COMMITT EE	DATE	CLASSIFICATION	REPORT NO.
Council	**25 January 2012**	**Unrestricted**	

REPORT OF:	TITLE:
Corporate Director-Resources ORIGINATING OFFICER(S): **Oladapo Shonola – Chief Financial Strategy Officer**	**TREASURY MANAGEMENT STRATEGY STATEMENT, MINIMUM REVENUE PROVISION POLICY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2011/12** Ward(s) affected: **All**

Lead Member	**Cllr Alibor Choudhury – Resources**
Community Plan Theme	**All**
Strategic Priority	**One Tower Hamlets**

1. SUMMARY

1.1 The Annual Investment Strategy is one of three strategy documents that the Council is obliged to produce in relation to its treasury management arrangements in line with Communities & Local Government (CLG) and the CIPFA Treasury Management Code of Practice (The Code). The three statements are :

- A Treasury Management Strategy which sets out the Council's proposed borrowing for the financial year and establishes the parameters (prudential and treasury indicators) within which officers under delegated authority may undertake such activities;
- An annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments; and
- A policy statement setting out the basis on which provision is to be made in the revenue accounts for the repayment of borrowing – Minimum Revenue Provision (MRP) Policy Statement.

1.3 All of these documents are regularly reviewed, but particularly so for the Investment Strategy to ensure that investment returns are maximised within the constraints of the Council's risk criteria. These reviews are undertaken to ensure that the Strategy is adapted to take advantage of new/emerging opportunities in the financial markets whilst still maintaining effective control over risk.

2. DECISIONS REQUIRED

Council is recommended to adopt:-

2.1 The Treasury Management Strategy Statement set out in sections 6-10 of **Appendix 1**.

2.2 The Revised Annual Investment Strategy set out in section 11 of **Appendix 1**.

2.3 The Minimum Revenue Provision Policy Statement set out in section 12 of **Appendix 1**.

3 REASONS FOR DECISIONS

3.1 It is consistent with the requirements of treasury management specified by CIPFA, to which the Council is required to have regard under the Local Government Act 2003 and regulations made under that Act, for the Council to produce three strategy statements to support the Prudential Indicators which ensure that the Council's capital investment plans are affordable, sustainable and prudent. The three documents that the Council should produce are:

- Treasury Management Strategy, including prudential indicators;
- Investment Strategy; and
- Minimum Revenue Provision Policy Statement.

3.2 The Treasury Management/Investment Strategies are continually reviewed to ensure that returns are being maximised within set credit risk criteria. Following recent meetings with the Council's treasury management advisors, Sector,, further opportunities to increase investment returns without significantly increasing the credit risk criteria have been identified. Legislation requires Council to approve the Treasury Management/Investment Strategies and any amendments there to.

4 ALTERNATIVE OPTIONS

4.1 The Council is bound by legislation to have regard to the CIPFA requirements for treasury management. 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.

4.2 The strategies and policy statement put forward in the report are considered the best methods of achieving the CIPFA requirements. Whilst it may be possible to adopt variations of the strategies and policy statement, this would risk failing to achieve the goals of affordability, sustainability and prudence.

5 BACKGROUND

5.1 Full Council approved the current Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and the Annual Investment Strategy in February 2011.

5.2 Officers have operated within the boundaries of the approved treasury management policies and statements and the Audit Committee continue to receive regular reports as outlined in the reporting framework also approved at Full Council in February 2011 and detailed in Appendix 1 of this report.

5.3 Although investment returns are in line with the budget for 2011-12, and having regard for the current uncertainties in the financial markets, the Council's treasury management advisors, Sector, recommended some changes to the current Annual Investment Strategy that would increase investment returns without any significant increase in the level of risk exposure.

5.4 The recommended changes are detailed in Section 6 below and have been incorporated in the amended Treasury management Strategy Statement and Annual Investment Strategy attached as Appendix 1.

6 PROPOSED CHANGES

6.1 The Investment Strategy for 2011/12 was put together in recognition of the recent relative recovery in the financial sector following the banking crisis that led to a global recession. Money markets in the UK have become more stable although Bank of England base rate is still being held at the historical low rate of 0.50%.

6.2 In 2009, the Corporate Director-Resources in response to market uncertainties implemented interim credit criteria which restricted term investments to UK institutions which had support guarantees from the British Government. But this policy is unsustainable in the long term which was why Members were asked to remove this restriction in February.

6.3 The current Strategy does not restrict investment in UK Government instruments or UK Government supported institutions (such as RBS and Lloyds Groups), but it dictates that investment can only be placed with institutions with high credit quality in countries with the highest sovereign ratings (AAA).

