

Date of Leadership Team meeting, Lead Member meeting or (in the case of individual Lead Member decisions) the earliest date the decision will be taken	Leadership Team - 13 January 2021 Forward Plan ref: (05798/21/K/A) Leadership Team Portfolio: Lead Member for Finance and Modernisation	 THE ROYAL BOROUGH OF KENSINGTON AND CHELSEA
Report title (decision subject)	TREASURY MANAGEMENT STRATEGY MID-YEAR REVIEW 2020/21	
Reporting officer	Mike Curtis, Executive Director of Resources	
Key decision	Yes	
Access to information classification	Public	

1 EXECUTIVE SUMMARY

- 1.1 The purpose of this report is to update members on the delivery of the Treasury Management Strategy Statement 2020/21 (TMSS) approved by Council on 4 March 2020.
- 1.2 The Council's borrowing position as at 30 September 2020 remains the same from the start of the year while investments have reduced by £46m and the yield earned on these has also reduced. Since the onset of COVID-19, the Council has kept new investments within the short term to cover cashflow liquidity needs and invest with only highly rated or UK Government backed institutions.

2 RECOMMENDATIONS

- 2.1 The Leadership Team is asked to recommend:
- That the Council approve and adopt the Treasury Management Strategy Mid-Year Review 2020/21.

3 REASONS FOR DECISION

- 3.1 To comply with the Local Government Act 2003, other regulations and guidance and to ensure that the Council's borrowing and investment plans are prudent, affordable and sustainable, and comply with statutory and Code of Practice requirements.

3.2 There are no changes proposed to the 2020/21 strategy and therefore this report is providing an update on the strategy approved by Full Council on 4 March 2020. Officers have begun undertaking a more detailed review of the Council’s treasury management strategy to investigate whether the Council may be able to optimise the return on its investments through exploring alternative investment opportunities that will be commensurate with proper levels of security and liquidity and within the Council’s risk parameters. Officers also expect to borrow Public Work Loans Board (PWLB) loans for the Housing Revenue Account (HRA) during this financial year.

4 BACKGROUND

4.1 Treasury management comprises:

- Managing the Council’s borrowing to ensure funding of the Council’s current and future capital programmes 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.

4.2 This report covers the following:

- A review of the Council’s borrowing strategy for 2020/21;
- A review of the Council’s investment portfolio for 2020/21;
- The economy and interest rates; and
- A review of compliance with Treasury Prudential Code indicators for 2020/21.

Treasury Position as at 30 September 2020

4.3 As at 30 September 2020, net cash balance was borrowing of £66.0m, a reduction of £45.9m on the position as at 31 March 2020 as shown below:

	30 September 2020 £’m	31 March 2020 £’m
Total borrowing	(263.8)	(263.8)
Total investments	197.8	243.7
Net Investments	(66.0)	(20.1)

4.4 The reduction in cash is mainly due to the Council’s reduction in Business Rate (NNDR) income collection in year as a result of the government’s COVID-19 restrictions and the rates relief offered to businesses impacted during the pandemic.

5 ANNUAL TREASURY STRATEGY UPDATE

Borrowing

- 5.1 At £263.8m, the Council's borrowing portfolio was comfortably within the Prudential Indicator limit for external borrowing, namely that borrowing should not exceed the capital financing requirement (CFR¹) for 2020/21 of £567.7m.
- 5.2 The table below shows the current borrowing levels versus the CFR at 30 September 2020:

2020/21 (£'M)	Capital Financing Requirement (CFR)	External Borrowing	Internal Borrowing
General Fund	356.4	125.0	231.4
HRA	211.3	138.8	72.5
	567.7	263.8	303.9

- 5.3 The Housing Revenue Account's (HRA) under borrowed position at £72.5m is funded internally by the General Fund, which receives interest from the HRA at PWLB three-month variable interest rates. The forecast interest receipt to the General Fund for 2020/21 is £0.62m. As the under borrowing is funded at a market rate, this is impacted by movements in interest rates.
- 5.4 The PWLB new loan rate for HRA housing was reduced on 12 March 2020 with the government's introduction of the housing revenue account certainty rate (HRA) rate. Currently, this rate is the relevant UK Gilt rate plus 80 basis points (BPS). There has not been significant volatility in PWLB rates since the start of the financial year. At 30 September 2020, the 50-year PWLB certainty rate for new long-term borrowing was at 2.60%.
- 5.5 The Council has an increasing capital financing requirement (CFR) and officers continue to monitor long term interest rates for suitable borrowing opportunities. The Council is planning new borrowing of £20m for the HRA during this financial year.
- 5.6 As part of the Treasury Management Strategy, the Council sets a number of treasury prudential limits for borrowing:
- The Capital Financing Requirement;
 - The Authorised Limit which is the expected maximum borrowing statutory limit with some built-in headroom for unexpected movements; and
 - The Operational Boundary which is the expected normal upper requirement of the capital programme were it to be fully funded by borrowing.

