Audit Committee

Monday, 22 January 2024 at 6.30 p.m.
Committee Room - Tower Hamlets Town Hall, 160 Whitechapel Road, London E1 1BJ

Supplemental Agenda 2

The reports in this supplemental pack were not published five clear days in advance of the meeting. Clearances for the report were received later than anticipated which resulted in the publishing deadline being missed for the reports to be presented to the Audit Committee.

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Non-Executive Report of the: **Audit Committee** **22 January 2024**	TOWER HAMLETS
Report of: Julie Lorraine, Corporate Director Resources	**Classification:** Unrestricted
Treasury Management Mid-Year Report for 2023-24	

Originating Officer(s)	Abdulrazak Kassim, Director of Finance, Procurement and Audit John Harrison, Interim Director of Finance, Procurement and Audit Paul Audu, Interim Head of Pensions & Treasury
Wards affected	All wards

Executive Summary

1) This report is produced in accordance with the CIPFA Treasury Management Code of Practice. The Treasury Management Strategy Statement and the Treasury Prudential Indicators for 2023-24 were approved by Council on 1 March 2023 as required by the Local Government Act 2003. This report covers the period 1 April 2023 to 30 September 2023.

2) The Council has substantial sums of money invested and is therefore exposed to financial risks including the loss of invested funds and the impact of changing interest rates and inflation. The successful identification, monitoring and control of risks are therefore key to the Council's treasury management strategy.

3) To date £76m has been invested in pooled funds. The value of pooled funds at 30 September is currently at a loss of £4.8m, however the Council continues to receive dividend income.

4) From the Benchmarking exercise, a total return of 5.14% was achieved for the reporting period. This was above the benchmark average of 4.34%.

5) Over the reporting period, all treasury management activities were performed in accordance with the approved limits and the prudential indicators (PI) set out in the Council's Treasury Management Strategy Statement.

Recommendations:

It is recommended to Audit Committee to:

1) Note the contents of the treasury management activities and performance against targets for the half year ending 30 September 2023; and
2) Note the Council's investments as set out in Appendix 1. The balances outstanding at 30 September 2023 were £265.5m.

1 REASONS FOR THE DECISIONS

1.1 The Local Government Act 2003 and the Local Authorities Capital Financing and Accounting) Regulations 2003 require that regular reports be submitted to the relevant Council Committee detailing the Council's treasury management activities.

1.2 This report updates members on both the borrowing and investment decisions made by the Corporate Director Resources under delegated authority in the context of prevailing economic conditions and considers the Council's treasury management performance.

1.3 The regular reporting of treasury management activities assists Members in scrutinizing officer decisions and monitoring progress on the implementation of its investment strategy as approved by Council.

1.4 This report includes the new requirement in the 2021 Prudential Code, mandatory from 1 April 2023, of quarterly reporting of the treasury management prudential indicators. The non-treasury prudential indicators are incorporated in the Authority's normal quarterly revenue and capital monitoring report.

2 ALTERNATIVE OPTIONS

2.1 The Council is bound by legislation to have regard to the Treasury Management TM Code. The Code requires that the Council or sub-committee of the Council (Audit Committee) should receive regular monitoring reports on treasury management activities. If the Council was to deviate from the requirements, there would need to be justifiable reason for doing so.

3 DETAILS OF THE REPORT

Background to Treasury Management

3.1 The Council's Treasury Management Strategy for 2023-24 was approved at the Council meeting of 1 March 2023. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested pooled funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Council's treasury management strategy.

3.2 The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve, as a minimum, treasury management semi-annual and annual outturn reports.

3.3 The 2021 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 1 March 2023.

External Context

3.4 **Economic background:** UK inflation remained stubbornly high over much of the period compared to the US and euro zone, keeping expectations elevated of how much further the Bank of England (BoE) would hike rates compared to the regions. However, inflation data published in the latter part of the period undershot expectations, causing financial markets to reassess the peak in BoE Bank Rate. This was followed very soon after by the BoE deciding to keep Bank Rate on hold at 5.25% in September, against expectation for another 0.25% rise.

3.5 Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.2%. However, monthly GDP data showed a 0.5% contraction in July, the largest fall to date in 2023 and worse than the 0.2% decline predicted which could be an indication the monetary tightening cycle is starting to cause recessionary or at the very least stagnating economic conditions.

3.6 July data showed the unemployment rate increased to 4.3% (3mth/year) while the employment rate rose to 75.5%. Pay growth was 8.5% for total pay (including bonuses) and 7.8% for regular pay, which for the latter was the highest recorded annual growth rate. Adjusting for inflation, pay growth in real terms were positive at 1.2% and 0.6% for total pay and regular pay respectively.

3.7 Inflation continued to fall from its peak as annual headline CPI declined to 6.7% in July 2023 from 6.8% in the previous month against expectations for a tick back up to 7.0%. The largest downward contribution came from food prices. The core rate also surprised on the downside, falling to 6.2% from 6.9% compared to predictions for it to only edge down to 6.8%.

3.8 The Bank of England's Monetary Policy Committee continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August. Against expectations of a further hike in September, the Committee voted 5-4 to maintain Bank Rate at 5.25%. Each of the four dissenters were in favour of another 0.25% increase.

3.9 Financial market Bank Rate expectations moderated over the period as falling inflation and weakening data gave some indication that higher interest rates were working. Expectations fell from predicting a peak of over 6% in June to

5.5% just ahead of the September MPC meeting, and to then expecting 5.25% to be the peak by the end of the period.

3.10 Following the September MPC meeting, Arlingclose, the authority's treasury adviser, modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate. In the short term the risks are to the upside if inflation increases again, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected.

3.11 **Financial markets**: Financial market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak. Gilt yields fell towards the end of the period. The 5-year UK benchmark gilt yield rose from 3.30% to peak at 4.91% in July before trending downwards to 4.29%, the 10-year gilt yield rose from 3.43% to 4.75% in August before declining to 4.45%, and the 20-year yield from 3.75% to 4.97% in August and then fell back to 4.84%. The Sterling Overnight Rate (SONIA) averaged 4.73% over the period.

3.12 **Credit review**: Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. This stance continued to be maintained at the end of the period.

3.13 Following the issue of a Section 114 notice, in September Arlingclose advised against undertaking new lending to Birmingham City Council, and later in the month cut its recommended duration on Warrington Borough Council to a maximum of 100 days.

3.14 Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and although no changes were made to recommended durations over the period, Northern Trust Corporation was added to the counterparty list. Heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

<u>Local Context</u>

3.15 On 31 March 2023, the Council had net investments of £252.8m arising from its revenue and capital income and expenditure. 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. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary at 31 March 2023

	31.03.23 Actual £m	31.03.24 Estimate £m
General Fund CFR	404.222	403.653
HRA CFR	165.503	181.067
Total CFR	**569.725**	**584.720**
Less other debt liabilities (PFI and Leases)	46.020	41.286
Borrowing CFR	**523.705**	**543.434**
Less external borrowing	68.709	68.709
Internal borrowing	454.996	475.725
Less usable reserves	649.675	543.825
Less working capital	58.152	58.152
Net investments	**252.831**	**127.252**

3.16 The treasury management position on 30 September 2023 and the change over the six months is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.03.23 Balance £m	Movement £m	30.09.23 balance £m	30.09.23 Rate %
Long-term borrowing	68.709	-	68.709	3.01
Short-term borrowing	-	-	-	
Total Borrowing	**68.709**	**0**	**68.709**	
Long-term investments	56.000	-	56.000	3.08
Short-term investments	20.000	-	20.000	4.64
Cash and cash equivalents	161.950	27.517	189.467	5.19
Total investments	**237.950**	**27.517**	**265.467**	**4.92**
Net investments	**169.241**	**27.517**	**196.758**	

Borrowing Update

3.17 CIPFA's 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Authority. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield unless these loans are for refinancing purposes.