6.4 Officers are continually reviewing the Investment Strategy to ensure that returns are maximised within agreed risk parameters. Following meetings with the Council's treasury management consultants, it was suggested that a revision of the Investment Strategy could lead to higher returns being achieved without significantly increasing the credit risk criteria approved by Council in February 2011.

6.5 In reviewing the investment strategy, officers along with the Council's treasury advisers are looking to balance risk and reward in a way that result in a balanced and optimised investment portfolio for the Council. Therefore, it is proposed that;

- the individual/group limit for investment in an institution or group that is wholly/partly owned by the UK government is increased to £45m (currently £30m). This measure does not increase the portfolio risk profile.
- up to £25m (previously £12m) of available cash balances may be invested for periods over 364 days and up to 3 years. Although, only £15m can be invested between 2 to 3 years maturity. This change is proposed to reflect the higher level of cash balances currently held compared to the original cash flow forecasts, and
- the Strategy allows investment in structured products within current limits/restrictions to facilitate lock in to premium rates from day one of an investment being made.

The detailed credit criteria are set out in section 11.5.5 of **Appendix 1** and it is recommended that these criteria be adopted.

6.6 A summary of the credit criteria is detailed in the tables below..

Specified Investments:

(All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high credit' quality criteria where applicable). The council will continue its policy of lending surplus cash to counterparties that have high credit ratings, defining 'high credit rating' as being F1+ Fitch short-term and AA- long-term credit rating.

Table 1

Institution	**Minimum High Credit Criteria**	**Use**	**Limit**
Debt Management Office (DMO) Deposit Facility	Not applicable	In-house	£100m*
Term deposits – Other Local Authorities	Not applicable	In-house	£10m**
Term deposits – banks and building societies	Short-term F1+, Long-term AA-	In-house	£30m
Institutions with Government guarantee on ALL deposits by high credit rated (sovereign rating) countries.	Sovereign rating	In-house	£30m
UK Government Gilts	Long Term AAA	In-house	£20m
Institutions with UK Government support.	Sovereign rating	In-house	£30m
Institutions that are owned/part owned by the UK Government	Sovereign rating	In-house	£45m
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)			
Money Market Funds	AAA rated	In-house	£10m

Definitions of credit ratings are attached at **Appendix 2**.

* Although limit has been set at £100m for the DMO, in reality there is no restriction on placement with the UK government.

** The group limit for local authorities has been set at £100m.

Non-Specified Investments:

All investments that do not qualify as specified investment are termed non-specified investments. The credit criteria for non-specified investments are detailed in the below table.

Table 2

Institution	**Minimum High Credit Criteria**	**Use**	**Limit**
Term deposits – Banks and Building Societies	Sovereign rating AAA Short-term F1+, Long-term AA-	In-house	£25m
Structured Deposits: Fixed term deposits with variable rate and variable maturities	Sovereign rating AAA Short-term rating F1+ Long-term rating AA-	In-house	£25m
UK Government Gilts	Long Term AAA	In-house	£25m

6.7 The Council uses Fitch ratings (or equivalent from other agencies if Fitch does not provide a rating) to derive its counterparty criteria, but will take into consideration ratings from all three main credit ratings providers when compiling its counterparty list. The Council will take an overall view on its counterparties so that an organisation could be removed from the list if the predominant view of the organisation is pessimistic. Where the overall view of the three main ratings agency is pessimistic, the Council is likely to adopt the most pessimistic of the available ratings.

7 COMMENTS OF THE CHIEF FINANCIAL OFFICER

7.1 The comments of the Chief Finance Officer have been incorporated into the report.

8 CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL SERVICES)

8.1 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.

8.2 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 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 Local Government Act 2003. 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.

8.3 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.

8.4 The report proposes that the treasury management strategy will incorporate prudential indicators. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 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.

8.5 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 Full council.

9 ONE TOWER HAMLETS CONSIDERATIONS

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

10 SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

10.1 There are no sustainable actions for a greener environment implication.

11 RISK MANAGEMENT IMPLICATIONS

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

11.2 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.

11.3 Treasury operations are undertaken by nominated officers within the parameters prescribed by the Treasury Management Policy Statement as approved by the Council.

11.4 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 Sector Treasury Services who specialise in Council treasury issues.

12 CRIME AND DISORDER REDUCTION IMPLICATIONS

12.1 There are no any crime and disorder reduction implications arising from this report.

13 EFFICIENCY STATEMENT

13.1 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.

