AUDIT COMMITTEE

Thursday, 30 January 2020 at 6.30 p.m.

C3 - Town Hall Mulberry Place

SUPPLEMENTAL AGENDA

This meeting is open to the public to attend.

Contact for further enquiries:
Farhana Zia, Democratic Services
1st Floor, Town Hall, Mulberry Place, 5 Clove Crescent, E14 2BG
Tel: 020 7364 0842
E-mail: farhana.zia@towerhamlets.gov.uk
Web: http://www.towerhamlets.gov.uk/committee

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AUDIT COMMITTEE (30th January 2019) & FULL COUNCIL (26th February 2019)	TOWER HAMLETS
Report of: Neville Murton, Corporate Director Resources	**Classification:** Unrestricted
Capital Strategy Report, Treasury Management Strategy Statement and Investment Strategy Report for 2020/21	

REASONS FOR URGENCY

There has been a significant delay in producing the 2018/19 accounts due to the complexities of resolving the issues identified by Deloittes that were reported to the July Audit Committee. This has led to a requirement to seek external validation of some key figures contained in the Treasury Management Strategy Statement and the Capital Strategy Report, such as the Minimum Revenue Provision. This, added to difficulties in staffing, has led to the report not being produced and published five clear working days of the meeting. The Policies need to be approved by this Audit Committee, before going to Council on the 20th February 2020, as the Policies need to be approved before the start of 2020/21financial year.

Executive summary

1) This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the MHCLG Guidance on Treasury Management.

2) The Council is required by legislation and guidance to produce three strategy statements in relation to its treasury management arrangements. The three statements are:

   a) a Treasury Management Strategy Statement which sets out the Council's strategy for the management of the Council's treasury investments and debt portfolio, including potential new borrowing, for the financial year and establishes the parameters (prudential and treasury indicators) within which officers under delegated authority may undertake such activities;

   b) an Investment Strategy which sets out the Council's service and commercial investments, its policies for managing existing investments and the governance/decision-making arrangements for new investments; and,

   c) a Capital Strategy Report which sets out an overview of how the Council's capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.

3) This report also covers the requirements of the 2017 Prudential Code, including setting of Prudential Indicators for 2020/21, which ensure that the Council's capital investment decisions remain affordable, sustainable and prudent. The Prudential Code also requires the production and approval of an annual Capital Strategy.

4) The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA TM Code) which requires the Authority to approve a treasury management strategy statement before the start of each financial year.

5) The Ministry of Housing, Communities and Local Government (MHCLG) issued revised Guidance on Local Authority Investments in February 2018 that requires the Authority to approve an investment strategy before the start of each financial year.

6) Clear delegated responsibility for overseeing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions is required. For this Council the delegated body is the Audit Committee. Officers will report details of the Council's treasury management activity to the Audit Committee at each of its meetings during the year. Additionally, a mid-year and full-year report will be presented to Full Council.

7) The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training will be arranged as required for members of the Audit Committee who are charged with reviewing and monitoring the Council's treasury management policies. The training of treasury management officers is also periodically reviewed and enhanced as appropriate.

Recommendations

It is recommended to Council to:

1) Approve and adopt the following policy and strategies:
    a) The Treasury Management Strategy Statement contained in Appendix A;
    b) The Investment Strategy contained in Appendix B;
    c) The Capital Strategy Report contained in Appendix C;
    d) the Prudential and Treasury Management indicators contained in Appendix D; and,
    e) the Treasury Management Policy Statement as set out in Appendix E.
2) Note that the Approved Limit for loans to local charities for service purposes of £0.6m was exceeded by £0.4m in 2019/20, as the approved limit did not consider a pre-existing loan to one charity, as set out in section 3.5 of the Investment Strategy, Appendix B. This limit has been suitably adjusted

1 REASONS FOR THE DECISIONS

1.1 The Council has adopted the relevant CIPFA Treasury Management and Prudential Codes, and follows the MHCLG Investment Guidance, as required to comply with the Local Government Act 2003. The guidance prescribes the production of three strategy documents, to be approved by the Council before the start of the financial year to which they relate.

1.2 The Prudential Code for Capital Finance in Local Authorities (2017) produced by CIPFA guides the Council in the production of a framework designed to ensure that the Council's capital expenditure and financing plans are prudent, sustainable and affordable

1.3 The Treasury Management in the Public Services: Code of Practice (2017) produced by CIPFA guides the Council in setting a risk management framework for the management of its surplus cash and new and existing borrowing.

1.4 The MHCLG Investment Guidance guides the Council in setting a decision-making, governance and risk management policy for its service and commercial investments.

1.5 The three strategy documents that the Council should produce are:

- Treasury Management Strategy, including prudential indicators
- Investment Strategy
- Capital Strategy.

2 ALTERNATIVE OPTIONS

2.1 The Council is bound by legislation to have regard to the CIPFA Codes and MHCLG Investment Guidance. If the Council were to deviate from those requirements, there would need to be some good reason for doing so. It is not considered that there is any such reason, having regard to the need to ensure that the Council's capital investment plans are affordable, sustainable and prudent, and its treasury management activity is managed within an adequate risk control framework.

3 DETAILS OF THE REPORT

3.1 Background to Treasury Management

3.2 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity primarily before considering investment return. A portion of the investment balance is invested on a long term basis to preserve purchasing power and generate higher returns to support the revenue budget.

3.3 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer term cash flow surpluses.

3.4 CIPFA defines treasury management as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.5 The Treasury Management Strategy Statement report forms part of an annual cycle of Committee and Council reports. The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

3.5.1 **A treasury management strategy statement** (Appendix A)

3.5.2 **A mid year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

3.5.3 **A treasury outturn report** – This provides details of annual actual prudential and treasury indicators and annual actual treasury operations compared to the annual estimates within the strategy.

3.6 The Council uses Arlingclose Limited as its external treasury management. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and officers will ensure that undue reliance is not placed upon the external service providers.

3.7 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members' responsible for scrutiny. Training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

3.8 **<u>The 2019/20 Strategy and Current Investment Position and Performance</u>**

3.9 The Strategy for 2019/20 was approved by Full Council in February 2019 and the Audit Committee recived a Treasury Management mid year review on 14th November 2019 which stated that:

a) The investment income budget for 2019/20 was £4m and is broadly on target:

b) From a benchmarking exercise, a total return of 1.6% was acheived for the reporting period, which was 0.46% above the average for similar Local Authorities return and 0.38% higher than the average return for all local authorities; and

c) the Prudential Indciators and Treasury Mangement indicators have been fully complied with.

3.10 **<u>Treasury Management Strategy</u>**

3.11 The Treasury Management Strategy Statement contained in Appendix A sets out the Council's proposed borrowing Strategy, in the context of the U.K.'s economic outlook, credit outlook and interest rate forecast as well as the local context of the requirement to borrow. Given the significant cuts to public expenditure and in particular to local government funding, the Authority's

borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

3.12 The Council is undertaking a review of its borrowing strategy as set out in the TMSS, following the Capital Programme Review and the revised strategy will be reported to the Audit Committee

3.13 The Authority has previously raised the majority of its long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it now a relatively expensive option. The Authority will now look to borrow any long-term loans from other sources including banks, pension funds and other local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

3.14 Alternatively, the Authority may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

3.15 Any decisions will be reported to the appropriate decision making body at the next available opportunity. Please note that the borrowing of monies purely to lend on and make a return is unlawful and the Council will not engage in such activity.