3.18 The Council has not invested in assets primarily for financial return or that are not primarily related to the functions of the Council. It has no plans to do so in future.

Borrowing Strategy and Activity

3.19 Although the Council has nor borrowed in many years, however, should the Council decide to borrow, the Council's chief objective when borrowing would be to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Council's long-term plans change being a secondary objective. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

3.20 There was a substantial rise in the cost of both long and short-term borrowing over the last 18 months. Bank Rate rose by 1% from 4.25% at the beginning of April to 5.25% at the end of September. Bank Rate was 2% higher than at the end of September 2022. On 30 September 2023, the PWLB certainty rates for maturity loans were 5.26% for 10-year loans, 5.64% for 20-year loans and 5.43% for 50-year loans. Their equivalents on 31 March 2023 were 4.33%, 4.70% and 4.41% respectively.

3.21 A new PWLB HRA rate which is 0.4% below the certainty rate was made available from 15 June 2023. Initially available for a period of one year, but extended by another year in the Autumn Statement, this discounted rate is to support local authorities borrowing for the Housing Revenue Account and for refinancing existing HRA loans.

3.22 At 30 September 2023, the Council held £68.7m of loans. Outstanding loans on 30 September are summarised in Table 3A below.

Table 3A: Borrowing Position

	31.03.23 balance £m	Movement £m	30.09.23 balance £m	30.09.23 rate %	30.09.23 WAM* years
Public Works Loan Board	51.209	-	51.209	2.55	44.7
Banks (fixed term)	17.500	-	17.500	4.34	54.0
Total borrowing	**68.709**		**68.709**		

**Weighted average maturity

Table 3B: Long-dated borrowing

	Amount £m	Rate %	Period years
PWLB maturity loan 1	1.209	4.5	29.5
PWLB maturity loan 2	20.000	2.61	45.2
PWLB maturity loan 3	10.000	2.50	44.2
PWLB maturity loan 4	20.000	2.40	45.4
Market loan 1	4.500	4.25	54.0
Market loan 2	13.000	4.37	54.0
Total borrowing	**68.709**	**3.01**	**47.1**

3.23 There remains a strong argument for diversifying funding sources, particularly if rates can be achieved on alternatives which are below gilt yields + 0.80%. The Authority will evaluate and pursue these lower cost solutions and opportunities with its advisor Arlingclose.

3.24 The UK Infrastructure Bank is one alternative source of funding which offers funding at gilt yields + 0.40% (0.40% below the PWLB certainty rate) and the possibility of more flexible funding structures than the PWLB. Funding from UKIB is generally only available for certain types of projects that meet its criteria of green energy, transport, digital, water and waste. The minimum loan size is £5 million.

Other Debt Activity

3.25 Other debt liabilities, Private Finance Initiative and leases, stood at £43.6m on 30 September 2023, taking total debt to £113.3m. The Council did not raise any new capital finance for Private Finance Initiative and finance leases between April 2023 and September 2023.

Treasury Management Investment Activity

3.26 The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Authority's cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

3.27 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the half year, the Council's investment balances ranged between £249.0m and £300m due to timing differences between income and expenditure. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position at 30 September by Financial Sector

	31.03.23 balance £m	Net movement £m	30.09.23 Balance £m	30.09.23 return %
UK banks	1.00	-	1.00	1.03
Government (incl. local authorities)	20.00	84.16	104.16	5.10
Overseas Banks	30.00	-	30.00	5.36
Money Market Funds	110.95	-56.64	54.31	5.20
Pooled Investment Funds:				
Cash plus funds	20.00	-	20.00	5.38
Short-dated bond funds	18.00	-	18.00	6.48
Strategic bond funds	9.00	-	9.00	8.77
Equity Income funds	13.00	-	13.00	10.18
Property funds	5.00	-	5.00	8.85
Multi asset income funds	11.0	-	11.00	3.54
Total investments (Market value)	**237.95**	**27.52**	**265.47**	**5.14**

3.28 Both the CIFA Code and government guidance require the Council to invest its funds prudently and to consider the security and liquidity of its treasury investments before seeking the optimum return rate, 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.

3.29 Bank Rate increased by 1% from 4.25% at the beginning of April to 5.25% by the end of September. Short-dated cash rates rose commensurately, with 3-month rates rising to around 5.25% and 12-month rates to nearly 6%. The rates on DMADF deposits also rose, ranging between 4.8% and 5.4% by the end of September. The return on the Council's Money Market Funds ranged between 4.6% and 4.9% at the end of September.

3.30 The progression of risk and return metrics are shown in the progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – treasury investments managed in-house

Period	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity days	Rate of Return %
31.03.2023	4.36	AA-	69%	35	2.13
30.06.2023	4.11	AA-	39%	84	4.82
30.09.2023	3.94	AA-	29%	54	5.14
Similar Las	4.50	A+	65%	49	4.34
All Las	4.47	AA-	59%	49	3.66

3.31 **Externally Managed Pooled Funds**: £76.0m of the Authority's investments is invested in externally managed cash plus funds and strategic pooled funds investing in bonds, equity, multi-asset and property funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. These funds generated an average total unrealised loss of 300k and £4.6m since purchase but delivered 2.3% and 0.4% capital returns and 3.1% and 4.5% income return over the year to 30 September 2023 respectively.

3.32 Financial market conditions were volatile during the six-month period. Global bond yields rose and remained elevated as it became apparent that policymakers were looking to keep rates high for some time amid persistently higher core inflation and tight labour markets.

3.33 Because these funds have no defined maturity date, but are available for withdrawal after a notice period, the Council's treasury adviser is currently in support of these investments being held by the Council on the understanding that strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns should exceed cash interest rates.

3.34 Income returns in the first six months of 2023-24 were above budgeted. The Authority has budgeted £2m income from these investments in 2023-24. Income earned up to 30 September was £5.9m.

Non-Treasury Investments

3.35 The definition of investments in CIPFA's revised 2021 Treasury Management Code covers all the financial assets an authority may hold as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

3.36 Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) also broadens the definition of investments to include all such assets held partially or wholly for financial return.

3.37 The Council held the following non-treasury investments which were made for service purposes (the Council does not invest for commercial purposes):

- shareholding in subsidiaries £6m
- loans to subsidiaries £2.175m

Treasury Performance

3.38 The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below.

Table 6: Forecast Performance at 30 September 2023

	Actual £m	Budget £m	Over/ under	Actual %
PWLB Interest Payable	1.325	1.490	-0.165	63.58%
Market Loan Interest Payable	0.759	0.760	0.000	36.42%
Total borrowing Interest	**2.084**	**2.250**	**-0.165**	**100.00%**
Money Market Funds	0.955	2.270	0.498	34.50%
Pooled Funds	1.001			36.16%
Fixed Deposits	0.719			25.98%
Call Accounts	0.093			3.36%
Total treasury investments income	**2.768**	**2.270**	**0.480**	**100.00%**

	Tower Hamlets		**16 London & Mets**	**121 Local authorities**
	31.03.23	**30.09.23**	**Average**	**Average**

Security				
Average Credit Score	4.40	3.90	4.50	4.47
Average Credit Rating	AA-	AA-	A+	AA-
Number of Counterparties & Funds	31	22	13	13
Proportion Exposed to Bail-in	59%	29%	65%	59%
Proportion Available within 7 days	39%	21%	64%	50%
Proportion Available within 100 days	78%	76%	85%	70%
Average Days to Maturity	38	42	29	13
Total Investments - Total Return	0.87%	5.14%	4.34%	3.66%

Compliance

3.39 The Corporate Director Resources reports that all treasury management activities undertaken during the year complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy Compliance with specific investment limits is demonstrated in table 7 below.

3.40 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 8 below.

