Audit Committee

Thursday, 27 January 2022 at 6.30 p.m.

Committee Room One - Town Hall, Mulberry Place, 5 Clove Crescent, London, E14 2BG

Supplemental Agenda

This meeting is open to the public to attend.

Further Information

For further information including Membership of this body and public information see the main agenda.

Contact for further enquiries:	Scan this code for an electronic agenda:
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London Borough of Tower Hamlets

Audit Committee

Thursday, 27 January 2022

6.30 p.m.

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Next Meeting of the Committee:
Thursday, 24 March 2022 at 6.30 p.m. to be held in the Committee Room One - Town Hall, Mulberry Place, 5 Clove Crescent, London, E14 2BG

Audit Committee 27 January 2022 **and** **Council 2 March 2022**	TOWER HAMLETS
Report of: Kevin Bartle, Interim Corporate Director Resources	**Classification:** Unrestricted
Treasury Management Strategy Statement, Investment Strategy Report and Capital Strategy Report for 2022-23	

Lead Member	**Councillor Candida Ronald, Cabinet Member for Resources and the Voluntary Sector**
Originating Officer(s)	Nisar Visram, Interim Divisional Director of Finance, Procurement and Audit
Wards affected	All wards
Key Decision?	Yes
Forward Plan Notice Published	November 2021
Reason for Key Decision	This report is a statutory requirement and forms part of the 2022-23 budget approval by Council.
Strategic Plan Priority / Outcome	1. People are aspirational, independent and have equal access to opportunities; 2. A borough that our residents are proud of and love to live in; 3. A dynamic outcomes-based Council using digital innovation and partnership working to respond to the changing needs of our borough.

REASONS FOR URGENCY

The Treasury Management Strategy Statement has been submitted as a late item. The reason the item has been delayed is due to the dependency of the treasury strategy on the capital programme to determine future cash flow, financing and borrowing requirements. The capital programme is to be presented to Cabinet on 9th February as part of the medium term financial strategy report and therefore the programme was still being finalised at the time of drafting the Treasury Strategy Statement. The publishing of the Treasury Statement was delayed to enable a more up to date capital position to reflected within the figures presented to audit committee.

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 DLUHC 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) 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) 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.

   c) 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. The Capital Strategy Report incorporates the Minimum Revenue Provision (MRP) Policy Statement.

3) This report also covers the requirements of the 2017 Prudential Code, including setting of Prudential Indicators for 2022-23, 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 2021 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 Department for Levelling Up Housing & Communities (DLUHC) 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 through presentation of a mid-year and outturn report.

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 Audit Committee to recommend to Council to:

1) Approve and adopt the following policy and strategies:
    - 1.1) The Treasury Management Strategy Statement contained in Appendix A;
    - 1.2) The Investment Strategy Report contained in Appendix B;
    - 1.3) The Capital Strategy Report, which includes the Minimum Revenue Provision (MRP) Policy Statement, contained in Appendix C;
    - 1.4) The Prudential and Treasury Management indicators contained in Appendix D; and
    - 1.5) The Treasury Management Policy Statement as set out in Appendix E.

1 REASONS FOR THE DECISIONS

1.1 The Council has adopted the relevant CIPFA Treasury Management and Prudential Codes and has regard to the DLUHC Investment Guidance (which came into force on 1st April 2018), 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 DLUHC 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 DLUHC 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

Background to Treasury Management

3.1 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 needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, with 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.

3.2 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.

3.3 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."

3.4 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.

I. **A treasury management strategy statement** (Appendix A)

II. **A mid-year treasury management report** – This will update members on year to date performance against the prudential and treasury indicators, amending indicators as necessary, and whether any policies require revision.

III. **A treasury outturn report** – This provides details of annual actual performance against the prudential and treasury indicators.

3.5 The Council uses Arlingclose Limited as its external treasury management advisors. 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.

3.6 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.

3.7 **The 2021-22 Strategy and Current Investment Position and Performance**

The Strategy for 2021-22 was approved by Full Council on 4th March 2021 and the Audit Committee received a Treasury Management mid-year review on 1st December 2021 which stated that:

a) The investment income budget for 2021-22 was £2.3m.

b) From a benchmarking exercise, a total return of 1.17% was achieved for the reporting period, which was 0.27% below the average for similar Local Authorities return and 0.79% lower than the average return for all Local Authorities; and

c) The Prudential Indicators and Treasury Management indicators have been fully complied with.

Treasury Management Strategy

3.8 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.

3.9 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.

3.10 The Authority had previously raised the majority of its long-term borrowing from the PWLB but will consider 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. On 25 November 2020, the government responded to the PWLB consultation by cutting the rate for all new Standard Rate loans from 1.80% to 1% (100 bps). PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.

3.11 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.

3.12 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.

3.13 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 capital strategy which is contained in Appendix C.

3.14 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.

3.15 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.

3.16 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 explore new opportunities for further diversification into more secure and/or higher yielding asset classes during 2022-23. The majority of the Authority's surplus cash remains invested in short-term unsecured bank deposits, money market funds and local authority deposits.