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

Compliance with Prudential Indicators

- 5.7 During the financial year to 30 Sep 2020, the Council has operated within the Prudential Indicators set out in the Treasury Management Strategy and in compliance with the Council's Treasury Management Practices. The Prudential Indicators and compliance with them are shown below:

Indicator	2020-21 indicator	2020-21 Expected Actual	Indicator Met
Capital Financing Requirement	£567.7m	£482.1m	Met
Net debt vs CFR	£303.9m under-borrowing	£209.9m under-borrowed	Met
Authorised Limit for External Debt	£415.0m	£415.0m	Met
Operational Debt Boundary	£395.0m	£395.0m	Met
Upper limit for fixed interest rate borrowing	100%	100%	Met
Upper limit for Variable Rate Debt	50%	0	Met
Limit on surplus funds invested for more than 364 days (i.e. non-specified investments)	0	0	Met
Maturity Structure of Borrowing	Upper limit under 12 months – 10%	6%	Met
	Lower limit 10 years and above – 30%	77%	Met

Capital expenditure and borrowing limits

- 5.8 The Capital Programme monitoring is reported on a quarterly basis. The latest position was reported to Leadership Team in December and the position at quarter 2. The current budget figure for capital spend in 2020/21 is £162.532m and this latest forecast was that £141.428m of capital investment will be delivered in 2020/21, meaning a further variance of £21.104m which will be re-phased into future years.

Investments

- 5.9 The Council's Investment Strategy, which forms part of the Treasury Management Strategy Statement (TMSS) for 2020/21, sets out the Council's policy for prioritising security and liquidity of its investments over the requirement for yield. The risk appetite of this Council is low in order to give priority to security of its investments.

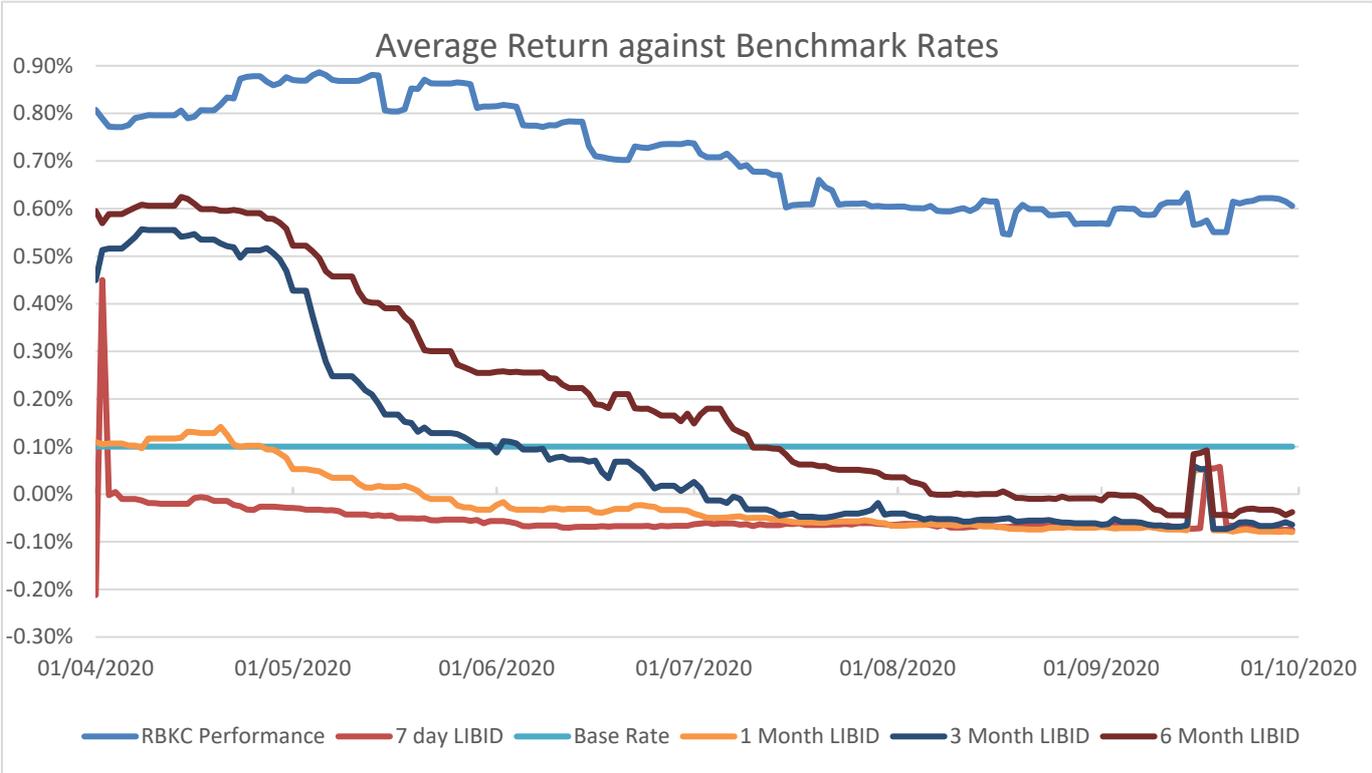
- 5.10 While the Bank of England has said it is unlikely to introduce a negative Bank Rate, at least in the next six to 12 months, some deposit accounts are already offering negative rates for shorter periods. Money market fund yields have continued to drift lower. Inter-local authority lending and borrowing rates have also declined due to large grant receipts received from the Government, leading to a surge in the level of local authority cash seeking a short-term home.
- 5.11 In the current economic climate, it is considered appropriate to keep investments short term and only invest with highly rated or UK Government backed institutions.
- 5.12 The average level of cash available for investment during the half year was £231.3m and the investment portfolio yielded 0.71% at 30 September 2020, analysed as follows:

Quarter Ended	Balance £m	Weighted Average Rate %	Average 7- Day Rate %
31 March 2020	243.7	0.88%	0.43%
30 June 2020	221.7	0.74%	-0.04%
30 September 2020	197.8	0.61%	-0.06%
Average 1 April - 30 September 2020	231.3	0.71%	-0.05%

- 5.13 As illustrated, the council outperformed the benchmark by 76 bps. The Council's budgeted investment return for the year on external investments is £1.60m. Investment income for the year to 30 September 2020 is £0.74m, with £1.06m interest projected to earn for the whole of 2020/21.
- 5.14 The table below provides a breakdown of the fund investments as at 30 September 2020, together with comparisons for the last financial year end.

Counterparty Type	Investment Type	30 September 2020 £m	31 March 2020 £m
Money Market Funds	Money Market Fund	75.3	58.2
Banks	Fixed Deposit	40.0	70.0
Local Authorities	Fixed Deposit	82.5	115.5
		197.8	243.7

5.15 The chart below shows the Council’s weighted average return of its investment portfolio from 1 April 2020 to 30 September 2020 compared with various benchmark rates. The return reduced from 0.80% at 1 April 2020 to 0.61% at 30 September 2020.



5.16 The Bank of England’s Monetary Policy Committee (MPC) reduced the base rate to 0.10% on 19 March 2020. Current Debt Management Office (DMO) rates are zero for deposits placed for less than three weeks, increasing to 0.01% for deposits placed for six months. One-month Treasury Bills have traded around -0.01%.

5.17 The counterparty criteria agreed in the 2020/21 TMSS are shown in Appendix 1.

6 THE ECONOMY AND INTEREST RATES

6.1 UK Gross Domestic Product (GDP) contracted by 20.4% from April to June 2020. However, it grew by 6.6% in July 2020 as lockdown measures eased. Future recovery will be dampened by the localised restrictions and lockdown imposed by the Government as a result of continuing outbreaks of the COVID-19 virus.

6.2 It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above 2% target in Q3 2022, which is based on market interest rate expectations for a further loosening in policy. Nevertheless, even if the Bank were to leave policy unchanged, inflation was still forecast to be above 2% in 2023.

- 6.3 The September 2020 the Monetary Policy Committee (MPC) kept the base rate unchanged at 0.10%. Forward guidance indicated that the Bank of England didn't favour negative rates. The base rate is projected to remain at the current level until March 2023.
- 6.4 Public Work Loan Board (PWLB) rates are offered at a fixed margin over prevailing gilt yields. At spring 2020 budget, the Government announced a new, discounted rate to support social housing. The value of the discount is 1% below the standard rate at which a local authority usually borrows from the PWLB.
- 6.5 Long term borrowing rates remain stable following the recent reduction in PWLB HRA rates. The rate forecasts up to March 2023 shows that 50-year PWLB rates moving between 2.40% and 2.70%.