3.16 Where spend is financed through the creation of debt, the Council is required to pay off an element of the accumulated capital spend each year. The payment is made through a revenue charge (the minimum revenue provision - MRP) made against the Council's expenditure, although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP). The MRP policy is set out in the TMSS which is contained in Appendix A.

3.17 The Council has chosen to adopt a Voluntary Revenue Provision (VRP) to be charged to the HRA This is in line with risks under consideration, the impact, and potential impact, on the Council's overall fiscal sustainability.

3.18 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

3.19 The investment strategy has been developed using the principle that the Council will also achieve optimum return on its investments commensurate with proper levels of security and liquidity. The Council's strategy is that given the risk and very low returns from short-term unsecured bank investments, the Authority will seek to explore new opportunities for further diversification into more secure and/or higher yielding asset classes during 2020/21. The majority of the Authority's surplus cash remains invested in short-term unsecured bank deposits, money market funds and local authority deposits.

3.20 The proposed structure for selecting counterparties is set out in the TMSS. The methodology has been proposed by Arlingclose Limited and after review, is being proposed to the Council for adoption. The Council has not listed all of the counterparties that meet these criteria in an appendix, as these counterparties will naturally change over time. The Council, in conjunction with its treasury management advisor, Arlingclose, will use Fitch, Moodys and Standard and Poor's ratings to derive its credit criteria. The Council's treasury adviser alerts officers to changes in ratings of all agencies.

3.21 The Corporate Director, Resources, has delegated responsibility to add or withdraw institutions from the counterparty list when circumstances change, either as advised by Arlingclose Limited (the Council's advisors) or from another reliable market source.

3.22 **Investment Strategy Report 2020/21**

3.23 The Investment Strategy Report is contained in Appendix B. This strategy meets the requirement of the Guidance issued by Government in January 2018 and sets out the Council's Strategy in relation to supporting local public services by lending to or buying shares in other organisations and earning investment income other than investment returns in cash balance (commercial investments). Members should note that as set out in section 3.5, the approved limit for charities' loans of £0.6m was exceeded by £0.4m in 2019/20, as the total approved limit did not take into account a pre-existing loan to one charity.

3.24 **Capital Strategy**

3.25 The capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

3.26 Decisions made this year on capital and treasury management will have financial consequences for the Authority for many years into the future. They are, therefore, subject to both a national regulatory framework and to local policy framework, summarised in this report.

3.27 The Capital Strategy Report is contained in Appendix C. The Report sets out how the Capital Financing Requirement (CFR) for both the General Fund (GF) and the Housing Revenue Account (HRA) will change through to 2022/23, along with the Authorised Limit and the Operational Limit of borrowing and 10 Prudential Indictors (PIs). Any shortfall of resources results in a funding borrowing need.

3.28 **Other Treasury Management Issues**

3.29 To meet statutory requirements, clear delegated responsibility for overseeing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. For this Council the delegated body is the Audit Committee. Officers will report details of the Council's treasury management activity to the Audit Committee at each of its meetings during the year. Additionally, a mid-year and full-year report will be presented to Full Council. set out in Appendices F and G

3.30 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members' responsible for scrutiny. Training will be arranged as required and a training plan will be submitted to Audit Committee during 2020/21. The training needs of treasury management officers are periodically reviewed and form part of the annual learning and development plan for individual officers

4 EQUALITIES IMPLICATIONS

4.1 There are no equalities implications arising directly from this report

5 OTHER STATUTORY IMPLICATIONS

a. This section of the report is used to highlight further specific statutory implications that are either not covered in the main body of the report or are required to be highlighted to ensure decision makers give them proper consideration. Examples of other implications may be:

- Best Value Implications,
- Consultations,
- Environmental (including air quality),
- Risk Management,
- Crime Reduction,
- Safeguarding.
- Data Protection / Privacy Impact Assessment.

b. **Best Value Implications:** The Treasury Management Strategy, Capital Strategy and Investment Strategy and the arrangements put in place to monitor them should ensure that the Council optimises the use of its monetary resources within the constraints placed on the Council by statute, appropriate management of risk and operational requirements. Assessment of value for money is achieved through monitoring against benchmarks and operating within budget.

c. **Risk Management:** There is inevitably a degree of risk inherent in all treasury activity. The Investment Strategy identifies the risk associated with different classes of investment instruments and sets the parameters within which treasury activities can be undertaken and controls and processes appropriate for that risk. Treasury operations are undertaken by nominated officers within the parameters prescribed by the Treasury Management Policy Statement as approved by the Council. The Council is ultimately responsible for risk management in relation to its treasury activities. However, in determining the risk and appropriate controls to put in place the Council has obtained independent advice from Arlingclose whom specialise in Local Authority treasury issues.

6 COMMENTS OF THE CHIEF FINANCE OFFICER

6.1 As this report is totally financial in nature it contains the comments of the Chief Financial Officer throughout the report. It contains the three strategy statements in relation to its treasury management arrangements.

7 LEGAL COMMENTS

7.1 The Local Government Act 2003 ('the 2003 Act') provides a framework for the capital finance of local authorities. It provides a power to borrow and imposes a duty on local authorities to determine an affordable borrowing limit. It provides a power to invest. Fundamental to the operation of the scheme is an understanding that authorities will have regard to proper accounting practices recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) in carrying out capital finance functions.

7.2 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 ('the 2003 Regulations') require the Council to have regard to the CIPFA publication "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes" ("the Treasury Management Code") in carrying out capital finance functions under the 2003 Act. If after having regard to the Treasury Management Code the Council wished not to follow it, there would need to be some good reason for such deviation.

7.3 It is a key principle of the Treasury Management Code that an authority should put in place "comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities". Treasury management activities cover the management of the Council's investments and cash flows, its banking, money market and capital market transactions, the effective control of risks associated with those activities and the pursuit of optimum performance consistent with those risks. It is consistent with the key principles expressed in the Treasury Management Code for the Council to adopt the strategies and policies proposed in the report.

7.4 The report proposes that the treasury management strategy will incorporate prudential indicators. The 2003 Regulations also requires the Council to have regard to the CIPFA publication "Prudential Code for Capital Finance in Local Authorities" ("the Prudential Code") when carrying out its duty under the Act to determine an affordable borrowing limit. The Prudential Code specifies a minimum level of prudential indicators required to ensure affordability, sustainability and prudence. The report properly brings forward these matters for determination by the Council. If after having regard to the Prudential Code the Council wished not to follow it, there would need to be some good reason for such deviation.

7.5 The Local Government Act 2000 and regulations made under the Act provide that adoption of a plan or strategy for control of a local authority's borrowing, investments or capital expenditure, or for determining the authority's minimum revenue provision, is a matter that should not be the sole responsibility of the authority's executive and, accordingly, it is appropriate for the Cabinet to agree these matters and for them to then be considered by Council.

7.6 The report sets out the recommendations of the Corporate Director Resources in relation to the Council's minimum revenue provision, treasury management strategy and its annual investment strategy. The Corporate Director Resources has responsibility for overseeing the proper administration of the Council's financial affairs, as required by section 151 of the Local Government Act 1972 and is the appropriate officer to advise in relation to these matters.

7.7 When considering its approach to the treasury management matters set out in the report, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector equality duty).