3.17 The proposed structure for selecting counterparties is set out in the TMSS. This 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 advisor alerts officers to changes in ratings of all agencies.

3.18 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.

Investment Strategy Report 2022-23

3.19 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).

Capital Strategy Report for 2022-23

3.20 This 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.

3.21 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.

3.22 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 2024-25, along with the Authorised Limit and the Operational Limit of borrowing and Prudential Indicators (PIs). Any shortfall of resources results in a borrowing need.

Other Treasury Management Issues

3.23 In order 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 rests with the Audit Committee. Officers will report details of the Council's treasury management activity to the Audit Committee through presentation of a mid-year and outturn report. The responsibilities and delegated decision-making path are set out in Appendices F and G.

3.24 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, for whom training will be arranged as required. 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 The Equality Act 2010 requires the Council in the exercise of its functions to have due regard to eliminate unlawful discrimination, harassment and victimisation, advance equality of opportunity and foster good relations between people who share a protected characteristic and those who do not.

4.2 Capital investment will contribute to achievement of the corporate objectives, including all those relating to equalities. Establishing the statutory policy statements required facilitates the capital investments and ensures that it is prudent.

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, Investment Strategy, Capital 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 who specialise in Local Authority treasury issues.

6 COMMENTS OF THE CHIEF FINANCE OFFICER

6.1 This report contains the three strategy statements in relation to the Council's treasury management arrangements. As this report is totally financial in nature the comments of the Chief Finance Officer have been incorporated throughout this report.

7 COMMENTS OF LEGAL SERVICES

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 treasury and 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 recommend these matters for agreement at full 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:
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Treasury Management Strategy Statement (TMSS) 2022-23 **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 is therefore central to the Authority's prudent financial management.

1.2 Treasury risk management in 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 the Investment Strategy Report included with this TMSS report.

1.4 This TMSS forms part of the authority's overall budget strategy and financial management framework.

2 External Context

Economic background: The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022-23.

2.1 The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme. The Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022.

2.2 UK Consumer Price Inflation (CPI) for November 2021 was 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% year on year from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

2.3 Gross domestic product (GDP) grew by 1.3% in Q3 2021, compared to a gain of 5.5% in the Q2. The annual rate rose to 6.6% from 23.6%. Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fourth month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

2.4 The US economy expanded at an annualised rate of 2.1% in Q3 2021 slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25%. The Fed also provided strong indications that interest rates are likely to increase at a faster pace in 2022, with three 0.25% movements now expected.

2.5 **Credit outlook**: Credit default swap (CDS) prices for the larger UK banks have remained low and steadily fallen back throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. Recent removal of coronavirus-related business support measures by the government means the full impact on the bank balance sheet may not be known for some time. The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

2.6 Looking forward, the potential for bank losses from bad loans remain as government and central bank support starts to be removed remains a risk. The Council's choice of counterparties is based on recommendations from the Arlingclose central list of institutions and sovereigns.

2.7 **Interest rate forecast:** The Authority's treasury management advisor Arlingclose is forecasting that Bank Base Rate will continue to rise in Q1 2022 to subdue inflationary pressures. Arlingclose interest rate forecast indicate a rise again but increases will not be to the extent predicted by financial markets.

2.8 Gilt yields are expected to remain broadly at current levels over the medium-term, with 5,10, while short-term yields are likely to remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20 year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will

almost certainly be short-term volatility due to economic and political uncertainty and events.

2.9 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A1.

3 Local Context

For the purpose of setting the Council's budget and MTFS, it has been assumed that new treasury investments in 2022-23 will be made at an average rate range of 0.10% - 0.40% depending on duration and future Bank of England rate rises, and that new long-term loans will be borrowed at an average rate of 2.5%.

On 31st December 2021, the Authority held £72m of borrowing and £316m of treasury investments. Forecast changes in these sums are shown in the balance sheet analysis in Table 1 below.

Table 1: Balance Sheet Summary

Line	£m	2020-21 Actual (draft) £m	2021-22 Current £m	2022-23 Forecast £m	2023-24 Forecast £m	2024-25 Forecast £m
1	General Fund CFR	332.466	378.419	395.802	406.121	426.452
2	HRA CFR	133.279	165.843	221.922	267.000	303.325
3	**Total CFR** *(Line 1+2)*	**465.745**	**544.262**	**617.724**	**673.121**	**729.777**
4	Less: Other debt liabilities *	(56.357)	(53.483)	(49.059)	(44.637)	(40.213)
5	**Borrowing CFR** *(Line 3-4)*	**409.388**	**490.779**	**568.665**	**628.484**	**689.564**
6	Less: External Borrowing **	(71.534)	(69.872)	(68.709)	(68.709)	(68.709)
7	**Internal Borrowing / (Over Borrowing)** *(Line 5-6)*	**337.854**	**420.907**	**499.956**	**559.775**	**620.855**
8	Less: Usable reserves	(638.306)	(588.300)	(588.300)	(588.300)	(588.300)
9	Less: Working capital	(96.900)	(96.900)	(96.900)	(96.900)	(96.900)
10	**(Treasury Investments)/New Borrowing** *(Line 7-8-9)*	**(397.352)**	**(264.293)**	**(184.244)**	**(125.425)**	**(64.345)**
11	**Net Investments** *(Line10-6)*	**(325.818)**	**(194.421)**	**(116.535)**	**(56.716)**	**(4.364)**

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

** *shows only loans to which the Authority is committed*

3.1 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. Actual internal borrowing on 31 March 2021 was £338m and forecast internal borrowing on 31 March 2022 is £500m.