14. APPENDICES

Appendix 1 – Revised Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2011/12

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

List of “Background Papers” used in the preparation of this report

Brief description of “background papers”	Name and telephone number of holder and address where open to inspection.
None	

APPENDIX 1

Revised Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2011/12

1. SUMMARY

1.2 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 which sets out the Council's proposed borrowing for the financial year and establishes the parameters (prudential and treasury indicators) within which officers under delegated authority may undertake such activities;
- An annual Investment Strategy sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments; and
- A policy statement on the basis on which provision is to be made in the revenue accounts for the repayment of borrowing – Minimum Revenue Provision (MRP) Policy Statement.

1.2 The Department of Communities and Local Government has issued revised investment guidance which came into effect from 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009.

1.3 The Council is required to have regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) which requires the following:

- A Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities
- Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives
- Approval by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy, and prudential indicators - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
- Clear delegated responsibility for overseeing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. For this Council the delegated body is the Audit Committee. The scheme of delegation for treasury management is attached at **Appendix 5**

1.4 The Council has formally adopted the revised Code and defined its Treasury Management Policy Statement. These are set out **Appendices 3 and 4** this report.

1.5 Officers will report details of the council's treasury management activity to the Audit Committee at each of its meetings during the year. Additionally, a mid year and full year report will be presented to Council. Full reporting arrangement is attached at **Appendix 6.**

2. DECISIONS REQUIRED

Cabinet is requested to:-

2.4 Recommend that Full Council adopt:

2.4.1 The Treasury Management Strategy Statement set out in sections 6-10 of this report.

2.4.2 The Annual Investment Strategy set out in section 11 of this report.

2.4.3 The Minimum Revenue Provision Policy Statement set out in section 12 of this report, which officers involved in treasury management must then follow.

2.5 Delegate to the Corporate Director-Resources after consultation with the Lead Member for Resources authority to vary the figures in this report to reflect decisions made in relation to the Capital Programme prior to submission to Budget Council.

3 REASONS FOR DECISIONS

3.1 It is consistent with the requirements of treasury management specified by CIPFA, to which the Council is required to have regard under the Local Government Act 2003 and regulations made under that Act, for the Council to produce three strategy statements to support the Prudential Indicators which ensure that the Council's capital investment plans are affordable, sustainable and prudent. The three documents that the Council should produce are:

- Treasury Management Strategy, including prudential indicators
- Investment Strategy; and
- Minimum Revenue Provision Policy Statement.

3.2 The Treasury Management/Investment Strategies are continually reviewed to ensure that returns are being maximised within set credit risk criteria. Following recent meetings with the Council's treasury management consultants, further opportunities to achieve additional return on investments with similar credit risk criteria to that approved by Council in March 2011 have been identified.

4 ALTERNATIVE OPTIONS

4.1 The Council is bound by legislation to have regard to the CIPFA requirements for treasury management. 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.

4.2 The strategies and policy statement put forward in the report are considered the best methods of achieving the CIPFA requirements. Whilst it may be possible to adopt variations of the strategies and policy statement, this would risk failing to achieve the goals of affordability, sustainability and prudence.

5 BACKGROUND

5.1 The Local Government Act 2003 Act requires the Council to establish a treasury strategy for borrowing, and an investment strategy for each financial year, which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

5.2 The strategy for 2011/12 encompasses elements of the treasury management function and incorporates the economic forecasts provided by the Council's treasury advisor. It specifically covers:

- Treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential and Treasury Indicators;
- The current treasury position;
- The borrowing requirement;
- Prospects for interest rates;
- The borrowing strategy (including policy on borrowing in advance of need);
- Debt Rescheduling;
- The Investment Strategy;
- Credit Worthiness Policy;
- Policy on use of external service providers; and
- The Minimum Revenue Provision strategy

6 TREASURY LIMITS FOR 2011/12 TO 2013/14

6.1 The Council must have regard to the Prudential Code when setting an Authorised Limit for borrowing (the level of borrowing to fund capital investment that is affordable), which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is affordable for taxpayers and tenants.

6.2 The Authorised Limit is to be set on a rolling basis, for the forthcoming financial year and two successive financial years. Details of the Authorised Limit and other indicators are attached at **Appendix 1.**

6.3 The Prudential Code requires that the Council set a series of indicators on a three year time frame, which are classified in two main categories; prudential and treasury indicators. It should be noted that these indicators are not for comparison with other local authorities, but are a means to support and record local decision-making.