Linked Reports, Appendices and Background Documents

Linked Report

- None

APPENDICES

Appendix A – Treasury Management Strategy Statement

Appendix B - Investment Strategy Report

Appendix C - Capital Strategy Report

Appendix D – Prudential and Treasury Indicators

Appendix E – Treasury Management Policy Statement

Appendix F – Treasury Management Scheme of Delegation

Appendix G – Treasury Management Reporting Arrangement

Appendix H – Glossary

Background Documents – Local Authorities (Executive Arrangements)(Access to Information)(England) Regulations 2012

- NONE

Officer contact details for documents:
N/A

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Treasury Management Strategy Statement 2020/21 **Appendix A**

1. Introduction

1.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management

1.2 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

1.3 Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

2 External Context

2.1 **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21. The General Election has removed some uncertainty within the market, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.

2.2 GDP growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

2.3 The headline rate of UK Consumer Price Inflation remained the same in November 2019 at 1.5% year-on-year, the same as October 2019, however continuing to fall from highs of 2.1% in July and April 2019 as accommodation services and transport

continued to contribute to a level of inflation below the Bank of England (BoE) target of 2%. Labour market data continues to be positive. The International Labour Organisation (ILO unemployment rate continues to hold at historic lows at 3.8%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.5% in November 2019 providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.9% in October 2019 and only likely to have a moderate impact on household spending.

2.4 Domestic inflationary pressures have abated, as domestic gas and electricity price freezes have taken effect until 2020. The price of oil has fallen through the year, despite a rise in prices in December 2019. The limited inflationary pressure from real wages will likely keep inflation below the Bank of England target of 2%. The Bank of England maintained Bank Rate to 0.75% in December following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

2.5 The US economy has continued to perform relatively well compared to other developed nations; however, the Federal Reserve has started to unwind its monetary tightening through 2019. The Federal Reserve has cut rates three times to 1.5% - 1.75%, to stimulate growth as GDP growth has started to fall (to 2.1%).

2.6 The fallout from the US-China trade war continues which, risks contributing to a slowdown in global economic activity in 2020. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change quickly. Slow growth in Europe, combined with changes in leadership at the ECB and IMF has led to a change of stance in 2019. Quantitative easing has continued and been extended.

2.7 **Credit outlook:** The recent Bank of England stress tests assessed all seven UK banking groups. The tests scenarios include deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis, combined with large falls in asset prices and a separate stress of misconduct costs. All seven banks passed relevant tests and a leverage ratio basis. Major banks have steadily increased their capital for many years now. However, there are a number of shortcomings in the Bank's approach; timeliness as the results are over 11 months of out date when they are published, being based on end-2018 balance

sheets; ringfencing, as the tests ignore the restrictions on transferring capital between ringfenced “retail” banks and non-ringfenced “investment” banks within the larger groups and; coverage – the tests should be expanded to cover a wider range of UK banks and building societies.

2.8 The Bank of England will seek to address some of these issues in 2020, when Virgin Money/Clydesdale will be added to the testing group and separate tests will be included of ringfenced banks.

2.9 Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffered adverse publicity and falling customer numbers.

2.10 Looking forward, the potential for a “no-deal” Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

2.11 **Interest rate forecast:** The Authority’s treasury management adviser Arlingclose is forecasting that Bank Base Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the recent general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

2.12 Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose’s interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

2.13 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix B1.

2.14 For the purposes of setting the Council’s budget and MTFS, it has been assumed that new treasury management investments will be made at an average rate of 1.60%.as per Appendix B2

3 Local Context

3.1 On 31st December 2019, the Authority held £73.293m of borrowing and £266m of treasury investments. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.19 Actual £m	**31.3.20 Estimate £m**	**31.3.21 Forecast £m**	**31.3.22 Forecast £m**	**31.3.23 Forecast £m**
General Fund CFR	288.415	337.783	388.083	422.283	415.083
HRA CFR	84.903	110.810	192.091	256.926	281.369
Total CFR	373.318	448.593	580.174	679.209	696.452
Less: Other debt liabilities *	(59.874)	(57.266)	(54.453)	(51.084)	(47.208)
Loans CFR	313.444	391.327	525.721	628.125	649.246
Less: External borrowing **	(73.293)	(72.288)	(72.288)	(72.288)	(72.288)
Internal borrowing	**240.151**	**319.039**	**453.433**	**555.837**	**576.958**
Less: Usable reserves	(521.642)	(444.826)	(356.100)	(307.693)	(307.693)
Less: Working capital	(98.900)	(98.900)	(98.900)	(98.900)	(98.900)
Treasury investments	**(380.391)**	**(224.687)**	**(1.567)**	**149.244**	**170.365**

* leases and PFI liabilities that form part of the Authority's total debt

** shows only loans to which the Authority is committed and excludes optional refinancing

3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.3 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2019/20.

4 Borrowing Strategy

4.1 The Authority currently holds £73.293million of loans, a decrease of £10 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority does not expect to need to borrow in 2020/21. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £555 million.

4.2 **Objectives:** The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

4.3 **Strategy:** The Authority's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Authority therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75% and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%). There are a number of factors that the Council needs to take into accounts when setting its borrowing strategy.

4.4 The Council is significantly increasing its capital expenditure over the next 3 years; the draft capital programme is £702m over the next 3 financial years. This programme is partly funded by borrowing of £112m in the GF for 2020/21 – 2022/23 and £182m in the HRA for the same period. The rest of the programme is being funded by other sources including payments from developers (CIL and Section 106), capital receipts and revenue contributions (the HRA). However, in previous years, the capital programme has had major slippage, including in the current year.

4.5 The Council's 2020-21 Budget Report and Medium Term Financial Strategy 2020-23 states that "a fundamental review of the provisional capital programme will be carried out over the next few months to ensure that programmes are delivering value for money and agreed outcomes for our communities and identifying where there are options to defer, reduce or delete schemes in order to minimise the requirement for prudential borrowing or allow headroom for new schemes that are currently unfunded. Outcomes from the Asset Strategy will form part of this review

4.6 It should further be noted that a number of programmes have been identified as having a requirement to identify funding; significant additional financial resources are expected to be required to cover future anticipated costs, such as for fire safety,

when the outcome of the Grenfell Inquiry is known. The Council has yet to agree a strategy to fund the 2nd 1,000 new Council homes and the impact of that needs to be assessed, alongside existing stock condition requirement.

4.7 The above increasing capital programme is taking place at a time when interest rates are stable and indeed the Bank of England interest rate may well be cut further; rates have been at historical lows for almost a decade. Interest rates reached a peak of 13.875% in the 1990s, then fell to 6% in 2000, and ranged between 6% - 3.75% from 2000 – 2007, before being cut to 0.5% in 2009. Rates have continued to hover between 0.25% and 0.75% since then.

4.8 It is proposed that the Council reviews both expenditure plans and the risks associated with interest rates over the next 3 months and develops a detailed strategy with regards to long term borrowing. This will involve the use of "trigger points" i.e. specific rates at which the Corporate Director Resources will actively consider taking out external debt in order to reduce the risk of a sharp, sudden and unexpected increase in rates

4.9 The Authority has previously raised the majority of its long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it now a relatively expensive option. The Authority will now look to borrow any long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

4.10 Alternatively, the Authority may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

4.11 In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.

4.12 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the London Borough of Tower Hamlets Pension Fund)

- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

4.13 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

4.14 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

4.15 **Short-term and variable rate loans**: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

4.16 **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

5 <u>Investment Strategy</u>

5.1 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £260 million and £390 million,

5.2 **Objectives:** The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to

strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

5.3 **Negative interest rates:** If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

5.4 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to explore opportunities to further diversify into more secure and/or higher yielding asset classes during 2020/21. The majority of the Authority's surplus cash remains invested in short-term unsecured bank deposits, money market funds and local authority deposits.