3.2 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 2022-23.

3.3 The table below shows the Council's existing investment and debt portfolio on 31 December 2021.

Existing Investment & Debt Portfolio Position

£m	**31.12.2021 Actual Portfolio £m**	**31.12.2021 Average Rate %**
External Borrowings: • Public Works Loans Board • Other Loans	 54.03 17.50	 2.64 4.34
Total External Borrowings	**71.53**	**3.05**
Other Long-Term Liabilities: • Private Finance Initiative • Leases	 29.35 27.00	
Total Other Long-Term Liabilities	**56.35**	
Total Gross External Debt	**127.88**	
Treasury Investments: • Banks & Building Societies (unsecured) • Government • Local Authority • Money Market Funds • Cash-Plus Funds • Strategic Pooled Funds	 15.00 20.00 55.00 150.50 20.0 56.0	 0.25 0.09 0.55 0.04 0.57 **5.78**
Total Treasury Investments	**316.50**	**1.17**
Net Debt	**188.62**	

4 Borrowing Strategy

4.1 The Authority currently holds £71.53m of loans, as part of its strategy for funding previous years' capital programmes. The Authority may borrow to pre-fund future years' requirements by borrowing in advance of need, providing this does not exceed the authorised limit for borrowing of £769.8m (2024-25).

4.2 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level of £75m at each year-end but minimise credit risk. This amount includes the Council's strategic investment portfolio of £56m, which is not planned to be liquidated over this period, and a liquidity balance of £20m, to maintain sufficient liquidity.

Table 2: Liability benchmark

	31.3.21 Actual £m	**31.3.22 Estimate £m**	**31.3.22 Revised Estimate £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**	**31.3.25 Forecast £m**
Borrowing CFR	409.388	569.649	490.779	568.665	628.484	689.564
Less: Usable reserves	(638.306)	(334.700)	(588.300)	(588.300)	(588.300)	(588.300)
Less: Working capital	(96.900)	(96.900)	(96.900)	(96.900)	(96.900)	(96.900)
Plus: Minimum investments *(Strategic Pooled Funds)*	76.000	76.000	76.000	76.000	76.000	76.000
Liability benchmark	**(249.818)**	**(214.049)**	**(118.421)**	**(40.5350)**	**19.284**	**80.364**

The liability benchmark suggests the Council will require a minimum level of borrowing in 2023-24 of £19m, to maintain the minimum investment level of £76m at year end. The actual level of borrowing at year end depends on whether the Council's spending plans proceed as planned and on the actual timing of borrowing as well as level of internal cash.

4.3 **Objectives:** The Authority's main 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.

4.4 **Strategy:** The Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

4.5 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of (internal/short-term) will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. The Authority's treasury adviser will assist with this 'cost of carry' and breakeven analysis if need be. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

4.6 The Authority therefore seeks to strike a balance between using internal resources, cheap short-term loans (currently available at around 0.15% - 0.60%) and long-term fixed rate loans where the future cost is known but higher. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield, the Authority intends to avoid this activity in order to retain its access to PWLB loans. there are several other factors that the Council needs to consider when setting its borrowing strategy.

4.7 As shown in the table below, the Council is planning to significantly increase its capital expenditure over the next 3 years; the provisional capital programme is £587m over the next 3 financial years (2022-23 to 2024-25). This plan is for the programme to be partly funded by borrowing of £90m in the General Fund for 2022-23 to 2024-25 and £149m in the HRA for the same period. The plan is for the rest of the programme to be 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 the current year.

Table demonstrating Capital Expenditure

Capital Expenditure	2020-21 Actual (draft) £m	2021-22 Estimate £m	2022-23 Forecast £m	2023-24 Forecast £m	2024-25 Forecast £m
Non-HRA	104.113	157.964	191.221	97.012	56.391
HRA	60.741	73.457	107.510	81.403	53.554
Total	**164.854**	**231.421**	**298.731**	**178.415**	**109.945**

4.8 The Authority had previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pension funds 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. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.

4.9 If necessary, 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.

4.10 The Authority may additionally borrow short-term loans to cover unplanned cash flow shortages. The Council is developing its borrowing strategy. Although rising, rates are currently low, and the Council wants to be prepared for the point at which rates move unfavourably.

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

- HM Treasury's PWLB Lending Facility (formerly the Public Works Loan Board)
- 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

4.12 **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

4.13 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is 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.