Table 7: Debt Limits

	31.03.23 actual £m	31.03.24 forecast £m	30.09.23 actual £m	2023-24 Operational Boundary £m	2023-24 Authorised Limit £m	Complied (Y/N)
Borrowing	68.709	67.709	68.709	555.161	585.161	✓
PFI & finance leases	46.020	41.286	41.286	41.286	41.286	✓
Total debt	**114.729**	**108.995**	**109.995**	**596.447**	**626.447**	

Table 8: Investment Limits at 30 September 2023

Treasury Management Indicators

Counterparty	Amount £m	Counter Party Limit	Sector Limit	Complied
Invesco MMF	10.000	30.000	Unlimited	✓
Federated MMF	25.000	30.000		✓
Morgan Stanley MMF	25.000	30.000		✓
SUB TOTAL	**60.000**			
DBS	15.000	15.000	Unlimited	✓
Santander	15.000	15.000		✓
DBS Bank	15.000	15.000		✓
Landesbk Hessen-Thuringen/London	15.000	15.000		✓
Australia & New Zealand Banking Group	15.000	15.000		✓
SUB TOTAL	**75.000**			
Doncaster Metropolitan Borough Council	20.000	30.000	Unlimited	✓
Liverpool City Council	20.000	30.000		✓
SUB TOTAL	**40.000**			
DMO	20.000	Unlimited	Unlimited	✓
DMO	5.000	Unlimited		✓
DMO	20.000	Unlimited		✓
DMO	20.000	Unlimited		✓
SUB TOTAL	**65.000**			
CCLA LAMIT Property Fund (POOLED)	5.000	30.000	75.000	✓
SUB TOTAL	**5.000**			
Payden & Rygel Sterling Reserve Fund (POOLED)	10.000	30.000	150.000	✓
Royal London Enhanced Cash Plus (POOLED)	10.000	30.000		✓
Local Authorities' Property Fund	5.000	30.000		✓
CCLA Diversified Income Fund (POOLED)	5.000	30.000		✓
Payden Absolute Return Bond Fund (POOLED)	10.000	30.000		✓
Columbia Threadneedle Global Equity Income Fund Z (POOLED)	3.000	30.000		✓
Columbia Threadneedle Strategic Bond Fund Z (POOLED)	5.000	30.000		✓
Columbia Threadneedle Sterling Short-Dated Corporate Bond Fund (POOLED)	8.000	30.000		✓
Investec Fund Series I Diversified Income (POOLED)	6.000	30.000		✓
Schroder Income Maximiser Fund (POOLED)	3.000	30.000		✓
M & G Global Dividend Fund (POOLED)	2.000	30.000		✓
M & G Optimal Income Fund (POOLED)	2.000	30.000		✓
M & G UK Income Distribution Fund (POOLED)	3.000	30.000		✓
M & G Strategic Corporate Bond Fund (POOLED)	4.000	30.000		✓
SUB TOTAL	**76.000**			
TOTAL	**247.300**			

3.41 The Council measures and manages its exposure to treasury management risks using the following indicators.

3.42 Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score 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.

	31.03.23 Actual	30.09.23 Actual	2023.24 Target	Complied (Y/N)
Portfolio average credit	AA-	AA-	AA-	✓

3.1 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. The Council can borrow each period without giving prior notice as long as its within its CFR.

	31.03.23 Actual	30.09.23 Actual	2023.24 Target	Complied (Y/N)
Total cash available within 3 months	225.200	96.300	50.000	✓
Total sum borrowed in past 3 months without prior notice	nil	nil	nil	✓

3.2 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 all borrowing were:

	31.03.23 Actual	30.09.23 Actual	30.09.23 %	Upper Limit	Complied (Y/N)
Under 12 months	1.163	-	-	50%	✓
12 months and within 24 months	-	-	-	50%	✓
24 months and within 5 years	-	-	-	60%	✓
5 years and within 10 years	-	-	-	75%	✓
10 years and within 20 years	-	-	-	100%	✓
20 years and within 30 years	-	-	-	100%	✓
30 years and within 40 years	1.209	1.209	1.76%	100%	✓
40 years and above	67.500	67.500	98.24%	100%	✓
Total Borrowing	**69.872**	**68.709**	**100.00%**		

3.3 Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2023-24	2024-25	2025-26
Actual principal invested beyond year end	£76m	£76m	£76m
Limit on principal invested beyond year end	£150m	£150m	£150m
Complied	✓	✓	✓

Arlingclose's Economic Outlook for the remainder of 2023-24

3.4 The Council's treasury management adviser expects Bank Rate to rise further during the remainder of 2022/23 and to reach 4.25% by around the first quarter of the financial year 2023/24. Gilt yields are expected to remain broadly steady over the medium term, although with continued volatility across shorter time periods.

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00

4. <u>EQUALITIES IMPLICATIONS</u>

4.1 There are no equality implications directly arising from this report.

5. <u>OTHER STATUTORY IMPLICATIONS</u>

5.1 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 include:

- Best Value implications
- Consultations
- Environmental (including air quality)
- Risk management
- Crime Reduction
- Safeguarding
- Data protection/ Privacy Impact Assessment

5.2 Best Value Implications

The Treasury Management Strategy and Investment Strategy and the arrangements put in place to monitor them should ensure that the Council optimises the use of its monetary resources within the constraints placed on the Council by statute, appropriate management of risk and operational requirements.

Assessment of value for money is achieved through:

- Monitoring against benchmarks
- Operating within budget

5.3 Risk Management

There is inevitably a degree of risk inherent in all treasury activities.

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 authorities' treasury issues.

6 COMMENTS OF THE CHIEF FINANCE OFFICER

6.1 This report provides an update on Treasury Management activities from April 2023 to September 2023.

6.2 As at 30th September 2023 the Council had an outstanding investments portfolio of £265.5m. The annual investment income budget is £2.0m and current estimates indicate that this will be exceeded.

7. LEGAL COMMENTS

7.1 The Local Government Act 2003 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 require the Council to consider the various CIPFA publications that amount to proper accountancy practices when carrying out capital finance functions.

7.3 This noting report of the Corporate Director of Resources advises the

Committee of the Council's borrowing and investment activities for the half-year ending 30th September 2023 and is consistent with the key principles expressed in the Treasury Management Code. The Corporate Director of 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.

7.4 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).

APPENDICES

Appendix 1 – Investments Outstanding at 30th September 2023

Appendix 2 – Glossary

Local Government Act, 1972 Section 100D (As amended)

List of "Background Papers" used in the preparation of this report

Arlingclose LTD - Treasury Management Benchmarking Report and Quarter 2 2023-24 and Treasury Management Mid-Year Report Template

Officer contact details for documents:

Paul Audu, Interim Head of Pensions & Treasury, 020 7364 4248

Appendix 1

Investments as at 30 September 2023

Time to Maturity	Counterparty	From	Maturity	Amount £m	Rate
Overnight	Invesco MMF		On demand	8.000	1.32%
	Federated MMF		On demand	25.000	1.50%
	Aviva MMF		On demand	21.300	1.39%
	CCLA MMF		On demand	0.007	
	SUB TOTAL			**54.307**	
< 1 Month	DBS	25/07/2022	25/10/2022	5.000	2.00%
	SUB TOTAL			**5.000**	
1 - 3 Months	Santander		Notice	1.000	0.98%
	DBS Bank	17/08/2023	19/09/2023	15.000	5.25%
	Australia & New Zealand Banking Group	17/08/2023	19/09/2023	15.000	5.22%
	Payden & Rygel Sterling Reserve Fund (POOLED)			9.812	
	Royal London Enhanced Cash Plus (POOLED)			9.913	
	SUB TOTAL			**50.725**	
3 - 6 Months					
	SUB TOTAL			**0.000**	
6 - 9 Months					
	SUB TOTAL			**0.000**	
9 - 12 Months					
	SUB TOTAL			**0.000**	
> 12 Months	CCLA LAMIT Property Fund (POOLED)			4.322	
	CCLA Diversified Income Fund (POOLED)			4.664	
	Payden Absolute Return Bond Fund (POOLED)			8.734	
	Columbia Threadneedle Global Equity Income Fund Z (POOLED)			3.376	
	Columbia Threadneedle Strategic Bond Fund Z (POOLED)			4.917	
	Columbia Threadneedle Sterling Short-Dated Corporate Bond Fund (POOLED)			7.351	