5.5 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

5.6 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£15m 5 years	£30m 20 years	£30m 50 years	£15m 20 years	£15m 20 years
AA+	£15m 5 years	£30m 10 years	£30m 25 years	£15m 10 years	£15m 10 years

AA	£15m 4 years	£30m 5 years	£30m 15 years	£15m 5 years	£15m 10 years
AA-	£15m 3 years	£30m 4 years	£30m 10 years	£15m 4 years	£15m 10 years
A+	£15m 2 years	£30m 3 years	£15m 5 years	£15m 3 years	£15m 5 years
A	£15m 13 months	£30m 2 years	£15m 5 years	£15m 2 years	£15m 5 years
A-	£15m 6 months	£30m 13 months	£15m 5 years	£15m 13 months	£15m 5 years
None	£1m 6 months	n/a	£30m 25 years	£1m 5 years	£15m 5 years
Pooled funds and real estate investment trusts		£30m per fund or trust			

This table must be read in conjunction with the notes below

5.7 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

5.8 **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

5.9 **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

5.10 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks.

These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

5.11 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £500,000 per company as part of a diversified pool in order to spread the risk widely.

5.12 **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

5.13 **Pooled funds:** Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

5.14 Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

5.15 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

5.16 **Operational bank accounts:** The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1 million per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

5.17 **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

5.18 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

5.19 **Other information on the security of investments**: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

5.20 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the

Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

5.21 **Investment limits**: In order that no more than approximately 25% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £30 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 3: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£30m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£30m per group
Any group of pooled funds under the same management	£75m per manager
Negotiable instruments held in a broker's nominee account	£75m per broker
Foreign countries	£30m per country
Registered providers and registered social landlords	£75m in total
Unsecured investments with building societies	£30m in total
Loans to unrated corporates	£30m in total
Money market funds	£150m in total
Real estate investment trusts	£75m in total

5.22 **Liquidity management**: The Authority uses a cash flow forecasting model to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on

long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast.

6 Treasury Management Indicators

6.1 The Authority measures and manages its exposures to treasury management risks using the following indicators:

6.2 **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating	A

6.3 **Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£50m

6.4 **Interest rate exposures**: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£2m
Upper limit on one-year revenue impact of a 1% fall in interest rates	-£2m

6.5 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

6.6 **Maturity structure of borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	0%

6.7 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

6.8 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£150m	£125m	£100m

7 Related Matters

7.1 The CIPFA Code requires the Authority to include the following in its treasury management strategy.

7.2 **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment)

7.3 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be considered when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

7.4 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

7.5 In line with the CIPFA Code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

7.6 **Housing Revenue Account:** On 1st April 2012, the Authority notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk.

7.7 **Markets in Financial Instruments Directive**: The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

8 Financial Implications

8.1 The budget for investment income in 2020/21 is £4 million, based on an average investment portfolio of £228 million at an interest rate of 1.60%. However, this is a prudent estimate of the investment portfolio, based on the budget and a prudent view of interest returns. The Council is reviewing its provisional capital programme over the next three months and part of that review will include a review of levels of borrowing.

9 Other Options Considered

9.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

APPENDICES

Appendix B1 – Arlingclose Economic & Interest Rate Forecast January 2020

Underlying assumptions:

- The global economy has entered a period of weaker growth in response to political issues. The UK economy continues to experience slower growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations are low.

- Some improvement in global economic data and a more positive outlook for US/China trade negotiations has prompted worst case economic scenarios to be pared back.

- The new Conservative UK government will progress with achieving Brexit on 31st January 2020. The more stable political environment will prompt a partial return in business and household confidence in the short term, but the subsequent limited Brexit transitionary period, which the government is seeking to enforce, will create additional economic uncertainty.

- UK economic growth stalled in Q4 2019. Inflation is running below target at 1.5%. The inflationary consequences of the relatively tight labour market have yet to manifest, while slower global growth should reduce the prospect of externally driven pressure, although escalating geopolitical turmoil could continue to push up oil prices.

- The first few months of 2020 will indicate whether the economy benefits from restored confidence. The government will undertake substantial fiscal easing in 2020/21, which should help support growth in the event of a downturn in private sector activity.

- The weak outlook for the UK economy and current low inflation have placed pressure on the MPC to loosen monetary policy. Two MPC members voted for an immediate cut in the last two MPC meetings of 2019. The evolution of the economic data and political moves over the next few months will inform policy, but upside risks to Bank Rate are very limited.

- Central bank actions and escalating geopolitical risks will produce volatility in financial markets, including bond markets.

Forecast:

- We have maintained our Bank Rate forecast at 0.75% for the foreseeable future. Substantial risks to this forecast remain, arising primarily from the government's policy around Brexit and the transitionary period.

- Arlingclose judges that the risks are weighted to the downside.
- Gilt yields remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.
- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.73**
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	**0.25**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.73**
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**
Downside risk	0.30	0.50	0.55	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	**0.60**
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	**0.37**
Arlingclose Central Case	**0.50**	**0.50**	**0.55**	**0.55**	**0.55**	**0.60**	**0.60**	**0.65**	**0.65**	**0.70**	**0.75**	**0.75**	**0.75**	**0.62**
Downside risk	0.35	0.50	0.55	0.55	0.55	0.60	0.60	0.65	0.65	0.70	0.75	0.75	0.75	**0.61**
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**0.75**	**0.80**	**0.80**	**0.85**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**1.10**	**0.92**
Downside risk	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	**0.45**
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	**1.40**	**1.32**
Downside risk	0.40	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.50	0.50	**0.45**
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	**1.40**	**1.32**
Downside risk	0.40	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.50	0.50	**0.45**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B2 – Existing Investment & Debt Portfolio Position

	31/12/2019 **Actual Portfolio £m**	31/12/2019 **Average Rate %**
External borrowing:		
Public Works Loan Board	55.8	2.82
Local authorities	-	-
LOBO loans from banks	-	-
Other loans	17.5	4.34
Total external borrowing	**73.3**	**3.18**
Other long-term liabilities:		
Private Finance Initiative	1.9	
Leases	0.9	
Transferred Debt	0	
Total other long-term liabilities	2.8	
Total gross external debt	76.1	
Treasury investments:		
Banks & building societies (unsecured)	40.0	1.05
Covered bonds & repo (secured)	-	-
Government (incl. local authorities)	42.0	1.20
Corporate bonds and loans	-	-
Money Market Funds	108.1	0.72
Cash-plus pooled funds	20.0	1.79
Strategic pooled funds	56.2	8.17
Real estate investment trusts	-	
Total treasury investments	**266.3**	**1.5**
Net debt	190.20	

Investment Strategy Report 2020-21 **Appendix B**

1. Introduction

1.1 The Authority invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
- to support local public services by lending to or buying shares in other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

1.2 This investment strategy meets the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

2. Treasury Management Investments

2.1 The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to fluctuate between £266m and £191m during the 2020-21 financial year.

2.2 **Contribution:** The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.

2.3 **Further details**: Full details of the Authority's policies and its plan for 2020/21 for treasury management investments are covered in a separate document, the treasury management strategy, appended to this report

3. Service Investments: Loans

3.1 **Contribution:** The Council lends money to its subsidiaries and associates, local charities and its employees to support local public services and stimulate local economic growth.