6.4 The prudential indicators are there to demonstrate that the Council can afford the proposed capital programme in addition to the borrowing undertaken to fund expenditure in the past and that such expenditure is sustainable and prudent going forward. Also it highlights the impact of capital investment decisions on council tax and housing rents. The Council has set the following prudential indicators, which are detailed at **Appendix 1** of this report as prescribed by the Code:

- **Capital Expenditure** – the amount the Council will spend

- **Ratio of Financing Costs to Net Revenue Stream** – Financing cost as a percentage of revenue budget, to ensure that borrowing does not overwhelm the capacity for other expenditure.
- **Net Borrowing Requirement** – Amount of external borrowing that will be required in the year.
- **In Year Capital Financing Requirement** – The amount of borrowing required in year
- **Capital Financing Requirement** – Overall capital financing required for all capital expenditure
- **Incremental Impact of Capital Investment Decisions** – Measures the impact of capital investment decisions on council tax and housing rents.

6.5 Treasury indicators are about setting parameters within which officers can take treasury management decisions. The Council has set the following treasury indicators, which are detailed at **Appendix 1** of this report as prescribed by the Code:

- **Authorised Limit for External Debt** – The upper limit on the level of gross external permitted. It must not be breached without Full Council approval.
- **Operational Boundary for External Debt** – Most likely and prudent view on the level of gross external debt requirement.
- **Actual External Debt** – This is the actual gross external debt that the Council currently has, which will not be comparable to the operational boundary or authorised limit, since the actual gross external debt will reflect the actual position at any one point in time.
- **Maturity Structure for Borrowing** – Profile of when loans in the Council's portfolio of debt are expected to mature

7 CURRENT PORTFOLIO POSITION

7.1 The Council's borrowing and investments as at the 30 November 2010 are as set out in Table 1. The Council's external borrowing total £354m. Investments currently total £151m.

Table 1

Type of Borrowing	Principal Amount £m	Total Principal Amount £m	Average Rate %	Total Average Rate %
Fixed Rate Borrowing				
PWLB (Public Works Loans Board)	257.173		7.786	
Market	13.000		4.370	
		270.173		7.633
Variable Rate Borrowing				
PWLB and Market	64.500		1.134	
				1.134
Total Debt		**353.673**		**6.448**

Investments		
Debt Management Office	0	
UK Banks & Building Societies	143.761	
Overseas banks	0	
Other UK Institutions	7.000	
Total Investments	**150.761**	

8 PROSPECTS FOR INTEREST RATES

8.1 The borrowing and investment strategy is in part determined by the economic environment within which it operates.

8.2 The Council has appointed Sector Treasury Services as treasury adviser and part of the service they provide is to assist the Council to formulate a view on interest rates. The following table gives Sector's overall view on interest rates for the next three years.

Table 2

	Q4 2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013
Bank Rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%	1.50%	1.75%	2.25%	2.75%	3.00%	3.25%
5Yr PWLB Rate	3.41%	3.30%	3.30%	3.40%	3.50%	3.60%	3.80%	3.90%	4.10%	4.30%	4.60%	4.80%	4.90%
10Yr PWLB Rate	4.64%	4.40%	4.40%	4.40%	4.50%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%	5.40%
25Yr PWLB Rate	5.29%	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%
50Yr PWLB Rate	5.21%	5.20%	5.20%	5.20%	5.30%	5.30%	5.40%	5.40%	5.40%	5.50%	5.50%	5.60%	5.70%

8.3 Sector's current interest rate projections are based on moderate economic recovery and moderate Bank of England Monetary Policy Committee concerns about the outlook for inflation.

8.4 Sector projects that Bank Rate:-

- will hold steady at 0.50% until the end of Q3 2012
- will start to rise from 0.50% in Q4 2012 reaching 3.25% by the end of Q2 2014; and
- long term (50 Year) PWLB rates to steadily increase reaching 5.70% by end of Q4 2013

8.5 At the time of writing, the Bank of England base rate stands at 0.5%. Inflation has remained above the Bank of England Monetary Policy Committee's (MPC) 2% target, and has recently been increasing. However, the MPC is confident that inflation will fall back under the target over the next two years. At present the council's treasury advisor's view is that there is unlikely to be any increase in Bank Rate until the end of 2012.

9 BORROWING STRATEGY

9.1 The Council will continue to borrow for the following purposes where it is deemed affordable, sustainable and prudent to do so:

- Supported Capital Expenditure Allocations
- Repayment of Maturing Debt (net of Minimum Revenue Provision)
- Unsupported (Prudential) Borrowing Capital Expenditure
- Short Term Cash Flow Financing

9.2 The Corporate Director-Resources under delegated powers will determine the timing, term, type and rate of new borrowing to take into account factors such as:

- Expected movements in interest rates
- Current maturity profile
- The impact of borrowing on the council's Medium Term Financial Plan
- Approved prudential indicators and limits

9.3 Officers will continue to monitor interest rate movements closely and adopt a pragmatic approach to changing circumstances. For example, the following potential scenarios would require a reappraisal of strategy:

- A significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity or further increases in inflation, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap
- A significant risk of a sharp fall in long and short term rates, due to e.g. growth rates weakening, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term funding will be considered.