7 OPTIONS AND ANALYSIS

- 7.1 The Leadership Team could choose to recommend the Council approve and adopt the Treasury Management Strategy Mid-Year Review 2020/21.
- 7.2 The Leadership Team could choose not to recommend the Council approve and adopt the Treasury Management Strategy Mid-Year Review 2020/21 and ask Officers to review the content of this report or the current year's TMSS.

8 LEGAL IMPLICATIONS

- 8.1 The Local Government Act 2003 provides that a local authority has the power both to borrow and invest money for any purpose relevant to its functions and for the prudent management of its financial affairs. The Act requires the Council to determine and to keep under review how much money it can afford to borrow. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended, provide that, in complying with this duty, the Council must have regard to the Prudential Code for Capital Finance in Local Authorities published by CIPFA.

Mike Curtis
Executive Director of Resources

Background papers: CIPFA Code of Practice on Treasury Management for the Public Sector
 CLG Guidance on Local Government Investments

Contact Officer Xing Rong Treasury Manager E-mail: xrong@westminster.gov.uk

Cleared by Finance (officer's initials)	TE
Cleared by <u>Corporate</u> Finance (officer's initials)	TE
Cleared by Director of Legal Services (officer's initials)	JG
Cleared by Communications & Community Engagement (officer's initials)	NP

Maximum Investment Amounts

Investment Instruments

Institution Type	Minimum Credit Rating Required (S&P / Moody's / Fitch)	Investment Limit	Maximum Period
Debt Management Office (DMO)	UK Government rating	Unlimited	6 months
UK Government (Gilts/Treasury Bills/Repos)	UK Government rating	Unlimited	5 years
Supranational Banks, European Agencies	LT: AAA/Aaa/AAA or Government backed	£50 million in total	3 years
Network Rail	Government Guarantee	£50 million	5 years
TfL	LT: AA-/Aa3/AA-	£50 million	2 years
UK Local Authorities meeting the Council's local authority lending criteria	N/A	Maximum of 50% of portfolio £10 million per authority	1 year
Partially nationalised banks and building societies in the UK or in highly credit rated countries	Outside of UK Sovereign Rating AAA	£10 million per institution	1 year
Banks and building societies (Deposit/Certificate of Deposit/Short Dated Bonds)	LT: AA+/Aa1/AA+ or above	£25 million per institution	5 years
	LT: AA-/Aa3/AA- or above	£15 million per institution	3 years
	LT: A/A2/A or above All subject to minimum short term ratings of F1	£10 million per institution	1 year
Money Market Funds	LT: AAA By at least one of the credit agencies	£30 million per institution £150 million in total	Up to 7 days' notice
LSR Vehicle	Addition	Addition	

- a) No differentiation is made between UK and overseas banks. However a limit will be placed on the total amount that can be deposited with all counterparties in any one country outside the United Kingdom as follows:

AAA/Aaa/AAA	Maximum 15% of the total portfolio
AA+/Aa1/AA+	Maximum 10% of the total portfolio

The countries covered by these criteria are:

<u>AAA/Aaa/AAA</u>	<u>Aa+/Aa1/AA+</u>
Australia	Canada
Denmark	Finland
Germany	United States of America
Luxembourg	
Netherlands	
Norway	
Singapore	
Sweden	
Switzerland	

- b) Wholly owned subsidiaries of UK clearing banks would have half of the limit allocated to the parent bank. Lending to the group will not exceed the total limit to the parent bank.
- c) The table above provides limits for both specified and non-specified investments. These are categories of investments set out under section 15(1) of the Local Government Act 2003.

A specified investment is defined as an investment which satisfies all of the conditions below:

- i. The investment and any associated cash flows are denominated in sterling;
- ii. The investment has a maximum maturity of one year;
- iii. The investment is not defined as capital expenditure; and
- iv. The investment is made with a body or in an investment scheme of high credit quality; or with the UK Government, a UK Local Authority or a parish/community council.

A non-specified investment is any investment that does not meet all the conditions above and can be used after taking into account cash flow requirements, the outlook for short to medium term interest rates and the approval of the Executive Director of Resources as Section 151 Officer.