3.2 **Security**: The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Loans for service purposes in £ millions

Category of borrower	**31.3.2019 actual**			**2020/21**
	Balance owing	**Loss allowance**	**Net figure in accounts**	**Approved Limit**
Subsidiaries & associates	0.04	0.00	0.04	54.20
Local charities	0.96	0.00	0.96	1.40
Employees	0.20	0.00	0.20	0.40
TOTAL	**1.20**	**0.00**	**1.20**	**56.00**

3.3 The loans to subsidiaries and associates comprise loans to PLACE Ltd, Seahorse Homes Ltd and Mulberry Housing, the Council's housing vehicles. The loans to local charities are to the Davenant Centre and Oxford House. The employees loans comprises loans for car loans. As referred to in the Budget Report being considered by Cabinet in January 2020, a review of the use of the 2 housing companies is underway and a decision on their future use will be presented for consideration to Cabinet in the coming months

3.4 The Authority assesses the risk of loss before entering and whilst holding service loans. Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments. The Council is expecting full repayment on the loans to subsidiaries and associates. The loans to charities are underpinned by first charges on the properties concerned. The Council anticipates full repayment on the employees' loans.

3.5 Members should note that the approved limit for charities' loans of £0.6m was exceeded by £0.4m, as the total approved limit did not take into account a pre-existing loan to one charity.

3.6 **Service Investments: Shares**

3.7 **Contribution:** The Council invests in the shares of its subsidiaries to support the provision of housing in the local community; local public services and stimulate local economic growth. The Council has nominal value shares in several companies; Capital Letters, PLACE Ltd, Tower Hamlets Local Education Partnership Ltd Mulberry Housing, Seahorse Homes Ltd and Tower Hamlets Homes. The Council is an 'A' shareholder in Capital Letters, along with 12 other London Boroughs. The Council is one of 5 London Boroughs with shareholdings in PLACE Ltd.

3.8 The Council has committed an initial £6m to Seahorse Homes Ltd, which is equity financing for a wholly owned company with the commercial purpose of providing homes for rent and sale. The approved limit reflects that £6m, which is contained in the Council's capital programme in 2021/22, pending the review of the Councils housing companies referred to in para 3.3. If the review confirms the investment, the capital programme may need to be amended and approved by Council depending on which year the investment is made, but the Approved Limit has been set at £6m, so this limit will not need to change if the decision is made to make that investment in 2020/21

3.9 **Security:** One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Table 2: Shares held for service purposes in £ millions

Category of company	**31.3.2019 actual**			**2020/21**
	Amounts invested	**Gains or losses**	**Value in accounts**	**Approved Limit**
Subsidiaries	0.0	0.0	0.0	6.0
Suppliers	0.0	0.0	0.0	0.0
TOTAL	**0.0**	**0.0**	**0.0**	**6.0**

3.10 **Risk assessment**: The Authority assesses the risk of loss before entering into and whilst holding shares. The investments in Seahorse Homes Ltd will be into property-backed assets that have a long-term track record of value appreciation, although there may be short-term value falls. Legal and independent advice was obtained before the company was created.

3.11 **Liquidity**: Proposed investments and loans are longer term in nature. Therefore these investments will not be used for short-term cash flow purposes. The maximum value of the investments is less than 20% of the Council's current investment portfolio.

3.12 **Non-specified Investments**: Shares are the only investment type that the Authority has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Authority's upper limits on non-specified investments. The Authority has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

4 Loan Commitments and Financial Guarantees

4.1 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Authority and are included here for completeness.

4.2 Between 1998 and 2010, the Council has historically provided financial guarantees on properties transferred to social landlords. No liabilities have been payable on these guarantees.

5 Capacity, Skills and Culture

5.1 **Elected members and statutory officers**: A training plan is being produced for the training of members and the Council has just appointed a new interim treasury manager

5.2 **Corporate governance:** The Audit committee meet on a quarterly basis to review the treasury management investments

6 Investment Indicators

6.1 The Council has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.

6.2 **Total risk exposure:** The first indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down and guarantees the Authority has issued over third party loans.

Table 3: Total investment exposure in £millions

Total investment exposure	**31.03.2019 Actual**	**31.03.2020 Forecast**	**31.03.2021 Forecast**
Treasury management investments	382.3	266.3	191.0
Service investments: Loans	1.20	1.40	1.4
Service investments: Shares	0.0	0.0	0.0
TOTAL INVESTMENTS	**383.5**	**267.7**	**192.4**
Commitments to lend	0..0	0.00	0.00
Guarantees issued on loans	0.00	0.00	0.00
TOTAL EXPOSURE	**383.5**	**267.7**	**192.4**

6.3 **How investments are funded**: Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure.

6.4 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 4: Investment rate of return (net of all costs)

Investments net rate of return	**2018/19 Actual**	**2019/20 Forecast**	**2020/21 Forecast**
Treasury management investments	1.16%	1.60%	1.60%
Service investments: Loans	n/a	n/a	n/a
Service investments: Shares	n/a	n/a	n/a
Commercial investments: Property	n/a	n/a	n/a
ALL INVESTMENTS	1.16%	1.60%	1.60%

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Capital Strategy Report 2020/21 **Appendix C**

1. Introduction

1.1 This capital strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

1.2 Decisions made this year on capital and treasury management will have financial consequences for the Authority for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

1.3 Financing Capital expenditure is where the Authority spends money on assets, such as property or vehicles that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Authority has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not capitalised and are charged to revenue in year.

1.4 In 2020/21, the Authority is planning capital expenditure of £319m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2018/19 actual	**2019/20 est.**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
General Fund (GF) services	97	159	180	155	36
Council housing (HRA)	35	55	139	122	70
TOTAL	**133**	**214**	**319**	**277**	**106**

The main General Fund capital projects include work on the new Town Hall, work on Liveable Streets, Carriageway, footway and street lighting improvements.

1.5 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately.

1.6 **Governance:** Service managers submit bids in order to include projects in the Authority's capital programme. The Senior Leadership Team appraises all bids based on a comparison of service priorities and makes recommendations to the Mayor's Advisory Board. The final capital programme is then presented to Cabinet in January and to Council in February each year.

1.7 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Authority's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2018/19 actual	**2019/20 Est.**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
External sources	35	60	81	90	32
Own resources	53	69	94	73	39
Debt	45	85	144	114	35
TOTAL	**133**	**214**	**319**	**277**	**106**

1.8 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of debt finance in £ millions

	2018/19 actual	**2019/20 est**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
Planned MRP payments	8.639	10.987	12.640	15.112	17.850

1.9 When the Council funds capital expenditure by borrowing it must put aside enough money from its revenue budget each year to repay that borrowing in later years. The amount charged to the revenue budget for the repayment of borrowing is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Ministry of Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2018.

1.10 The broad aim of the MHCLG Guidance is to ensure that capital expenditure funded by borrowing is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

1.11 The Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods. This statement is consistent with that approved by the Council for 2019/20:

1.11.1 For supported capital expenditure MRP will be determined in accordance with the former regulations that applied on 31st March 2008, incorporating an "Adjustment A" of £17.5m. *(MHCLG Guidance Option 1 – the Regulatory Method)*

1.11.2 For unsupported capital expenditure MRP will be charged over the expected useful life of the relevant asset in equal instalments, starting in the year after that in which the asset becomes operational. There are two areas where asset lives are bound by regulation. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years. *(MHCLG Guidance Option 3 – the Asset Life Method)*

1.11.3 For assets acquired by leases or the Private Finance Initiative, MRP will be determined as being equal to the element of the rent or

charge that goes to write down the balance sheet liability *(per MHCLG Guidance)*.