9.4 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

9.5 In determining whether borrowing will be undertaken in advance of need the Council will;

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

10 DEBT RESCHEDULING

10.1 The Corporate Director-Resources will continue to consider options to reschedule and restructure the Council's debt portfolio, having due regard for the broad impact of such exercises on the following:

- The maturity profile – council will only undertake debt restructuring where it benefits the maturity profile
- Ongoing revenue savings will be achieved
- The effect on the HRA
- The impact of premiums and discounts has been fully considered; and
- The impact on prudential indicators.

11 ANNUAL INVESTMENT STRATEGY

11.1 The Investment Strategy for 2011/12 has been put together in recognition of the recent relative recovery in the financial sector following the banking crisis that led to a global recession. Money markets are becoming more stable although Bank of England base rate is still being held at the historical low rate of 0.50%.

11.2 In 2009, the Corporate Director-Resources in response to market uncertainties implemented interim credit criteria which restricted term investments to UK institutions which had support guarantees from the British Government. This policy is however difficult to sustain in the long term because of the limited number of counterparties and the relatively low returns obtainable given historically low interest rates being offered by UK institutions.

11.3 Following meetings with the Council's treasury management consultants, it was agreed that a revision of the Investment Strategy could lead to additional returns being achieved with similar credit risk criteria to that approved by Council in March 2011.

11.4 In reviewing the investment strategy, officers along with the Council's treasury advisers are looking to balance risk and reward in a way that result in a balanced investment portfolio for the Council. It is proposed that;

- the individual/group limit for investment in an institution or group that is wholly/partly owned by the UK government is increased to £45m (currently £30m). This measure does not necessarily increase the portfolio risk profile given the UK government limit within current Strategy is only a notional limit - the individual/group limit for all other institutions will remain at £30m,
- up to £25m (previously £12m) of available cash balances may be invested for periods over 364 days and up to 3 years. Although, only £15m can be invested between 2 to 3 years maturity. This change is necessary to reflect the higher level of balances currently held, and
- the Strategy allows investment in structured products within current limits/restrictions to facilitate lock in to premium rates from day one of an investment being made.

The detailed credit criteria are set out in section 11.5.5 and it is recommended that these criteria be adopted.

11.5 Investment Policy:

11.5.1 The Council will have regard to the Department of Communities and Local Government's (DCLG) Guidance on Local Government Investments ("the Guidance") issued in March 2004 and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code"). The Council's investment priorities are:

- The security of capital;
- The liquidity of investments to ensure that the Council has cash available to discharge its liabilities as necessary; and that;
- Within these priorities, the Council will also aim to achieve the optimum return on its investments commensurate with appropriate levels of security and liquidity; and
- All investments will be in Sterling.

11.5.2 To achieve these objectives, the Council is required to classify investment products as either "specified" or "non-specified" as defined within the guidance.

11.5.3 Specified investments comprise investment instruments which the Council considers offer high security and liquidity. These instruments can be used with minimal procedural formalities. The guidance issued by the Government considers that specified investments have the following characteristics: -

- Denominated in Sterling and have a term of less than one year
- Have "high" credit ratings as determined by the Council itself.

11.5.4 All other investments are termed non-specified investments. These involve a relatively higher element of risk, and consequently the Council is required to set a limit on the maximum proportion of their funds which will be invested in these instruments. The Strategy should also specify the guidelines for making decisions and the circumstances in which professional advice is obtained.

11.5.5 Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

11.5.5.1 **Specified Investments:**

(All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high credit' quality criteria where applicable). The council will continue its policy of lending surplus cash to counterparties that have high credit ratings, defining 'high credit rating' as being F1+ Fitch short-term and AA- long-term credit rating.

Table 3

Institution	Minimum High Credit Criteria	Use	Limit
Debt Management Office (DMO) Deposit Facility	Not applicable	In-house	£100m*
Term deposits – Other Local Authorities	Not applicable	In-house	£10m**
Term deposits – banks and building societies	Short-term F1+, Long-term AA-	In-house	£30m

Institutions with Government guarantee on ALL deposits by high credit rated (sovereign rating) countries.	Sovereign rating	In-house	£30m
UK Government Gilts	Long Term AAA	In-house	£20m
Institutions with UK Government support.	Sovereign rating	In-house	£30m
Institutions that are owned/part owned by the UK Government	Sovereign rating	In-house	£45m
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)			
Money Market Funds	AAA rated	In-house	£10m

Definitions of credit ratings are attached at **Appendix 2**.

* Although limit has been set at £100m for the DMO, in reality there is no restriction on placement with the UK government.