	Investec Fund Series I Diversified Income (POOLED)			5.518	
	Schroder Income Maximiser Fund (POOLED)			2.301	
	M & G Global Dividend Fund (POOLED)			2.557	
	M & G Optimal Income Fund (POOLED)			1.817	
	M & G UK Income Distribution Fund (POOLED)			2.765	
	M & G Strategic Corporate Bond Fund (POOLED)			3.411	
	SUB TOTAL			**51.733**	
	GRAND TOTAL			**161.765**	

Appendix 2 – Glossary

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

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

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

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Non-Executive Report of the: **Audit Committee 22nd January 2024** **and** **Council 28th February 2024**	TOWER HAMLETS
Report of: Julie Lorraine, Corporate Director Resources	**Classification:** Unrestricted
DRAFT Treasury Management Strategy Statement, Investment Strategy Report and Capital Strategy Report for 2024-25 to 2026-27	

Originating Officer(s)	Abdulrazak Kassim, Director of Finance, Procurement and Audit John Harrison, Interim Director of Finance, Procurement and Audit Paul Audu, Interim Head of Pensions & Treasury
Wards affected	All wards

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 2021 Prudential Code and Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA TM

Code) and Department for Levelling Up Housing & Communities (DLUHC) issued revised Guidance on Local Authority Investments.

4) 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.

5) 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 (TMSS) contained in Appendix A;

   1.2) The recommended investment counterparties and limits in Appendix A paragraph 5.7;

   1.3) The Investment Strategy Report contained in Appendix B;

   1.4) The Capital Strategy, which includes the Minimum Revenue Provision (MRP) Policy Statement, contained in Appendix C;

   1.5) The Prudential and Treasury Management indicators contained in Appendix D; and

   1.6) The Treasury Management Policy Statement as set out in Appendix E.

   1.7) To note that the draft report may be subject to further changes as we finalise the budget reports.

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 (2021) 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 (2021) 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 <u>ALTERNATIVE OPTIONS</u>

1.2 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 <u>DETAILS OF THE REPORT</u>

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.

The 2023-24 Strategy and Current Investment Position and Performance

3.7 The Strategy for 2023-24 was approved by Full Council on 1 March 2023 and the Audit Committee received a Treasury Management mid-year review on 22 January 2024 which stated that:

a) The investment income budget for 2023-24 was £2m.

b) From a benchmarking exercise, a total return of 5.14% was achieved for the reporting period, which was 0.8% above the average 4.34% for similar Local Authorities return and 1.48% higher than the average return of 3.66% for all Local Authorities in the exercise; 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 UK'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, in particular 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 Authority had previously raised the majority of its long-term borrowing from the Public Works Loans Board (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 to retain its access to PWLB loans.

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

3.11 All long-term borrowing 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.

3.12 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 where affordable (voluntary revenue provision (VRP). The MRP policy is set out in the Capital Strategy contained in Appendix C.

3.13 There is no requirement to make an MRP for Housing Revenue Account (HRA) debt. To maximise resources available for investment in the existing stock and the new build programme, there will be no budgeted VRP to repay HRA debt. In order to assess borrowing affordability and constraints in the HRA, the Council will ensure that the interest cover ratio does not exceed 1.15. This change has been discussed with the Council's technical advisor and is in line with the policies of other London Boroughs.

3.14 Although reducing, 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.

3.15 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 majority of the Authority's surplus cash remains invested in short-term unsecured bank deposits, money market funds and local authority deposits.

3.16 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 the counterparties that meet these criteria 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.

3.17 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 2024-25

3.18 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 on cash balance (commercial investments).

Capital Strategy Report for 2024-25

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

3.20 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.

3.21 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 2026-27, along with the Authorised Limit and the Operational Limit for borrowing and Prudential Indicators (PIs). Any shortfall of resources results in a borrowing need.

Other Treasury Management Issues

3.22 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.

3.23 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

5.1 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.

a. **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.

b. **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 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 agree these matters and for them to then be considered by Council.

7.6 The report sets out the recommendations of the Corporate Director Resources in relation to the Council's Minimum Revenue Provision, Treasury Management Strategy and its Annual Investment Strategy. The Corporate Director Resources has responsibility for overseeing the proper administration of the Council's financial affairs, as required by section 151 of the Local Government Act 1972 and is the appropriate officer to advise in relation to these matters.

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

Linked Reports, Appendices and Background Documents

Linked Report

- None

Appendices

Appendix A - Treasury Management Strategy Statement

Appendix B - Investment Strategy Report

Appendix C - Capital Strategy Report

Appendix D - Prudential and Treasury Indicators

Appendix E - Treasury Management Policy Statement

Appendix F - Treasury Management Scheme of Delegation

Appendix G - Treasury Management Reporting Arrangement

Appendix H - Glossary

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

- None

Officer contact details for documents:
Paul Audu, Interim Head of Pensions & Treasury

Appendix A

Draft Treasury Management Strategy Statement (TMSS) 2024-25

1. Introduction

1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council 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 Council's prudent financial management.

1.2 Treasury risk management in the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council'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 Council's overall budget strategy and financial management framework.

2. External Context

2.1 **Economic background**: The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with war in Ukraine and the Middle East, will be major influences on the Authority's treasury management strategy for 2024-25.

2.2 The Bank of England (BoE) increased Bank Rate to 5.25% in August 2023, before maintaining this level for the rest of 2023. In December 2023, members of the BoE's Monetary Policy Committee voted 6-3 in favour of keeping Bank Rate at 5.25%. The three dissenters wanted to increase rates by another 0.25%.

2.3 The November quarterly Monetary Policy Report (MPR) forecast a prolonged period of weak Gross Domestic Product (GDP) growth with the potential for a mild contraction due to ongoing weak economic activity. The outlook for CPI inflation was deemed to be highly uncertain, with upside risks to CPI falling to the 2% target coming from potential energy price increases, strong domestic wage growth and persistence in price-setting.

2.4 Office for National Statistics (ONS) figures showed CPI inflation was 3.9% in November 2023, down from a 4.6% rate in the previous month and, in line with the recent trend, lower than expected. The core CPI inflation rate declined to 5.1% from the previous month's 5.7%, again lower than predictions. Looking ahead, using the interest rate path implied by financial markets the BoE expects CPI inflation to continue falling slowly, but taking until early 2025 to reach the 2% target before dropping below target during the second half 2025 and into 2026.

2.5 ONS figures showed the UK economy contracted by 0.1% between July and September 2023. The BoE forecasts GDP will likely stagnate through 2024. The BoE forecasts that higher interest rates will constrain GDP growth, which will remain weak over the entire forecast horizon.

2.6 **Credit outlook**: Credit Default Swap (CDS) prices were volatile during 2023, spiking in March on the back of banking sector contagion concerns following the major events of Silicon Valley Bank becoming insolvent and the takeover of Credit Suisse by UBS. After then falling back in Q2 of calendar 2023, in the second half of the year, higher interest rates and inflation, the ongoing war in Ukraine, and now the Middle East, have led to CDS prices increasing steadily.

2.7 Moody's revised its outlook on the UK sovereign to stable from negative to reflect its view of restored political predictability following the volatility after the 2022 mini-budget. Moody's also affirmed the Aa3 rating in recognition of the UK's economic resilience and strong institutional framework. Following its rating action on the UK sovereign, Moody's revised the outlook on five UK banks to stable from negative and then followed this by the same action on five rated local authorities. However, within the same update the long-term ratings of those five local authorities were downgraded.