1.11.4 For loans to third parties that are required to be capitalised and are to be repaid in annual or more frequent instalments of principal, the Council will not make MRP but will instead apply the capital receipts arising from the principal repayments to finance this expenditure. In years where there is no principal repayment MRP will be charged based on the estimated life of the relevant asset. While this is not one of the options in the MHCLG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred is fully financed.

1.11.5 Under the MHCLG Guidance MRP is not required to be charged in respect of assets held within the Housing Revenue Account (HRA). Following removal of the HRA debt cap by central government the Council has determined to make a Voluntary Revenue Provision (VRP) on new HRA debt funded capital expenditure. VRP is charged over the expected useful life of the relevant assets in equal instalments, starting in the year after that in which the assets become operational.

1.12 The Authority's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP capital receipts used to replace debt. The CFR is expected to increase by £132m during 2020/21. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31.3.2019 actual	**31.3.2020 est.**	**31.3.2021 budget**	**31.3.2022 budget**	**31.3.2023 budget**
General Fund services	288.415	337.783	388.083	422.283	415.083
Council housing (HRA)	84.903	110.810	192.091	256.926	281.369
TOTAL CFR	**373.318**	**448.593**	**580.174**	**679.209**	**696.452**

1.13 **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects until 2021/22. Repayments of capital grants,

loans and investments also generate capital receipts. The Council plans to receive £54m of capital receipts in the coming financial year as follows:

Table 5: Capital receipts receivable in £ millions

	2018/19 actual	2019/20 est.	2020/21 budget	2021/22 budget	2022/23 budget
Asset sales	22	52	54	35	17
Loans repaid	0	0	0	0	0
TOTAL	**22**	**52**	**54**	**35**	**17**

2 Treasury Management

2.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Authority is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

2.2 Due to decisions taken in the past, the Authority currently has £73m borrowing at an average interest rate of 3.18% and £266m treasury investments at an average rate of 1.60%.

2.3 **Borrowing strategy**: The Authority's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Authority therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75% and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%). There are a number of factors that the Council needs to take into accounts when setting its borrowing strategy.

2.4 The Council is significantly increasing its capital expenditure over the next 3 years; the draft capital programme is £702m over the next 3 financial years. This programme is partly funded by borrowing of £112m in the GF for 2020/21 – 2022/23 and £182m in the HRA for the same period. The rest of the programme is being funded by other sources including payments from developers (CIL and Section 106), capital receipts and revenue contributions (the HRA). However, in previous years, the capital programme has had major slippage, including in the currently year.

2.5 The Council's 2020-21 Budget Report and Medium Term Financial Strategy 2020-23 states that "a fundamental review of the provisional capital programme will be carried out over the next few months to ensure that programmes are delivering value for money and agreed outcomes for our communities and identifying where there are options to defer, reduce or delete schemes in order to minimise the requirement for prudential borrowing or allow headroom for new schemes that are currently unfunded. Outcomes from the Asset Strategy will form part of this review"

2.6 It should further be noted that a number of programmes have been identified as having a requirement to identify funding; significant additional financial resources are expected to be required to cover future anticipated costs, such as for fire safety, when the outcome of the Grenfell Inquiry is known. The Council has yet to agree a strategy to fund the 2nd 1,000 new Council homes and the impact of that needs to be assessed, alongside existing stock condition requirement.

2.7 The above increasing capital programme is taking place at a time when interest rates are stable and indeed the Bank of England interest rate may well be cut further; rates have been at historical lows for almost a decade. Interest rates reached a peak of 13.875% in the 1990s, then fell to 6% in 2000, and ranged between 6% - 3.75% from 2000 – 2007, before being cut to 0.5% in 2009. Rates have continued to hover between 0.25% and 0.75% since then.

2.8 It is proposed that the Council reviews both expenditure plans and the risks associated with interest rates over the next 3 months and develops a detailed strategy with regards to long term borrowing. This will involve the use of "trigger points" i.e. specific rates at which the Corporate Director Resources will actively consider taking out external debt in order to reduce the risk of a sharp, sudden and unexpected increase in rates.

2.9 Projected levels of the Authority's total outstanding debt (which comprises borrowing, PFI liabilities and leases are shown below, compared with the capital financing requirement (see above); as the Council is undertaking a review, for the purposes of these figures, it is assumed that no further external debt is taken out.

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	2018/19 actual	**2019/20 est.**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
Debt (incl. PFI & leases)	133.167	129.555	126.742	123.373	119.497
Capital Financing Requirement	373.318	448.593	580.174	679.209	696.452

2.10 Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Authority expects to comply with this in the medium term.

2.11 **Affordable borrowing limit**: The Authority is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2019/20 limit	**2020/21 limit**	**2021/212 limit**	**2022/23 limit**
Authorised limit – borrowing	421.327	525.741	658.125	679.244
Authorised limit – PFI and leases	57.266	54.453	51.084	47.208
Authorised limit – total external debt	478.593	610.174	709.209	726.452
Operational boundary – borrowing	391.327	525.721	628.125	649.244
Operational boundary – PFI and leases	57.266	54.453	51.084	47.208
Operational boundary – total external debt	448.593	580.174	679.209	696.452

2.12 **Treasury Investment Strategy**: Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

2.13 The Authority's policy on treasury investments is to prioritise security and liquidity over yield that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Authority may request its money back at short notice.

2.14 **Risk Management:** The effective management and control of risk are prime objectives of the Authority's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

3.15 **Governance**: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Finance and staff, who must act in line with the treasury management strategy approved by Council. Quarterly reports on treasury management activity are presented to the Audit Committee. The Audit Committee is responsible for scrutinising treasury management decisions.

3 Investments for Service Purposes

3.1 The Authority makes investments to assist local public services, including making loans to its subsidiaries & associates, local charities and its employees to support local public services and to stimulate economic growth In light of the public service objective, the Council is willing to take more risk than with treasury investments, however it still plans for such investments to generate a profit after all costs.

3.2 Total investment for service purposes are currently valued at £1.20m with the largest being a loan to Oxford House which is underpinned by a charge on the property.

3.3 **Governance**: Decisions on service investments are made by the relevant service manager in consultation with the Director of Finance and must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

4 Liabilities

4.1 In addition to debt of £130m detailed above, the Authority is committed to making future payments to cover its pension fund deficit (valued at £699m). It has also set aside £21.7m to cover risks of contract disputes, business rates appeals, repayment of contractor deposits and a range of risks for which the Council self-insures. The Authority is also at risk of having to pay for any defaults on loans by housing associations in connection with residential properties transferred to them by the Council, and the pension liabilities of Tower Hamlets Homes should the ALMO is not able to meet its pension obligations. As at 31 March 2019, the Tower Hamlets Homes pension fund had a IAS19 deficit of £7.3m. The Council has not put aside any money for these potential liabilities.

4.2 **Governance**: Decisions on incurring new discretional liabilities are taken by service managers in consultation with the Director of Finance

5 Revenue Budget Implications

5.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Table 8: Prudential Indicator: Proportion of financing costs to net revenue stream

	2018/19 actual	**2019/20 Est.**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
Financing costs (£m)	8.2	9.3	10.5	11.3	12.7
Proportion of net revenue stream	2.5%	0.59%	3.14%	3.51%	3.89%

5.2 **Sustainability**: Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Director of Finance is satisfied that the proposed capital programme is prudent, affordable and sustainable because a detailed independent assessment has been made of the costs of borrowing in future years.