** The group limit for local authorities has been set at £100m.

11.5.5.2 **Non-Specified Investments:**

The Council revised its investment strategy in the wake of the banking crisis in 2007. This led to wide ranging restriction being placed on the counterparty list. As part of the strategy review in 2007, a temporary cessation of investment with overseas institutions and all investment restricted to a term of less than 365 days until stability returned to the banking sector, globally. The situation has now settled enough for clear decisions to be made on whether the council should return to investing with overseas banks.

It is recommended that the Council should make non-specified investment as outlined in below table.

Table 4

Institution	Minimum High Cred Criteria	Use	Limit
Term deposits – Banks and Building Societies	Sovereign rating AAA Short-term F1+, Long-term AA-	In-house	£25m
Structured Deposits: Fixed term deposits with variable rate and variable maturities	Sovereign rating AAA Short-term rating F1+ Long-term rating AA-	In-house	£25m
UK Government Gilts	Long Term AAA	In-house	£25m

11.6 The Council uses Fitch ratings (or equivalent from other agencies if Fitch does not provide a rating) to derive its counterparty criteria, but will take into consideration ratings from all three main credit ratings providers when compiling its counterparty list. The Council will take an overall view on its counterparties so that an organisation could be removed from the list if the predominant view of the organisation is pessimistic. Where the overall view of the three main ratings agency is pessimistic, the Council is likely to adopt the most pessimistic of the available ratings.

11.7 The minimum credit rating required for an institution to be included in the Council's counterparty list is as follows:

Table 5

Agency	Long-Term	Short-Term	Individual	Support
Fitch	AA-	F1	C	1
Moodys	Aa3	P-1	N/A	C
Standard & Poors	AA-	A-1	N/A	N/A

Sovereign Rating	AAA

Money Market Fund	AAA

11.8 The Council will only use approved counterparties from countries with minimum sovereign credit rating of AAA from Fitch as outlined above. The following countries are currently rated AAA:

- Canada
- Denmark
- Finland
- France
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- United Kingdom
- United States of America

11.9 All credit ratings will be monitored on at least a monthly basis and the Council is alerted to changes in ratings through its use of the Sector creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria as outlined in 11.5, its further use as a new investment will be withdrawn immediately.

- If a body is placed on negative rating watch (i.e. there is a reasonable probability of a rating change and the likelihood of that change being negative) and it is currently near the floor of the of the minimum acceptable rating for placing investments with that body as outlined in 11.5, then no further investments will be made with that body.

11.10 The credibility of credit ratings providers has been called into question because they failed to identify the potential problems with Icelandic Banks prior to the Icelandic Banking Crisis. In order to further improve the security of council funds and in line with CIPFA guidance, the Council as well as using credit rating agencies will now also use financial press, market data, information on government support for banks and the credit ratings of that government support when compiling its counterparties list.

11.11 Institutions with which the Council can place funds are as follows:

- Bank of England Debt management Office (DMO).
- The institutions that were included in the UK Government's permanent capital investment and short-term liquidity support programme.
- Other UK institutions meeting our minimum credit rating criteria
- UK AAA rated Money Market Funds
- Other local authorities
- Overseas institutions (falling within the Council's minimum credit criteria) from countries with sovereign ratings of AAA from all rating agencies

11.12 The Council anticipates its fund balances in 2011/12 to average approximately £175m. Although the actual amount available for investment at any one time will fluctuate as a result of timing of significant items such as:

- Expenditure on capital projects
- Council tax, business rates, council house rent income
- Receipt of government grants
- Capital receipts in respect of major asset sales

11.13 It is proposed that the Council adopts a prudential indicator limit of £25m for 2011/12 for term deposits over 365 days (but no more than 3 years). Although, only £15m can be invested between 2 to 3 years maturity.

11.14 Investment Strategy:

11.14.1 **In-house funds**: The Council's in house investments are principally related to cashflow. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates.

11.14.2 **Interest rate outlook**: Bank of England Base Rate has remained at 0.50% since the initial tumble down from a high of 5.75% in November 2007 to the current rate in March 2009. The council's treasury advisors forecast that interest rates will start to rise steadily from Q4 of 2012 and would have risen to 3.25% by Q4 of 2014.

11.14.3 The pace of the economic recovery has slowed and the outlook for global economy is for slow/flat growth in the medium term. There remains a distortion in the inter-relationships between money market rates and bank rate. The 2011/12 budget has been set to take account of low interest rates, but officers will continue to invest to maximise returns in line with the Council's counterparty criteria.