2.8 There remain competing tensions in the banking sector, on one side from higher interest rates boosting net income and profitability against another of a weakening economic outlook and likely recessions that increase the possibility of a deterioration in the quality of banks' assets.

2.9 However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

2.10 **Interest rate forecast (December 2023):** Although UK inflation and wage growth remain elevated, the Council's treasury management adviser Arlingclose forecasts that Bank Rate has peaked at 5.25%. The Bank of England's Monetary Policy Committee will start reducing rates in 2024 to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose sees rate cuts from Q3 2024 to a low of around 3% by early mid 2026.

2.11 Arlingclose expects long-term gilt yields to be broadly stable at current levels (amid continued volatility), following the decline in yields towards the end of 2023, which reflects the expected lower medium-term path for Bank Rate. Yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

3 Local Context

3.1 For the purpose of setting the Council's budget and MTFS, it has been assumed that new treasury investments in 2024-25 will be made at an average rate range of 5.25% depending on duration and future Bank of England rate rises, and that new long-term loans will be borrowed at an average rate of 5.0%. However, reduction in cash balances will significantly impact interest earned.

3.2 On 31 December 2023, the Council held £68.7m of external debt and £249.98m of treasury investments. This is set out in further detail at Annex B. Forecast changes in these sums are shown in the balance sheet analysis Table below.

Table 1: Balance Sheet summary and forecast

	31.03.23 actual £m	31.03.24 estimate £m	31.03.25 forecast £m	31/03/26 forecast £m	31/03/27 forecast £m
General Fund CFR	404.222	403.653	423.473	434.576	423.092
HRA CFR	165.503	181.067	219.091	266.694	311.601
Total CFR	**569.725**	**584.720**	**642.564**	**701.270**	**734.693**
Less other debt liabilities *	(46.020)	(41.286)	(55.789)	(49.673)	(46.070)
Borrowing CFR	**523.705**	**543.434**	**586.775**	**651.597**	**688.623**
External borrowing	(68.709)	(68.709)	(68.709)	(68.709)	(68.709)
Internal borrowing	**454.996**	**474.725**	**518.564**	**582.888**	**619.914**
Less usable reserves	(649.675)	(543.825)	(477.880)	(452.480)	(422.780)
Less working capital	(43.271)	(58.152)	(58.152)	(58.152)	(58.152)
Treasury investments or (new borrowing)	**237.950**	**127.252**	**17.966**	**(72.526)**	**(138.982)**

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

3.3 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 Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.4 Actual internal borrowing on 31 March 2023 was £455.0m and forecast internal borrowing on 31 March 2024 is forecast at £474.7m. Internal borrowing represents the actual borrowing which is yet to be financed with external debt. By not borrowing to date the council has saved millions of pounds in debt interest.

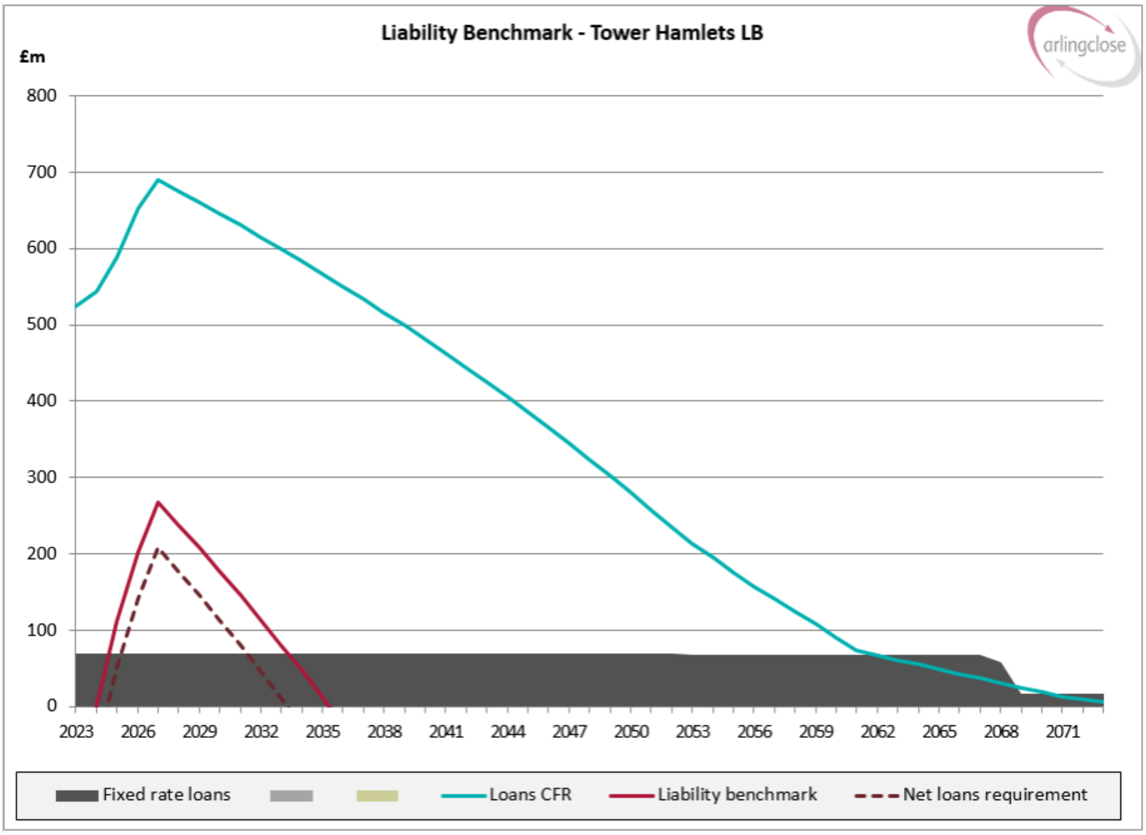
3.5 However, the Council has an increasing borrowing requirement (CFR) due to the capital programme and lower cash balances as the level of reserves is reduced. The Council could therefore be required to borrow at least £267.7m over the forecast period.

3.6 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation between 2024-25 to 2026-27.

3.7 **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 £60m at each year-end to maintain sufficient liquidity but minimize credit risk.

Table 2: Liability benchmark

	31/03/23 Actual £m	31/03/24 Estimate £m	31/03/25 Forecast £m	31/03/26 Forecast £m	31/03/27 Forecast £m
Borrowing CFR	**523.705**	**543.434**	**586.775**	**651.597**	**689.121**
Less usable reserves	(649.675)	(543.825)	(477.880)	(452.480)	(422.780)
Less working capital	(58.152)	(58.152)	(58.152)	(58.152)	(58.152)
Net loans requirement	**(184.122)**	**(58.543)**	**50.743**	**141.965**	**208.189**
Plus liquidity allowance	60.000	60.000	60.000	60.000	60.000
Liability benchmark	**(124.122)**	**1.457**	**110.743**	**200.965**	**267.691**



3.8 The liability benchmark suggests the Council will require a minimum level of new borrowing of £45m in 2024-25 to maintain the minimum investment level of £60m at the year end. This largely represents the nominal value of strategic funds the Council has invested for long-term returns, these can however be sold if necessary. The actual level of borrowing at the year-end depends on whether the Council's spending plans proceed as planned, cash flows and the actual timing of borrowing.

4 Borrowing Strategy

4.1 The Council currently holds £68.7m of external borrowing, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 2 shows that the Council expects to borrow around £50m in 2024-25 (the difference between the liability benchmark and existing borrowing). The Council may also borrow to pre-fund future years' requirements, provided this does not exceed the authorized limit for borrowing of £637m.

4.2 **Objectives:** The Council'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 Council's long-term plans change is a secondary objective.