6 Knowledge and Skills

6.1 The Authority employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Finance is a qualified accountant with 28 years' experience; The Council pays for junior staff to study towards relevant professional qualifications including CIPFA.

6.2 Where Authority staff do not have the knowledge and skills required use is made of external advisers and consultants that are specialists in their field. The Authority currently employs Arlingclose Limited as treasury management advisers and Savills as property consultants. This approach is more cost effective than employing such staff directly, and ensures that the Authority has access to knowledge and skills commensurate with its risk appetite.

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS FOR 2019/20 **APPENDIX D**

Prudential Indicators	2018/19	2019/20	2019/20	2020/21	2021/22	2022/23
Extract from Estimate and rent setting reports	**Actual**	**Original Estimate**	**Revised Estimate**	**Estimate**	**Estimate**	**Estimate**
	£m	£m	£m	£m	£m	£m
Capital Expenditure						
General Fund	97.309	253.199	159.097	180.420	155.592	35.626
HRA	35.391	108.763	54.785	138.761	121.653	70.362
TOTAL	**132.700**	**361.962**	**213.882**	**319.181**	**277.245**	**105.988**
Ratio of Financing Costs to Net Revenue Stream						
General Fund	2.50%	0.59%	2.87%	3.14%	3.51%	3.89%
HRA	0.49%	7.09%	1.81%	2.34%	3.90%	4.98%
	£m	£m	£m	£m	£m	£m
Gross Debt and Capital Financing Requirement						
Gross Debt	133.167	129.555	129.555	126.742	123.373	119.497
Capital Financing Requirement	373.318	448.593	448.593	580.174	679.209	696.452
Over/(Under) Borrowing	**(240.151)**	**(319.038)**	**(319.038)**	**(453.432)**	**(555.836)**	**(576.955)**
Capital Financing Requirement as at 31 March						
General Fund	288.415	337.783	337.783	388.083	422.283	415.083
HRA	84.903	110.810	110.810	192.091	256.926	281.369
TOTAL	**373.318**	**448.593**	**448.593**	**580.174**	**679.209**	**696.452**
Incremental Impact of Financing Costs (£)						
Increase in Council Tax (band D) per annum	35.908	42.112	42.112	46.770	40.680	42.310
Increase in average housing rent per week	2.152	2.525	2.525	3.809	2.940	0.0000

Treasury Management Indicators	2018/19	2018/19	2019/20	2020/21	2021/22	2022/23
	Actual	Original Estimate	Revised Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
Authorised Limit For External Debt -						
Borrowing & Other long term liabilities	376.488	373.318	448.593	580.174	679.209	696.452
Headroom	20.000	30.000	30.000	30.000	30.000	30.000
TOTAL	**396.488**	**403.318**	**478.593**	**610.174**	**709.209**	**726.452**
Operational Boundary For External Debt -						
Borrowing	316.614	313.444	391.327	525.721	628.125	649.244
Other long term liabilities	59.874	57.266	57.266	54.453	51.084	47.208
TOTAL	**376.488**	**373.318**	**448.593**	**580.174**	**679.209**	**696.452**
Gross Borrowing	**73.293**	**72.288**	**72.288**	**72.288**	**72.288**	**72.288**
Upper Limit For Fixed Interest Rate Exposure						
Net principal re fixed rate borrowing / investments	**£450m**	**£450m**	**£450m**	**£450m**	**£450m**	**£450m**
Upper Limit For Variable Rate Exposure						
Net interest payable on variable rate borrowing / investments	**£450m**	**£450m**	**£450m**	**£450m**	**£450m**	**£450m**
Upper limit for total principal sums invested for over 364 days (per maturity date)	**£150m**	**£150m**	**£150m**	**£150m**	**£150m**	**£150m**

Maturity structure of new fixed rate borrowing during 2019/20	Upper Limit	Lower Limit
Under 12 months	10%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	80%	0%
10 years and above	100%	0%

Appendix E

Treasury Management Policy Statement

The London Borough of Tower Hamlets defines the policies and objectives of its treasury management activities as follows: -

1. This organisation defines its treasury management activities as:
   "The management of the Council's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management."

Policy on use of an External Treasury Advisor

The Council shall employ an external treasury advisor to provide treasury management advice and cash management support services. However, the Council shall control the credit criteria and the associated counter-party list for investments.

The Council recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Appendix F

Treasury Management Scheme of Delegation

1. Full Council / Cabinet

- receiving and reviewing reports on treasury management policies. practices and activities
- receiving the mid-year and annual (outturn) reports
- approval of annual strategy
- approval of capital strategy report.

2. Cabinet /Section 151 Officer

- approval of/amendments to the organisation's adopted clauses and treasury management policy statement
- budget consideration and approval
- approval of the division of responsibilities
- approving the selection of external service providers and agreeing terms of appointment.

3. Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- receiving and reviewing regular monitoring reports and acting on recommendations

Appendix G

Treasury Management Reporting Arrangement

Area of Responsibility	Council/Committee/ Officer	Frequency
Treasury Management Strategy Statement/ Annual Investment Strategy/ Minimum Revenue Provision Policy/Capital Strategy Report	Full Council	Annually before the start of the financial year to which policies relate
Mid-Year Treasury Management Report	Full Council	Semi-Annually in the financial year to which policies relate
Updates or revisions to the Treasury Management Strategy Statement/ Annual Investment Strategy/ Minimum Revenue Provision Policy/Capital Strategy Report	Audit Committee or Full Council	As necessary
Annual Treasury Outturn Report	Audit Committee and Full Council	Annually by 30 September after the year end to which the report relates
Treasury Management Practices	Corporate Director, Resources	N/A
Scrutiny of Treasury Management Strategy Statement/capital Strategy Report/Annual Investment Strategy	Overview and Scrutiny Committee (if called in) / Audit Committee	Annually before the start of the financial year to which the report relates
Scrutiny of Treasury Management Performance	Audit Committee	Quarterly

GLOSSARY Appendix H

Asset Life	How long an asset, e.g. a Council building is likely to last.
Borrowing Portfolio	A list of loans held by the Council.
Borrowing Requirements	The principal amount the Council requires to borrow to finance capital expenditure and loan redemptions.
Capitalisation direction or regulations	Approval from central government to fund certain specified types of revenue expenditure from capital resources.
CIPFA Code of Practice on Treasury Management	A professional code of Practice which regulates treasury management activities.
Capital Financing Requirement (CFR)	Capital Financing Requirement- a measure of the Council's underlying need to borrow to fund capital expenditure.
Certificates of Deposits	A certificate of deposit (CD) is a time deposit, a financial product. CDs are similar to savings accounts in that they are insured and thus virtually risk free; they are "money in the bank." They are different from savings accounts in that the CD has a specific, fixed term (often monthly, three months, six months, or one to five years) and, usually, a fixed interest rate. It is intended that the CD be held until maturity, at which time the money may be withdrawn together with the accrued interest.
Commercial paper	Commercial paper is a money-market security issued (sold) by large corporations to obtain funds to meet short-term debt obligations (for example, payroll), and is backed only by an issuing bank or corporation's promise to pay the face amount on the maturity date specified on the note. Since it is not backed by collateral, only firms with excellent credit ratings from a recognized credit rating agency will be able to sell their commercial paper at a reasonable price. Commercial paper is usually sold at a discount from face value, and carries higher interest repayment rates than bonds
Counterparties	Organisations or Institutions the Council lends money to e.g. Banks; Local Authorities and MMF.
Corporate bonds	A corporate bond is a bond issued by a corporation. It is a bond that a corporation issues to raise money effectively in order to expand its business. The term is usually applied to longer-term debt instruments, generally with a maturity date falling at least a year after their issue date.
Covered bonds	A covered bond is a corporate bond with one important enhancement: recourse to a pool of assets that secures or "covers" the bond if the originator (usually a financial institution) becomes insolvent. These assets act as additional credit cover; they do not have any bearing on the contractual cash flow to the investor, as is the case with Securitized assets.
Consumer Prices Index & Retail Prices Index (CPI & RPI)	The main inflation rate used in the UK is the CPI. The Chancellor of the Exchequer bases the UK inflation target on