12 MINIMUM REVENUE PROVISION POLICY STATEMENT 2010/11

12.1 The Council is required to provide an annual amount in its revenue budget to provide for the repayment of the debt it has incurred to finance its General Fund capital investment. The calculation of this sum termed the Minimum Revenue Provision (MRP) was previously prescribed by the Government.

12.2 The Department of Communities and Local Government (DCLG) now require Councils to establish a policy statement on the MRP and has published guidance on the four potential methodologies to be adopted.

12.3 The guidance distinguishes between supported borrowing which relates to assumed borrowing which is incorporated into the Governments Formula Grant calculation and consequently has an associated amount of government grant and unsupported borrowing. Unsupported borrowing is essentially prudential borrowing the financing costs of which have to be met by the Council locally.

12.4 The DCLG guidance provides two options for the calculation of the MRP associated with each classes of borrowing.

12.5 The two options for the supported borrowing are variants of the existing statutory calculation which is based on 4% of the aggregate assumed borrowing for general fund capital investment - termed the Capital Financing requirement (CFR). The two options are:

- **Option 1 (Regulatory Method)**: To continue the current statutory calculation based on the gross CFR less a dampening factor to mitigate the impact on revenue budgets of the transition from the previous system. This calculation is further adjusted to repay debt transferred to the Council when the Inner London Education Authority (ILEA) was abolished.
- **Option 2 (Capital Financing Requirement Method)**: The statutory calculation without the dampener which will increase the annual charge to revenue budget.

12.6 The options purely relate to the timing of debt repayment rather than the gross amounts payable over the term of the loans. The higher MRP payable under option 2 will accelerate the repayment of debt.

12.7 It is recommended that because of budget constraints in the medium term the existing statutory calculation with the ILEA adjustment be adopted as the basis of the Councils MRP relating to supported borrowing.

12.8 The guidance provides two options for the MRP relating to unsupported borrowing. The options are:-

- **Option 3 (Asset Life Method)**: To repay the borrowing over the estimated life of the asset with the provision calculated on either an equal instalment or annuity basis. This method has the advantage of simplicity and relating repayments to the period over which the asset is providing benefit.

- **Option 4 (Depreciation Method)**: A calculation based on depreciation. This is extremely complex and there are potential difficulties in changing estimated life and residual values.

12.9 It is recommended that option 3 is adopted for unsupported borrowing.

12.10 The Council is required regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2003 to determine for each financial year an amount of minimum revenue provision which it considers to be prudent. It is proposed that the Council makes Minimum Revenue Provision using Option 1 (Regulatory Method) for supported borrowing and Option 3 (Asset Life Method) for unsupported borrowing.

13. APPENDICES

Appendix 1 – Prudential and Treasury Indicators

Appendix 2 – Definition of Credit Ratings

Appendix 3 – Adoption of the revised CIPFA Treasury Management Code of Practice 2009

Appendix 4 – Treasury Management Policy Statement

Appendix 5 – Treasury Management Scheme of Delegation

Appendix 6 – Treasury Management Reporting Arrangement

APPENDIX 1

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS

Prudential indicators	2009/10	2010/11	2011/12	2012/13	2013/14
	Actual	Probable Outturn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Capital Expenditure					
Non – HRA	88,878	149,876	134,012	83,159	50,656
HRA	50,497	47,587	37,636	36,911	30,000
TOTAL	139,375	197,463	171,648	120,070	80,656
Ratio of financing costs to net revenue stream					
Non – HRA	2.98%	2.62%	2.51%	2.55%	2.43%
HRA	16.91%	18.75%	19.39%	19.9%	20.31%
Net borrowing requirement					
brought forward 1 April	322.198	354.250	303.764	308.079	315.622
carried forward 31 March	354.250	303.764	308.079	315.622	322.424
in year borrowing requirement	32.052	-50.486	4.315	7.543	6.802
In year Capital Financing Requirement					
Non - HRA	1.352	0	0	0	0
HRA	15.500	15.500	6.000	6.000	6.000
TOTAL	16.852	15.500	6.000	6.000	6.000
Capital Financing Requirement as at 31 March					
Non - HRA	161.570	160.784	152.599	146.142	139.944
HRA	276.480	292.480	298.480	304.480	310.480
TOTAL	438.050	453.264	451.079	450.622	450.424
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum	8.46	4.27	0	0	0
Increase in average housing rent per week	0	0	0	0	0