4.3 **Strategy:** The Council'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 at a 15-year high but are expected to fall in the coming years, it is likely to be more cost-effective over the medium-term to either use internal resources, or to borrow short-term loans instead.

4.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing or short-term borrowing 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. Council officers are able to draw on borrowing advice as required to ascertain whether the Council borrows additional sums at long-term fixed rates in 2024-25 with a view to keeping future interest costs low, even if this causes additional costs in the short-term.

4.5 The Council 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 Council intends to avoid this activity in order to retain its access to PWLB loans.

4.6 The Council 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. The Council may additionally borrow short-term loans to cover unplanned cash flow shortages.

4.7 The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB Lending Facility (formerly the Public Works Loan Board)
- UK Infrastructure Bank Ltd
- 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
- retail investors via a regulated peer-to-peer platform
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

4.8 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
- similar asset-based finance

4.9 **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.

4.10 **Short-term and variable rate loans**: These loans may leave the Council 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. The Council will avoid variable rate loans except on advice.

4.11 **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 Council 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. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

5 Treasury Investment Strategy

5.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's treasury investment balance has ranged between £237.95m and £283.94m. Investment levels are expected to reduce in the forthcoming year as capital expenditure increases and reserves and balances reduce.

5.2 The CIPFA Code requires the Council 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 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.

5.3 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. The Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

5.4 **Strategy:** As demonstrated by the liability benchmark in table 3, since capital expenditure is not fully funded with Council resources, capital receipts or grants, the Council expects to be a long-term borrower and new or existing treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risks into different sectors and boost investment income.

5.5 **Business models:** Under the IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council 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):** Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Authority's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

5.7 **Approved counterparties:** The Council 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 and current financial status)*	25 years	£25m	Unlimited
Secured investments *	25 years	£25m	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

5.8 **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.

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

5.10 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities, and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK 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.

5.11 **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.

5.12 **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.

5.13 **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.

5.14 **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 Council will exercise due care by diversifying its liquid investments across various providers, to ensure access to cash at all times.

5.15 **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 Council 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 Council's investment objectives will be monitored regularly.

5.16 **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.

5.17 **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 Council's investment at risk.

5.18 **Operational Bank Accounts:** The Council 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 5.7. 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 Council maintaining operational continuity.

5.19 **Risk Assessment and Credit Ratings**: Credit ratings are obtained and monitored by the Council'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.

5.20 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.

5.21 **Other information on the security of investments**: The Council 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 Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

5.22 The Authority is aware that investment with certain counterparties, while considered secure from a purely financial perspective, may leave it open to criticism, valid or otherwise, that may affect its public reputation, and this risk will therefore be taken into account when making investment decisions.

5.23 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council 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 Council'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.

5.24 **Investment limits**: In order that no more than 25% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £30 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

5.25 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 4 - 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

5.26 **Liquidity management**: The Council 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 Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast. The Council 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 Council measures and manages its exposures to treasury management risks using the following indicators.

6.2 **Security:** The Council 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 Council 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	£30m

6.4 **Interest rate exposures**: This indicator is set to control the Council'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

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.

6.5 **Maturity structure of borrowing:** This indicator is set to control the Council'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%

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.

6.6 **Long-term Treasury management investments:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury investments will be:

Price risk indicator	2024-25	2025-26	2026-27
Limit on principal invested beyond year end/ no fixed maturity date	£150m	£140m	£125m

7 Related Matters

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

7.2 **Financial Derivatives:** The Council 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 Council 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.

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

7.4 **Housing Revenue Account:** The Council maintains two loan pools General Fund and HRA. Loans are 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) are 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 Council's average interest rate on treasury investments, adjusted for credit risk.

7.5 **External Funds:** From time to time, the Council may hold funds on behalf of other bodies which will be separated where possible from the Council's cash via separate bank accounts or separate ledger codes. Where possible interest will be apportioned, and appropriate impairment losses applied as necessary.

7.6 **Markets in Financial Instruments Directive (MiFID)**: The Council 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 Council's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

8 Financial Implications

8.1 The draft budget for investment income in 2024-25 is £7.8m, based on an average investment portfolio £175m at an average interest rate of 4.5%. The draft budget for debt interest payable in 2024-25 is £3.3m, based on an average debt portfolio of £85m at a consolidated average interest rate of 3.9%. If actual levels of investments and borrowing, or actual interest rates, differ from that forecast, performance against budget will be correspondingly different.

8.2 The revised budget for MRP (borrowing) in 2023-24 is £10.7m and for 2024-25 £11.2m.

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 due to amount invested in each counterparty
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 borrowing 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

Annex A

Arlingclose Economic and Interest Rate Forecast – December 2023

Underlying assumptions:

- UK inflation and wage growth remain elevated but have eased over the past two months fueling rate cuts expectations. Near-term rate cuts remain unlikely, although downside risks will increase as the UK economy likely slides into recession.

- The MPC's message remains unchanged as the Committee seeks to maintain tighter financial conditions. Monetary policy will remain tight as inflation is expected to moderate to target slowly, although some wage and inflation measures are below the Bank's last forecasts.

- Despite some deterioration in activity data, the UK economy remains resilient in the face of tighter monetary policy. Recent data has been soft but mixed; the timelier PMI figures suggest that the services sector is recovering from a weak Q3. Tighter policy will however bear down on domestic and external activity as interest rates bite.

- Employment demand is easing. Anecdotal evidence suggests slowing recruitment and pay growth, and we expect unemployment to rise further. As unemployment rises and interest rates remain high, consumer sentiment will deteriorate. Household and business spending will therefore be weak.

- Inflation will fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. We believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects has diminished.

- Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling, will require significant policy loosening in the future to boost activity.

- Global bond yields will remain volatile. Markets are currently running with expectations of near-term US rate cuts, fuelled somewhat unexpectedly by US policymakers themselves. Term premia and bond yields have experienced a marked decline. It would not be a surprise to see a reversal if data points do not support the narrative, but the current 10-year yield appears broadly reflective of a lower medium- term level for Bank Rate.

- There is a heightened risk of fiscal policy and/or geo-political events causing substantial volatility in yields.

Forecast:

- The MPC held Bank Rate at 5.25% in December. We believe this is the peak for Bank Rate.

- The MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. We see rate cuts from Q3 2024 to a low of around 3% by early-mid 2026.

- The immediate risks around Bank Rate have become more balanced, due to the weakening UK economy and dampening effects on inflation. This shifts to the downside in the short term as the economy weakens.

- Long-term gilt yields are now substantially lower. Arlingclose expects yields to be flat from here over the short-term reflecting medium term Bank Rate forecasts. Periodic volatility is likely.

	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
3-month money market rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.40	5.40	5.40	5.30	5.15	4.80	4.30	4.10	3.80	3.50	3.25	3.05	3.05
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
5yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.77	3.75	3.75	3.75	3.70	3.60	3.50	3.50	3.40	3.30	3.30	3.30	3.35
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
10yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.72	3.75	3.80	3.80	3.80	3.80	3.80	3.80	3.75	3.65	3.60	3.65	3.70
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
20yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.16	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.25
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
50yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.76	3.80	3.85	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.95	3.95	3.95
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

PWLB Standard Rate = Gilt yield + 1.00%
PWLB Certainty Rate = Gilt yield + 0.80%
PWLB HRA Rate = Gilt yield + 0.40%
UK Infrastructure Bank Rate = Gilt yield + 0.40%

Annex B

Existing Investment and Debt Portfolio Position

£m	31.12.2023 Actual Portfolio £m	31.12.2023 Average Rate %
External borrowing:		
Public Works Loans Board	51.209	2.55
Other Loans	17.500	4.34
Sub-total external borrowing	**68.709**	**3.01**
Other long-term liabilities:		
Private Finance Initiative	26.655	
Leases	26.828	
Sub-total other long-term liabilities	**53.483**	
Total gross external debt	**123.355**	
Treasury Investments		
Bank Call Accounts	1.000	0.40
Banks & Building Societies (unsecured)	00.000	0.00
Government	40.000	16.00
Local authority	00.000	0.00
Money Market Funds	132.983	53.20
Cash-plus funds	20.000	8.00
Strategic pooled funds	56.000	22.40
Total treasury investments	**249.983**	
Net Debt	**126.628**	

Appendix B

Draft Non-treasury Investment Strategy Report 2024-25

1. Introduction

1.1 The Council invests its money for two broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments)
- to support local public services by lending to or buying shares in other organisations (service investments)

1.2 This investment strategy meets the requirements of the statutory guidance issued by the Government in January 2018 and focuses on service investments.