4.14 **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.

4.15 **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>Treasury 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 treasury investment balance has ranged between £200 million and £340 million a lot of which has been due to increase in reserve and covid and related grants.

5.2 **Objectives:** The CIPFA Code requires the Authority to invest its treasury 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:** Although this has not been the case, the COVID-19 pandemic increased the risk that the Bank of England will set its Bank Rate at rates below 0.10%, should this had been the case, this was expected to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. 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 2022-23. The Council continues to maintain its current strategy of investing surplus cash in short-term unsecured bank deposits, money market funds, strategic pooled funds, cash plus 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 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 **Environmental Social and Governance (ESG):** The Mayor declared a climate emergency in March 2019 and the Authority has committed to become a net zero carbon council by 2025 and a net zero carbon borough by 2045 or sooner. The Authority as an ethical investor will consider where possible the environmental, social and governance issues (ESG) criteria to guide their engagement with corporate bodies. Each of the Authority's fund managers are at difference stages and influence the council can bring as a pooled fund investor is minimal. Investments will be in accordance with counterparty and creditworthiness as detailed in 5.8 below. The Authority as required will take necessary advice from its treasury adviser and use its investments to promote ESG factors without compromising on security, liquidity, and yield.

5.7 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in Table 3 below, subject to the limits shown.

Table 3: Recommended investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities *(subject to checks on their balance sheet position depending on duration)*	25 years	£30m	Unlimited
Secured investments *	25 years	£30m	Unlimited
Banks (unsecured) *	13 months	£15m	Unlimited
Building societies (unsecured) *	13 months	£15m	£30m
Registered providers (unsecured) *	5 years	£15m	£75m
Money market funds *	n/a	£30m	Unlimited
Strategic pooled funds*	n/a	£30m	£150m
Real estate investment trusts	n/a	£30m	£75m
Other investments *	5 years	£15m	£30m

This table must be read in conjunction with the notes below

Minimum Credit rating: Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is not lower than A-. 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 during decision making. This is monitored on a regular basis in liaison with our Advisors.

For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality following an external credit assessment.

5.8 **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 Government are deemed to be zero

credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

5.9 **Secured Investments:** These are investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies 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. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

5.10 **Banks and Building Societies (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.

5.11 **Registered Providers:** Loans to, and bonds issued by or 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.

5.12 **Money Market Funds (MMFs): Pooled funds that offer same-day or short notice liquidity and very low or no price volatility** by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will exercise due care by diversifying its liquid investments various providers, to ensure access to cash at all times. It is worth noting that in the event of very significant economic crashes when Central Banks reduce rates to the extent that rates become negative, MMFs will become Variable Net Asset Values and / or accumulating funds.

5.13 **Strategic Pooled Funds:** Bond, equity and property funds that 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. As 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.

5.14 **Real Estate Investment Trusts (REITS):** Shares in companies that invest mainly in real estate and pay most 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.

5.15 **Other Investments:** This category covers treasury investments not listed above, for example, unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

5.16 **Operational Bank Accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services to any UK bank with credit ratings not 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 £2m if it falls below the minimum bank credit rating referred to in 5.6. 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. The credit rating agencies in current use are listed in the Treasury Management Practices document. 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 "negative watch") which may make it 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.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, 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 or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

5.20 **Investment limits**: In order that no more than approximately 25% of available reserves for credit losses 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.

5.21 Limits are also 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 demonstrating Additional Investment limits

	Cash Limit
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

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.

The Authority will spread its liquid cash over at least four providers (e.g., bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

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	Minimum
Portfolio average credit rating	A	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	£20m

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 new market 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	60%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 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 **Long-term Treasury management investments 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	2022-23	2023-24	2024-25
Limit on principal invested beyond year end/ no fixed maturity date	£200m	£150m	£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, assessed using the appropriate credit rating for derivative exposures. 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 two pools. 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 **External Funds:** From time to time, the Authority may hold funds on behalf of other bodies will be separated where possible from the Authority's cash via separate bank accounts or separate ledger codes. Where possible interest will be apportioned, and appropriate impairment losses applied as necessary.

7.8 **Markets in Financial Instruments Directive (MiFID)**: 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 <u>Financial Implications</u>

8.1 The budget for investment income in 2021-22 is £1.6m, based on prudent assumptions made for the returns on the Council's various treasury investments including the pooled fund portfolio and term deposits and cash rates. The budget for debt interest payable in 2021-22 is £2.359m which includes growth of £0.109m being agreed as part of the Council's 2021-24 Medium Term Financial Strategy. If actual levels of investments and borrowing, or actual interest rates, differ from that forecast, performance against budget will be correspondingly different.