TABLE 4: Treasury management indicators	2009/10	2010/11	2011/12	2012/13	2013/14
	Actual	Probable Outturn	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
borrowing	483,,050	498,264	496,079	495,424	495,424
other long term liabilities	0	0	0	0	0
TOTAL	483,,050	498,264	496,079	495,424	495,424
Operational Boundary for external debt -					
borrowing	463,050	478,264	476,079	475,424	475,424
Other long term liabilities	0	0	0	0	0
TOTAL	463,050	478,264	476,079	475,424	475,424
Actual external debt					
Upper limit for fixed interest rate exposure					
expressed as either:-					
Net principal re fixed rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
expressed as either:-					
Net principal re variable rate borrowing / investments	20%	20%	20%	20%	20%
Upper limit for total principal sums invested for over 364 days	0	0	12,000	12,000	12,000
(per maturity date)					

TABLE 5: Maturity structure borrowing during 2011/12	Upper Limit	Lower Limit
under 12 months	10%	0%
12 months and within 24 months*	30%	0%
24 months and within 5 years*	40%	0%
5 years and within 10 years	80%	0%
10 years and above	100%	0%

* This upper limit has been increased to allow for the risk of lenders option being exercised on the Council's debt portfolio in 2012/13. It is not anticipated that this will happen.

Appendix 2: Definition of Credit Ratings

Support Ratings

Rating	
1	A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-term rating floor of 'A-'.
2	A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-term rating floor of 'BBB-'.
3	A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'BB-'.
4	A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'B'.
5	A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-term rating floor no higher than 'B-' and in many cases no floor at all.

Short-term Ratings

Rating	
F1	**Highest credit quality.** Indicates the strongest capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.
F2	**Good credit quality.** A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.
F3	**Fair credit quality.** The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

Long-term Ratings

Rating	Current Definition (August 2003)
AAA	**Highest credit quality.** 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
AA	**Very high credit quality.** 'AA' ratings denote a very low expectation of credit risk. They indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A	**High credit quality.** 'A' ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.
BBB	**Good credit quality.** 'BBB' ratings indicate that there is currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. This is the lowest investment-grade category

Individual Ratings

Rating	
A	A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment or prospects.
B	A strong bank. There are no major concerns regarding the bank. Characteristics may include strong profitability and balance sheet integrity, franchise, management, operating environment or prospects
C	An adequate bank, which, however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects.
D	A bank, which has weaknesses of internal and/or external origin. There are concerns regarding its profitability, substance and resilience, balance sheet integrity, franchise, management, operating environment or prospects. Banks in emerging markets are necessarily faced with a greater number of potential deficiencies of external origin.
E	A bank with very serious problems, which either requires or is likely to require external support.

Appendix 3

Adoption of the revised CIPFA Treasury Management Code of Practice 2009

INTRODUCTION

The CIPFA Code of Practice on Treasury Management in Local Authorities was last updated in 2001 and has been revised in 2009 in the light of the default by Icelandic banks in 2008. The revised Code requires that a report be submitted to the council, board or other appropriate body. setting out four amended clauses which should be formally passed in order to approve adoption of the new version of the Code of Practice and Cross-Sectoral Guidance Notes.

The revised Code also includes an amended version of the treasury management policy statement (TMPS) incorporating just three clauses and a revised definition of treasury management activities. The Code does not require this statement to be approved by the council. board or other appropriate body.

RESOLUTIONS

CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances. the following four clauses.

1. This organisation will create and maintain. as the cornerstones for effective treasury management:
   - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
   - suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

   The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code. subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.
2. This organisation (i.e. full council) will receive reports on its treasury management policies. practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.
3. This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to The Corporate Director-Resources, who will act in accordance with the organisation's policy statement and TMPs and if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
4. This organisation nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Appendix 4

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 authority'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."

Appendix 5

Treasury Management Scheme of Delegation

1. Full Council / Cabinet

- receiving and reviewing reports on treasury management policies. practices and activities
- approval of annual strategy.

2. Cabinet /Section 151 Officer

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

3. Audit Committee

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

Appendix 6

Treasury Management Reporting Arrangement

Area of Responsibility	**Council/Committee/Officer**	**Frequency**
Treasury Management Strategy Statement/ Annual Investment Strategy/ Minimum Revenue Provision Policy	Full Council	Annually before the start of the financial year to which policies relate
Treasury Management Strategy Statement/ Annual Investment Strategy/ Minimum Revenue Provision Policy	Full Council	Mid year of financial year to which policies relate
Updates or revisions to the Treasury Management Strategy Statement/ Annual Investment Strategy/ Minimum Revenue Provision Policy	Full Council	
Annual Treasury Outturn Report	Audit Committee	Annually by 30 September after the year end to which the report relates
Treasury Management Practices	Corporate Director-Resources	
Scrutiny of Treasury Management Strategy Statement	Overview and Scrutiny Committee	Annually before the start of the financial year to which the report relates
Scrutiny of Treasury Management Performance	Audit Committee	Quarterly