1.3 The statutory guidance defines investments as "all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios." The Council interprets this to exclude (a) trade receivables which meet the accounting definition of financial assets but are not investments in the everyday sense of the word and (b) property held partially to generate a profit but primarily for the provision of local public services. This aligns the Council's definition of an investment with that in the 2021 edition of the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, a more recent piece of statutory guidance.

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 CIPFA. The balance of treasury management investments is expected to fluctuate between £56m and £200m during the 2024-25 financial year.

2.2 The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities. Full details of the Council's policies and its plan for 2024-25 for treasury management investments are covered in a separate document, the Treasury Management Strategy Statement.

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 and Oxford House.

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 1 - loans for service purposes

Category of borrower	Actuals at 31.03.2023			2024-25
	Balance owing £m	Loss allowance £m	Net figure in accounts £m	Approved Limit £m
Subsidiaries & associates				
Seahorse	0.030	-	0.030	50.000
Place Ltd	0.646	-	0.646	
Mulberry Homes	0.010	-	0.010	
Local charities				2.000
Oxford House	0.728	-	0.728	
Employees	0.160	-	0.160	0.700
Sundry loan advances	0.601	-	0.601	
TOTAL	**2.175**	**-**	**2.175**	**52.700**

3.3 Loans to local charities relate to Oxford House. 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 The Council assesses the risk of loss before entering and whilst holding service loans. Accounting standards require the Council 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 shares to support the provision of local public services, housing in the local community and to stimulate local economic growth. The Council has nominal value shares in several companies - Tower Hamlets Local Education Partnership Ltd, Mulberry Housing, Seahorse Homes Ltd and Tower Hamlets Homes. Capital Letters is owned along with other London boroughs, the company is limited by guarantee. The Council is one of five London boroughs with shareholdings in PLACE Ltd. The company is limited by guarantee therefore the Council has no shareholdings in PLACE Ltd.

4.2 Seahorse Homes is a wholly owned company limited by shares established in 2017, to provide market rented homes and deliver a return on investments, both to cross-subsidise affordable housing and to fund wider General Fund services. The Council holds 10% of the shares in this company and has initially committed £6m in equity. The company has yet to start trading.

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

Table 2 - shares held for service purposes

Category of company	Actuals at 31.03.2023			2024-25
	Amounts invested £m	Gains or losses £m	Value in accounts £m	Approved Limit £m
Subsidiaries	6.00	-	6.00	6.00
Suppliers	-	-	-	-
TOTAL	**6.00**	**-**	**6.00**	**6.00**

4.4 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.

4.5 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.

4.6 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 The Council has historically provided financial guarantees on properties transferred to social landlords. No liabilities have been payable on these guarantees.

6. Capacity, Skills and Culture

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

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

7. Investment Indicators

7.1 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.

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

Table 3 - total investment exposure

Total investment exposure	31.03.2023 Actual £m	31.03.2024 Forecast £m	31.03.2025 Forecast £m
Treasury management investments	237.950	175.000	130.000
Service investments: Loans	2.175	2.175	2.175
Service investments: Shares	6.000	6.000	6.000-
TOTAL INVESTMENTS	**246.125**	**183.175**	**138.175**
Commitments to lend	-	-	-
Guarantees issued on loans	-	-	-
TOTAL EXPOSURE	**246.125**	**183.175**	**138.175**

7.3 **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.

7.4 **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 4 - investment rate of return (net of all costs)

Investments net rate of return	2022-23 Actual	2023-24 Forecast	2024-25 Forecast
Treasury management investments	2.5%	5.25%	4.5%
Service investments: Loans	-	-	-
Service investments: Shares	-	-	-
Commercial investments: Property	-	-	-
All Investments	2.5%	5.25%	4.5%

*forecast return includes income returns from externally managed pooled funds

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Appendix C

Capital Strategy 2024-25

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 in Tower Hamlets Council along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes-technical areas.

1.2 Decisions made this year on capital and treasury management will have financial consequences for the Council 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.

Capital Expenditure and Financing

1.3 Capital expenditure is where the Council spends money on assets, such as property or vehicles that will be used for more than one year. The Council has some limited discretion on what counts as capital expenditure. At this stage capital budgets are still subject to change, including changes arising due to the implementation of IFRS 16 - Accounting for Leases.

1.4 In 2024-25 the Council's planned capital spending is £250.4m, £128.3m in the General Fund and £122.2m in the HRA, as summarised below:

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

Capital Expenditure	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
General Fund	94.199	88.862	128.282	59.672	14.301
HRA	43.079	72.260	122.161	151.993	109.465
TOTAL	**137.278**	**161.122**	**250.443**	**211.665**	**123.766**

* Capital expenditure arising from a change in the accounting for leases does not represent cash expenditure.

1.5 The main General Fund capital projects include work on the New Leisure Centre, waste and recycling, capital footway and public realm improvement and new infrastructure.

1.6 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 and includes £357.9m on the building of new homes over the period 2023-24 to 2026-27 of which £151.3m is forecast to be funded from prudential borrowing.

1.7 **Governance**: Following an officer process, taking account of service priorities and Mayor's Advisory Board direction, the final capital programme is presented to Cabinet in January and to Council in February/March each year for approval.

1.8 All capital expenditure must be financed, from external sources (e.g., government grants, Community Infrastructure Levy (CIL) and other contributions), the Council's own resources (revenue, reserves, capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the approved capital programme is as follows:

Table 2: Capital financing in £ millions

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
External resources	53.170	73.694	121.657	45.869	16.949
Capital receipts	11.343	19.504	42.320	58.735	26.409
Revenue resources	23.748	35.303	31.884	30.067	30.000
Debt	49.017	32.621	54.582	76.994	50.408
TOTAL	**137.278**	**161.122**	**250.443**	**211.665**	**123.766**

** debt arising from changes to accounting for leases are to be reflected in the approved capital programme*

1.9 Debt is only a temporary source of finance since loans and leases must be repaid. This is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP). Proceeds from capital receipts is also used to finance the capital program. Table 3 below shows the level of capital receipts used in place of debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of debt finance in £millions

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
Planned MRP	13.503	17.627	16.738	18.288	16.985
Capital receipts	-	-	-	-	-
TOTAL	**13.503**	**17.627**	**16.738**	**18.288**	**16.985**

1.10 The Council's full Minimum Revenue Provision Statement is attached at Annex A.

1.11 The Council'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 and capital receipts used to replace debt. The CFR is expected to increase by £38.3m during 2024-25. 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

Capital Financing requirement (CFR)	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
General Fund	404.222	403.653	423.473	434.576	423.092
HRA	165.503	181.067	219.091	266.694	311.601
TOTAL CFR	**569.725**	**584.720**	**642.564**	**701.270**	**734.693**

The CFR has been increased in respect of changes in the accounting for leases.

1.12 **Asset management**: To ensure that capital assets continue to be of long-term use, the Council has an asset management strategy in place.

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. The Authority is currently also permitted to spend capital receipts “flexibly” on service transformation projects until 2025-26. Repayments of capital grants, loans and investments also generate capital receipts.