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, having consulted with the treasury advisers Arlingclose, the Cabinet Member for Resources and Corporate Leadership Team 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

Appendix A1 – Arlingclose Economic & Interest Rate Forecast December 2021

Underlying assumptions:

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a remainder of the potential downside risks.
- CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.
- Longer-term government bond yields remain relatively low despite the more hawkish signals from the Bank of England and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later.
- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment indicating the that economic outlook will be challenging but signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

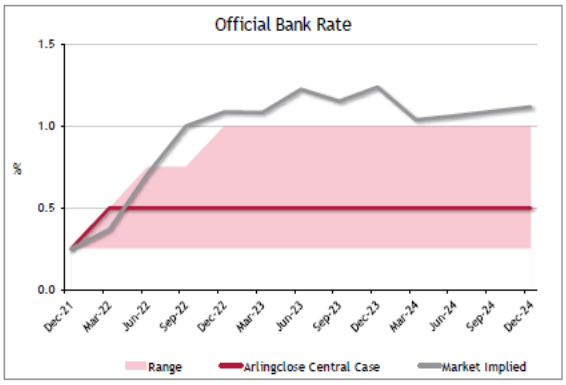
Forecast:

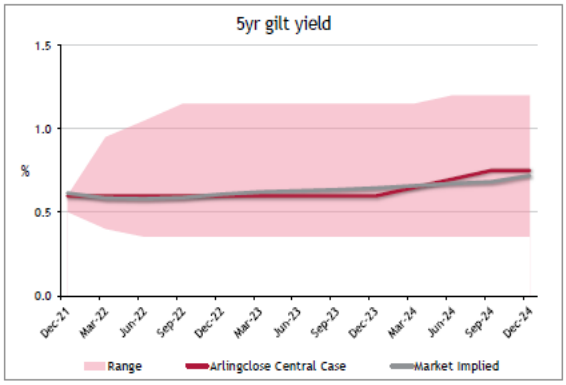
- Arlingclose expects Bank Rate to rise to 0.50% in Q1 2022, but then remain there. Risks to the forecast are initially weighted to the upside but becoming more balanced over time. This forecast remains below the market forward curve.
- Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.

- Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.
- The risks around the gilt yield forecasts vary. The risk for short- and medium-term yield is initially on the upside but shifts lower later. The risk for long-term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month money market ra													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
10yr gilt yield													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
20yr gilt yield													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
50yr gilt yield													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%


Official Bank Rate
1.5
1.0
%
0.5
0.0
Dec-21
Mar-22
Jun-22
Sep-22
Dec-22
Mar-23
Jun-23
Sep-23
Dec-23
Mar-24
Jun-24
Sep-24
Dec-24
Range
Arlingclose Central Case
Market Implied


5yr gilt yield
1.5
1.0
%
0.5
0.0
Dec-21
Mar-22
Jun-22
Sep-22
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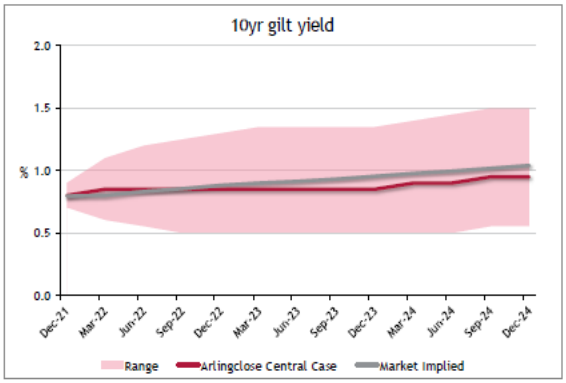
Range
Arlingclose Central Case
Market Implied


10yr gilt yield
2.0
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% 1.0
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Dec-21
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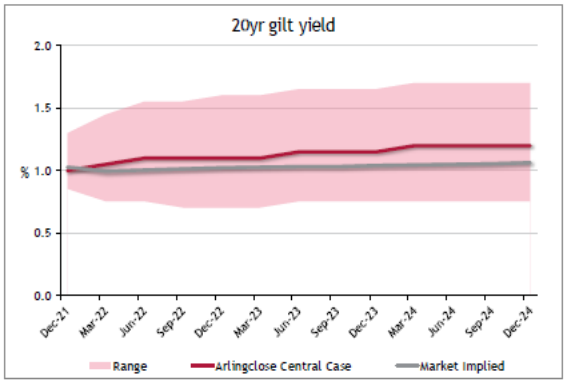
Range
Arlingclose Central Case
Market Implied


20yr gilt yield
2.0
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Jun-23
Sep-23
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Mar-24
Jun-24
Sep-24
Dec-24
Range
Arlingclose Central Case
Market Implied

Investment Strategy Report 2022-23 **Appendix B**

1. Introduction

1.1 The Authority invests its money for two broad purposes:

- 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), and
- to support local public services by lending to or buying shares in other organisations (service investments).
- To support local public services by lending to or buying shares in other organisations. (service investments).

1.2 This investment strategy meets the requirements of the statutory guidance issued by the government in January 2018.

2. Treasury Management Investments

2.1 The Authority typically receives its income in cash (e.g. from taxes, grants and fees & charges) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure. 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 £290m and £100m during the 2022-23 financial year.

