	£283.1m	Met
5b	Operational debt boundary	£340.0m	£283.1m	Met
6	Working capital balance	£0.0m	£0.0m	Met
8c	Limit on surplus funds invested for more than 364 days (i.e. non-specified investments)	£120.0m	£0.0m	Met
9	Maturity structure of borrowing	Upper limit under 12 months - 15.0% Lower limit 10 years and above - 100.0%	Upper limit under 12 months - 3.0% Lower limit 10 years and above - 78.8%	Met Met

apital expenditure and borrowing limits

3.2

3.3 orrowing

- he 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 is a disproportionate level of loans maturing. The table below shows that the maturity structure of the Council's borrowing as at 30

September 2020 is within the limits set and does not highlight any significant issues.

Maturity structure of borrowing	Upper Limit (%)	Lower Limit (%)	Actual as at 30 September 2020 (%)
Under 12 months	15.0	0.0	4.0
12 months and within 24 months	15.0	0.0	0.0
24 months and within 5 years	60.0	0.0	7.1
5 years and within 10 years	75.0	0.0	7.6
10 years and above	100.0	0.0	81.4

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 3.8% with an average redemption period of 24 years. This reflects the historical legacy of borrowing taken out some years ago which is higher than PWLB interest rates for comparable loans if they were taken out now. Officers have considered loan refinancing but the premia 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.

4. THE ECONOMY AND INTEREST RATES

This report is the mid-year review for 2020/21 and therefore reflect the economic backdrop at 30 September 2020. Any developments since that date will be reflected in the treasury management outturn report.

4.1 As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 16 September 2020. It also kept unchanged the level of quantitative easing at £745.0bn. Its forecasts were optimistic in terms of two areas:

- The fall in GDP in the first half of 2020 was revised from -28.0% to -23.0% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected

as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.

- It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2.0% target in Q3 2022 (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation is still projected to be above 2.0% in 2023.

4.2 It also does not see a place for using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be "less effective as a tool to stimulate the economy" at this time when banks are worried about future loan losses. It also has "other instruments available", including further application of QE and the use of forward guidance.

4.3 The MPC expected the £300.0bn of quantitative easing purchases announced between its March 2020 and June 2020 meetings to continue until the "turn of the year". This implies that the pace of purchases will slow further to about £4.0bn a week, down from £14.0bn a week at the height of the crisis and £7.0bn more recently.

4.4 In conclusion, this would indicate that the Bank could now wait and observe, as the economy was recovering better than expected. However, the MPC acknowledged that the "medium-term projections were a less informative guide than usual" and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term. The second wave of the virus is now impacting many countries, including Britain. In addition, uncertainties ahead of the exit from the EU's year-end deadline are likely to be a drag on recovery.

4.5 Overall, the pace of recovery is not expected to be in the form of a rapid V-shape, but a more elongated and prolonged one after a sharp recovery in June 2020 through to August 2020 which left the economy 11.7% smaller than in February 2020. The last three months of 2020 are now likely to show no growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be additional QE.

4.6 There will be some painful longer-term adjustments as office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

4.7 One key addition to the Bank's forward guidance is 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". In other words, even if inflation rises to 2.0% in a couple of years' time, we should not expect any action from the MPC to raise the Bank Rate, until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate

4.8 The Financial Policy Committee (FPC) report on 6 August 2020 revised down their expected credit losses for the banking sector to "somewhat less than £80.0bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15.0%.

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 and Pensions 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, 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 Trade following the UK's departure from the European Union and the impact of Covid-19 on the global economy.

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 inform 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 local economy in H&F is likely to contract between 7 and 13% based on projections from Oxford Economics, the Council's ability to continue with major projects will be crucial to support wider recovery efforts. 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: Kamal Motalib, 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 2020.

Appendix 1
Limits and exposures as at 30 September 2020

Category	Limit per Counterparty (£m)	Duration Limit	Counterparty Name	Current Exposure (£m)
Money Market Funds	£30m per fund. £200m Total	Up to three day notice	GS Sterling Liquid Reserve Institutional Inc	5.8
			BlackRock ICS Institutional Sterling Liquidity Heritage Dis	30.0
			Insight Liquidity Sterling C5	30.0
			Federated Prime Rate Sterling Liquidity 3	30.0
			Morg Stnly Sterling Liquidity Inst	30.0
			Aberdeen Sterling Fund Flexible Income F130 Fund	30.0
			BNP Paribas InstiCash GBP I Dis GBP	30.0
Total Money Market Fund				**185.8**
UK Banks (A-/A3/A-)	£50m	3 years	Lloyds Bank	25.0
Total Notice Accounts				**25.0**
UK Local Authorities	£30m per local authority; £200m in aggregate	3 years	Cheshire West and Chester Council	7.0
			London Borough of Hackney	5.0
			Canterbury City Council	5.0
			Thurrock Borough Council	15.0
Total Term Deposits				**32.0**
Total cash invested				**242.8**