	the CPI. The CPI inflation target is set at 2%. The CPI differs from the RPI in that CPI excludes housing costs. Also used is RPIX, which is a variation of RPI, one that removes mortgage interest payments.
Credit Default Swap (CDS)	A kind of protection that can be purchased by MMF companies from insurance companies (for their investment) in exchange for a payoff if the organisation they have invested in does not repay the loan i.e. they default.
Credit watch	Variety of special programs offered by credit rating agencies and financial institutions to monitor organisation/individual's (e.g. bank) credit report for any credit related changes. A credit watch allows the organisation/individuals to act on any red flags before they can have a detrimental effect on credit score/history.
Credit Arrangements	Methods of Financing such as finance leasing
Credit Ratings	A scoring system issued by credit rating agencies such as Fitch, Moody's and Standard & Poors that indicate the financial strength and other factors of a bank or similar Institution.
Creditworthiness	How highly rated an institution is according to its credit rating.
Debt Management Office (DMO)	The DMO is an agency of the HM Treasury which is responsible for carrying out the Government's Debt Management Policy.
Debt Rescheduling	The refinancing of loans at different terms and rates to the original loan.
Depreciation Method	The spread of the cost of an asset over its useful life.
Gilt	Gilt-edged securities are bonds issued by certain national governments. The term is of British origin, and originally referred to the debt securities issued by the Bank of England, which had a gilt (or gilded) edge. Hence, they are known as gilt-edged securities, or gilts for short. Today the term is used in the United Kingdom as well as some Commonwealth nations, such as South Africa and India. However, when reference is made to "gilts", what is generally meant is "UK gilts," unless otherwise specified.
Interest Rate exposures	A measure of the proportion of money invested and what impact movements in the financial markets would have on them.
The International Monetary Fund (IMF)	is an intergovernmental organisation which states its aims as to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.
Impaired investment	An investment that has had a reduction in value to reflect changes that could impact significantly on the benefits expected from it.
LIBID	The London Interbank Bid Rate – it is the interest rate at which

	major banks in London are willing to borrow (bid for) funds from each other.
Market Loans	Loans from banks available from the London Money Market including LOBOS (Lender Option, Borrowing Option) which enable the Council to take advantage of low fixed interest for a number of years before an agreed variable rate comes into force.
Money Market Fund (MMF)	A 'pool' of different types of investments managed by a fund manager that invests in lightly liquid short term financial instruments with high credit rating.
Monetary Policy Committee (MPC)	Committee designated by the Bank of England, whose main role is to regulate interest rates.
Minimum Revenue Provision (MRP)	This is the amount which must be set aside from the revenue budget each year to cover future repayment of loans.
Non Prime Investments	Investments deemed to have a greater element of risk such as investments for longer than one year
Premium	Cost of early repayment of loan to PWLB to compensate for any losses that they may incur
Prudential Indicators	Set of rules providing local authorities borrowing for funding capital projects under a professional code of practice developed by CIPFA and providing measures of affordability and prudence reflecting the Council's Capital Expenditure, Debt and Treasury Management.
PWLB	Public Works Loan Board, a statutory body whose function is to lend money to Local Authorities (LAs) and other prescribed bodies. The PWLB normally are the cheapest source of long term borrowing for LAs.
Prime Investments	Investments that meet the Council's high credit quality criteria and repayable within 12 months.
Supranational bonds	Supranational bonds are issued by institutions that represent a number of countries, not just one. Thus, organisations that issue such bonds tend to be the World Bank or the European Investment Bank. The issuance of these bonds are for the purpose of promoting economic development
Treasury bills (or T-bills)	Treasury bills (or T-bills) mature in one year or less. Like zero-coupon bonds, they do not pay interest prior to maturity; instead they are sold at a discount of the par value to create a positive yield to maturity. Many regard Treasury bills as the least risky investment available.
Unrated institution	An institution that does not possess a credit rating from one of the main credit rating agencies.
Unsupported Borrowing	Borrowing where costs are wholly financed by the Council.

AUDIT COMMITTEE WORK PLAN 2019/20

Contact Officer:	**Farhana Zia** Democratic Services
Email:	farhana.zia@towerhamlets.gov.uk
Telephone:	020 7364 0842
Website:	www.towerhamlets.gov.uk/committee
Last updated:	29th January 2020

Agenda Item 5.1

AUDIT COMMITTEE WORK PLAN 2019/20

REPORT TITLE	BRIEF SUMMARY	LEAD OFFICER	OTHER CTTEE MEETINGS
2ND APRIL 2020			
1. Deloitte	Standing Item • External Auditors report on the Annual Financial Accounts 2018/19	Jonathan Gooding / Angus Fish	
2. Annual Financial Accounts 2018/19	The approval of the Annual accounts by the Audit Committee.	Kevin Bartle	
3. Draft Annual Governance Statement 2018/19	Committee to undertake a review of the Corporate Governance process. Is linked to the Annual Financial Accounts.	Paul Rock.	
4. Anti- Money Laundering Policy	Report updating the Anti-Money Laundering Policy.	Agnes Adrien	Deferred from 30/01 mtg
5. Risk Management Report 2019/20 - Q4	An update on risks on the Corporate Risk Register.	Anthony Sotande-Peters	
6. Internal Audit and Anti-Fraud update 2019/20 – Q4	An update on progress against the delivery of the 2019/20 Annual Internal Audit Plan and highlights any significant issues since the last report to the Audit Committee.	Paul Rock/Bharat Mehta/ Tony Qayum	
7. Treasury Management Report 2019/20 – Q4	Progress on the Treasury Management Strategy Statement and the Treasury Prudential Indicators.	Allister Bannin	
8. Annual Internal Audit and Counter-Fraud Strategy & Plan	Draft Internal Audit Plan for 2020/21- For review and approval by the Committee.	Paul Rock	
9. Review of Code of Corporate Governance	(Annually) Monitoring Officer	Asmat Hussain	
10. Whistleblowing Report	Annually – Monitoring Officer	Asmat Hussain	

AUDIT COMMITTEE WORK PLAN 2019/20

REPORT TITLE	BRIEF SUMMARY	LEAD OFFICER	OTHER CTTEE MEETINGS
11. Risk Management Strategy	Review and approve.	Paul Rock / Anthony Sotande-Peters	
12. Terms of Reference	Review and approve JULY 2020	Farhana Zia / Paul Rock	
13. Annual Self - Assessment and report of the Audit Committee	Self - Assessment – Apr 2020 Audit Report by Chair – July 2020 to go to Full Council.	Cllr Whitehead/Paul Rock & Farhana Zia	
14. Audit Committee Work Plan	Review and agree items on the work plan for the Committee.	Audit Committee Members	

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