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

3. Service Investments: Loans

3.1 The Council may lend money to its subsidiaries and associates, local charities, housing associations and its employees to support local public services and stimulate local economic growth. For example loans to PLACE Ltd.

3.2 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 demonstrating loans for service purposes

Category of borrower	Actuals at 31.03.2021			2022-23
	Balance owing £m	Loss allowance £m	Net figure in accounts £m	Approved Limit £m
Subsidiaries & associates	0.686	-	-	50.0
Local charities (Oxford House and Davenant Centre)	1.329	-		2.0
Employees	0.230	-		0.7
TOTAL	**2.245**	**-**		**52.7**

3.3 Loans to local charities relate to Oxford House and Davenant Centre. Employee loans relate to car loans, bicycle loans and train season tickets. Loans to subsidiaries and associates relate to PLACE Ltd, Seahorse Homes and Mulberry Homes.

3.4 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 charities and employees.

4. Service Investments: Shares

4.1 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 a not- for- profit company limited by guarantee a collaborative enterprise between a group of London Boroughs to lease private properties for use as a temporary accommodation and securing assured shorthold tenancies to prevent homelessness, 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. The company is limited by guarantee therefore the Council has no shareholdings in PLACE Ltd.

4.2 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 demonstrating shares held for service purposes

Category of company	Actuals at 31.03.2021			2022-23
	Amounts invested £m	Gains or losses £m	Value in accounts £m	Approved Limit £m
Subsidiaries	-	-	-	6.0
Suppliers	-	-	-	-
TOTAL	**-**	**-**	**-**	**6.0**

4.3 **Risk assessment:** The Authority assesses the risk of loss before entering into and whilst holding shares. The investments in Seahorse Homes Ltd will be turned 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.

4.4 **Liquidity:** Proposed investments and loans are longer term in nature. These investments will, therefore, 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.

4.5 **Non-specified Investments:** Shares are the only non-treasury 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.

5. Loan Commitments and Financial Guarantees

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

5.2 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.

6. Borrowing in Advance of Need

6.1 Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. This currently under borrowed and will not borrow in advance of its borrowing need except on advice from its advisers.

7. Capacity, Skills and Culture

7.1 A training plan is being produced for the training of elected members and Council officers attend regular training during the year.

7.2 To ensure corporate governance, the Audit Committee is presented with mid-year and outturn reports to enable the review of treasury management activities.

8. Investment Indicators

8.1 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.

8.2 **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 that the Authority has issued over third party loans.

Table demonstrating total investment exposure (delete 2020 column later)

Total investment exposure	31.03.2020 Actual £m	31.03.2021 Actual £m	31.03.2022 Forecast £m	31.03.2023 Forecast £m
Treasury management investments	257.80	273.90	224.10	150.00
Service investments:	1.59	2.25	2.0	1.0

Total investment exposure	31.03.2020 Actual £m	31.03.2021 Actual £m	31.03.2022 Forecast £m	31.03.2023 Forecast £m
Loans				
Service investments: Shares	-	-	-	
TOTAL INVESTMENTS	**259.39**	**276.15**	**226.10**	**151.00**
Commitments to lend	-	-	-	
Guarantees issued on loans	-	-	-	
TOTAL EXPOSURE	**259.39**	**276.15**	**226.10**	**151.00**

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

8.4 **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 in which they are incurred.

Table demonstrating investment rate of return (net of all costs) 2022/23

Investments net rate of return	2020-21 Actual	2021-22 Forecast	2022-23 Forecast
Treasury management investments	3.47%	1.10%	1.00%
Service investments: Loans	-	-	-
Service investments: Shares	-	-	-
Commercial investments: Property	-	-	-
ALL INVESTMENTS	3.47%	1.10%	1.00%

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Capital Strategy Report 2022-23 **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 some of these 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 2022-23, the Authority is planning capital expenditure of £299m as summarised below:

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

Capital Expenditure	2020-21 Actual (draft)	2021-22 Estimate	2022-23 Forecast	2023-24 Forecast	2024-25 Forecast
Non-HRA	**104.113**	**157.964**	**191.221**	**97.012**	**56.391**
HRA	**60.741**	**73.457**	**107.510**	**81.403**	**53.554**
Total	**164.854**	**231.421**	**298.731**	**178.415**	**109.945**

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.

Capital investments includes loans and shares made for service purposes. Where possible, bids are evaluated for environmental, social and governance criteria including sustainability.

1.6 **Governance:** Following an officer process, taking account of service priorities, recommendations are made to the Mayor's Advisory Board. The final capital programme is then presented to Cabinet in February and to Council in February/March 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

	2020-21 Actual	**2021-22 Estimate**	**2022-23 Budget**	**2023-24 Budget**	**2024-25 Budget**
External sources	42.344	82.068	141.538	75.976	16.140
Own resources	56.891	57.580	68.094	29.149	17.310
Debt	65.619	91.773	89.099	73.290	76.495
TOTAL	**164.854**	**231.421**	**298.731**	**178.415**	**109.945**

** debt arising from changes to accounting for leases are not included in the above.*

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) shown in table 5 below may be used to replace debt finance. Planned MRP are as follows:

Table 3: Replacement of debt finance in £millions

	2020-21 Actual (draft)	**2021-22 Estimate**	**2022-23 Budget**	**2023-24 Budget**	**2024-25 Budget**
Planned MRP	11.158	13.257	15.637	17.893	19.839

payments					

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 Department for Levelling Up Housing & Communities' s *Guidance on Minimum Revenue Provision* (the DLUHC Guidance).