Table 5: Capital Receipts receivable in £ millions

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
General Fund	28.650	25.000	20.000	20.000	20.000
Loans repaid	-	-	-	-	-
TOTAL CFR	**28.650**	**25.000**	**20.000**	**20.000**	**20.000**

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 Council 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 2023, the Council had £68.7m of borrowings at an average interest rate of 3.01% and £225.15m of treasury investments at an average rate of 4.9%.

2.3 **Borrowing strategy**: The Council’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 Council therefore seeks to strike a balance between cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher. The Council does not borrow to invest for the primary purpose of financial return and therefore retains full access to Public Works Loans Board as its main source of borrowing.

2.4 Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities and leases) are shown below, compared with the Capital Financing Requirement (see above).

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

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
Actual debt (including PFI & leases)	114.729	109.995	124.498	118.382	114.779
Estimated new borrowing	-	-	50.000	135.000	205.000
Total debt	**114.729**	**109.995**	**174.498**	**253.382**	**319.779**
Capital Financing Requirement	**569.725**	**584.720**	**642.564**	**701.270**	**734.693**

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

2.6 **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 that cash and investment balances are kept to a minimum level of £60m at each year-end. This benchmark is forecast to increase to £267.7m over the next three years.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.03.23 Actual	31.03.24 Forecast	31.03.25 Budget	31.03.26 Budget	31.03.27 Budget
Forecast borrowing	68.709	68.709	118.709	203.709	273.709
Liability benchmark	(124.122)	1.457	110.743	200.965	267.691

2.7 The table shows that the Council expects to remain borrowed above its liability benchmark.

2.8 **Affordable borrowing limit**: The Council 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

	2023-24	2024-25	2025-26	2026-27
	Limit	Limit	Limit	Limit

Authorised limit – borrowing	573.000	637.000	702.000	788.000
Authorised limit - PFI and leases	47.000	76.000	70.000	67.000
Authorised limit - total external debt	**620.000**	**713.000**	**772,000**	**855.000**
Operational boundary – borrowing	543.000	587.000	652.000	688.000
Operational boundary - PFI and leases	47.000	56.000	50.000	47.000
Operational boundary – total external debt	**585.000**	**643.000**	**702.000**	**735.000**

2.9 **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.

2.10 The Council'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, money market funds 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, strategic pooled funds, 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 Council may request its money back at short notice.

Table 9: Treasury Management Investment forecast in £ millions

	31.03.23 actual	**31.03.24 forecast**	**31.03.25 budget**	**31.03.26 budget**	**31.03.27 budget**
Near-term investments	197.000	71.000	12.000	7.000	10.000
Longer-term investments	56.000	56.000	56.000	56.000	56.000
TOTAL	**253.000**	**127.000**	**68.000**	**63.000**	**66.000**

2.11 Further details on treasury investments are in pages 5.1 to 5.26 of the Treasury Management Strategy

2.12 **Risk Management**: The effective management and control of risk are prime objectives of the Council'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.

2.13 The treasury management prudential indicators are at paragraphs 6.1 to 6.6 of the Treasury Management Strategy.

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 Council 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 £2.1m with the largest being loans to Oxford House and PLACE Ltd.

3.3 Governance: Decisions on service investments are made by the relevant service manager in consultation with the Strategic Heads of Finance and 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

3.4 Prudential indicator: Net income from commercial and service investments to net revenue stream. The Council has nominal commercial/service investments and has not borrowed to invest in the commercial portfolio.

4. Liabilities

4.1 In addition to debt detailed above, the Council is committed to making future payments to cover its pension fund deficit (valued at £419m at 31 March 22). The Council 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 2022, the Tower Hamlets Homes pension fund had an IAS19 surplus of £8.4m. 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 Strategic Heads of Finance and Corporate Director Resources. The risk of liabilities crystalising and requiring payment is reported in the Council's accounts.

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. 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 10a: Proportion of Financing Costs to Net Revenue Stream (General Fund)

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
Financing costs (£m)	4.126	7.324	6.131	8.839	10.985
Proportion of net revenue stream	1.4%	1.6%	1.3%	1.9%	2.4%

Table 10b: Proportion of Financing Costs to Net Revenue Stream (HRA)

	2022-23 Actual	2023-24 Forecast	2024-25 Budget	2025-26 Budget	2026-27 Budget
Financing costs (£m)	6.985	7.634	8.426	9.086	10.463
Proportion of net revenue stream	6.9%	6.7%	6.8%	7.0%	7.7%

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 in some cases for up to 50 years into the future. The Corporate Director Resources is satisfied that the proposed capital programme is prudent, affordable and sustainable.

6. Knowledge and Skills

6.1 The Council 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 Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers and Savills as property consultants. This approach ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

Minimum Revenue Provision (MRP) Policy Statement 2024-25

1. 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 2023-24

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

3. For unsupported capital expenditure incurred after 31 March 2008, MRP will be determined by charging 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).

4. 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).

5. Where former operating leases are brought onto the balance sheet due to the adoption of the IFRS 16 Leases accounting standard, the asset values adjusted for accruals, prepayments then, the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.

6. For capital expenditure loans to third parties, the Authority will make nil MRP unless (a) the loan is an investment for commercial purposes and no repayment was received in year or (b) an expected credit loss was recognised or increased in-year, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment on loans that are investments for commercial purposes, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. Sufficient MRP will be charged to ensure that the outstanding capital financing requirement (CFR) on the loan is no higher than the principal amount outstanding less the expected credit loss. This option was proposed by the government in its recent MRP consultation and in the Authority’s view is consistent with the current regulations.

7. Under the DLUHC Guidance MRP is not required to be charged in respect of assets held within the Housing Revenue Account (HRA). Since removal of the HRA debt cap by central government in 2018, the Council has made a voluntary revenue provision (VRP) on new HRA debt funded capital expenditure. Future provision will

be subject to affordability and the HRA Business Plan.

8. Where there is a change in policy from the previous year for any category of expenditure, this change will be reported to Council including reason the change is prudent.

9. Capital expenditure incurred during 2023-24 will not be subject to a MRP charge until 2024-25 or later.

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Appendix D

Draft PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS FOR 2024-25

Capital Expenditure	**2022-23 actual £m**	**2023-24 current £m**	**2024-25 forecast £m**	**2025-26 forecast £m**	**2026-27 forecast £m**
General Fund	94.199	88.862	128.282	59.672	14.301
Housing Revenue Account (HRA)	43.079	72.260	122.161	151.993	109.465
Total	**137.278**	**161.122**	**250.443**	**211.665**	**123.766**
Financed by:					
External resources (grants and developer contributions)	53.170	73.694	121.657	45.869	16.949
Capital Receipts	11.343	19.504	42.320	58.785	26.409
Revenue Financing	23.748	35.303	31.884	30.067	30.000
Net financing need (borrowing) for the year	**49.017**	**32.621**	**54.582**	**76.994**	**50.408**
Prudential Borrowing - GF	33.808	14.866	16.558	29.391	5.501
HRA Borrowing	15.209	17.755	38.024	47.603	44.907
Net financing need (borrowing) for the year	**49.017**	**32.621**	**54.582**	**76.994**	**50.408**

	2022-23 Limit £m	2023-24 Limit £m	2024-25 Limit £m	2025-26 Limit £m	2026-27 Limit £m
Authorised limit - borrowing	609	573	637	702	788
Authorised limit - PFI and leases	49	47	61	55	52
Authorised limit - total external debt	**658**	**620**	**698**	**757**	**840**
Operational boundary - borrowing	569	543	587	652	688
Operational boundary - PFI and leases	49	42	56	50	47
Operational boundary - total external debt	**618**	**585**	**643**	**702**	**735**
Upper limit for total principal sums invested for over 365 days (per maturity date)	**£150m**	**£150m**	**£150m**	**£140m**	**£125m**

Maturity structure of new fixed rate borrowing during 2024-25	**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

- 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. 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.
BID	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.