1.10 The broad aim of the DLUHC 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.

Minimum Revenue Provision (MRP) Policy Statement

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. *(DLUHC 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. *(DLUHC 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 DLUHC 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 DLUCH 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 DLUHC 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 £73m during 2022-23. 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

	2020-21 Actual	**2021-22 Estimate**	**2022-23 Budget**	**2023-24 Budget**	**2024-25 Budget**
General Fund services	332.466	378.419	395.802	406.121	426.452
Council housing (HRA)	133.279	165.843	221.922	267.000	303.325
TOTAL CFR	**465.745**	**544.262**	**617.724**	**673.121**	**729.777**

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 2023-24. Repayments of capital grants, loans and investments also generate capital receipts.

Table 5: Capital receipts receivable in £ millions

	2020-21 Actual (draft)	**2021-22 Estimate**	**2022-23 Budget**	**2023-24 Budget**	**2024-25 Budget**
Asset sales	38.648	5.690	4.000	4.000	3.000
Loans repaid	-	-	-	-	-
TOTAL	**38.648**	**5.690**	**4.000**	**4.000**	**3.000**

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 As of 31 December 2021, the Authority had £72m of borrowings at an average interest rate of 3.12% and £317m of treasury investments at an average rate of 1.16%.

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 0.10% - 0.50%) and long-term fixed rate loans where the future cost is known but higher (PWLB certainty rates currently range from 1.77% to 2.12% without Certainty Rate adjustments). There are several factors that the Council needs to consider when setting its borrowing strategy.

2.4 The Council is significantly increasing its capital expenditure over the next 3 years; the provisional capital programme is £587m over the next 3 financial years. This programme is partly funded by borrowing of £238m in both and HRA for 2022-25. 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 above increasing capital programme is taking place at a time when interest rates are starting to rise but remain historically low and the Bank of England is expected to increase interest rate further from 0.25% to 0.75% by March 2023 amidst rising inflation. 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 fell to 0.10% in March 2020 after which the Bank of England increased rates to 0.25% in December 2021.

2.6 It is proposed that the Council reviews both expenditure plans and the risks associated with interest rates over the next 3 months on an ongoing basis 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.

2.7 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. 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

	2020-21 Actual (draft	**2021-22 Estimate**	**2022-23 Budget**	**2023-24 Budget**	**2024-25 Budget**
Debt (incl. PFI & leases)	127.891	123.355	117.768	113.346	108.922
Capital Financing Requirement	465.745	544.262	617.724	673.121	729.777

**table above excludes IFRS16 adjustments to balance sheet*

2.8 Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. Table 6 above demonstrates that the Authority expects to comply with this in the medium term.

2.9 **Liability benchmark:** To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £76m at each year-end. The table below shows the Authority expects to remain borrowed above its liability benchmark.

Table 7: Borrowing and the Liability Benchmark in £millions

	2020-21 Actual (draft	**2021-22 Estimate**	**2022-23 Budget**	**2023-24 Budget**	**2024-25 Budget**
Outstanding borrowing	71.534	69.872	68.709	68.709	68.709
Liability benchmark	(249.818)	(118.421)	(40.535)	19,284	80.369

2.10 **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 8: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2021-22 Limit	**2022-23 Limit**	**2023-24 Limit**	**2024-25 Limit**
Authorised limit – borrowing	599.649	608.665	668.484	729.564
Authorised limit – PFI and leases	52.469	49.059	44.637	40.213
Authorised limit – total external debt	**652.119**	**657.724**	**713.121**	**769.777**
Operational boundary – borrowing	569.649	568.665	628.484	689.564
Operational boundary – PFI and leases	52.469	49.059	44.637	40.213
Operational boundary – total external debt	**622.118**	**617.724**	**673.121**	**729.777**

2.11 **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.

2.12 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.

2.13 **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.

2.14 **Governance**: Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Corporate Director Resources and staff, who must act in line with the treasury management strategy approved by Council. The Audit Committee is presented with mid-year and outturn reports on treasury management activities. 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 protect the real term value of the Council's financial assets.

3.2 Total investment for service purposes are currently valued at £2.25m with the largest being loans to Oxford House and the Davenant Centre.

3.3 **Governance**: Decisions on service investments are made by the relevant service manager in consultation with the Corporate Director Resources 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 £201m detailed above, the Authority is committed to making future payments to cover its pension fund deficit (valued at £424m). 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 not be able to meet its pension obligations. As of 31 March 2020, the Tower Hamlets Homes pension fund had an IAS19 surplus of £5.2m. 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 Corporate Director Resources.

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 9: Prudential Indicator: financing costs

	2020-21 Actual (draft)	**2021-22 Estimate**	**2022-23 Budget**	**2023-24 Budget**	**2024-25 Budget**
Financing costs (£m)	13.292	15.379	34.134	19.904	21.850

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 Corporate Director Resources 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 Interim Corporate Director Resources is a qualified accountant with over 30 years' experience and 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.

Appendix D

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS FOR 2022-23

Prudential Indicators	2020-21	2021-22	2022-23	2023-24	2024-25
	Actual (draft)	Revised Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
Capital Expenditure					
General Fund	104.113	157.964	191.221	97.012	56.391
HRA	60.741	73.457	107.510	81.403	53.554
TOTAL	**164.854**	**231,421**	**298.731**	**178.415**	**109.945**
Gross Debt and Capital Financing Requirement					
Gross Debt	314.660	399.185	481.147	550.017	622.085
Capital Financing Requirement	465.745	544.262	617.724	673.121	729.777
Over/(Under) Borrowing	(151.085)	(145.077)	(136.577)	(123.104)	(107.692)
Capital Financing Requirement as at 31 March					
General Fund	332.466	378.419	395.802	406.121	426.452
HRA	133.279	165.843	221.922	267.000	303.325
TOTAL	**465.745**	**544.262**	**617.724**	**673.121**	**729.777**

Treasury Management Indicators	2020-21	2021-22	2022-23	2023-24	2024-25
	Actual (draft)	**Revised Estimate**	**Estimate**	**Estimate**	**Estimate**
	£m	£m	£m	£m	£m
Authorised Limit for External Debt -					
Borrowing & Other long-term liabilities	465.745	544.262	617.118	713.022	726.093
Headroom	30.000	30.000	30.000	40.000	40.000
TOTAL	**495.745**	**574.262**	**647.118**	**753.022**	**766.093**
Operational Boundary for External Debt -					
Borrowing	409.388	490.779	568.665	628.484	689.564
Other long-term liabilities (PFI & Fin Leases)	56.357	53.483	49.059	44.637	40.213
TOTAL	**465.745**	**544.262**	**617.724**	**673.121**	**729.777**
Gross Borrowing	**72.289**	**69.872**	**68.709**	**68.709**	**68.709**
Upper limit for total principal sums invested for over 364 days (per maturity date)	**£150m**	**£150m**	**£150m**	**£125m**	**£100m**

Maturity structure of new fixed rate borrowing during 2022/23	Upper Limit	Lower Limit
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and within 50 years	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. Council / Cabinet

- receiving reports from the Audit Committee on treasury management policies, practices and activities
- approval of annual Treasury Management and Investment Strategy
- approval of annual Capital Strategy

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 policies, practices and activities and making recommendations to the responsible body
- receiving the mid-year and annual outturn reports
- 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	Council	Annually before the start of the financial year to which policies relate
Mid-Year Treasury Management Report	Audit Committee or Council	Annually during the financial year to which the report relates
Updates or revisions to the Treasury Management Strategy Statement / Annual Investment Strategy / Minimum Revenue Provision Policy / Capital Strategy Report	Audit Committee or Council	As necessary
Annual Treasury Outturn Report	Audit Committee or Council	Annually after the year end to which the report relates
Treasury Management Practices	Corporate Director, Resources	Annually
Scrutiny of Treasury Management Strategy Statement / Annual Investment Strategy / Capital 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

Appendix H

GLOSSARY

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 similar to a fixed deposit with a bank but is more liquid as it can be sold to another counterparty should the need arise.
Commercial paper	Commercial paper is a discounted security issued by large corporations to obtain funds to meet short-term debt obligations.
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 to raise debt funding.
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.
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 for the Bank of England on the CPI. The CPI inflation target is set at 2%. The CPI differs from the RPI in that CPI excludes housing costs.
Credit Default Swap (CDS)	A derivative providing protection against counterparty

	default.
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 to indicate the financial strength of a counterparty.
Creditworthiness	The strength of a counterparty with regard to its chances of becoming insolvent and therefore defaulting.
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.
Gilts	Gilt-edged securities are bonds issued by the UK government to raise funding from investors to meet the fiscal deficit.
Interest Rate exposure	A measure of the impact movements in interest rates will have on the Council's debt cost and investment income budgets.
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.
Money Market Fund (MMF)	A 'pool' of investments managed by a fund manager that invests in highly liquid short-term financial instruments. The Council can invest in these funds to maintain liquidity and gain the creditworthiness benefits of the diversified structure.
Monetary Policy Committee (MPC)	Committee designated by the Bank of England whose main role is to set monetary policy.
Minimum Revenue Provision (MRP)	This is the amount which must be set aside from the revenue budget each year to cover future repayment of the CFR.
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.
Treasury bills (or T-bills)	Treasury bills (or T-bills) are short-term debt securities issued by the UK government to manage its cash position.
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.