Cabinet 8 January 2014	TOWER HAMLETS
Report of: Chris Holme, Interim Corporate Director Resources	**Classification:** Unrestricted
Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2014-15	

Lead Member	**Councillor Alibor Choudhury, Cabinet Member for Resources**
Originating Officer(s)	Paul Thorogood – Service Head, Finance and HR Development Oladapo Shonola – Chief Financial Strategy Officer
Wards affected	All wards
Community Plan Theme	**One Tower Hamlets**
Key Decision?	No

1. SUMMARY

1.1 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 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 on the basis ofwhich provision is to be made in the revenue accounts for therepayment of borrowing – Minimum Revenue Provision (MRP) Policy Statement.

1.2 This report also deals with the setting of Prudential Indicators for 2014-15, which ensure that the Council's capital investment decisions remain affordable, sustainable and prudent; the proposed indicators are detailed in Appendix 1.With the introduction of the government's self- financing arrangements for the Housing Revenue Account (HRA) there are now specific indicators relating to HRA capital investment.

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:

- Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities(Appendix 3);

- Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;
- approval by 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 together with arrangements for a Mid-year Review Report and an Annual 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 shown in Appendix 4.

1.4 Officers will report details of the council's treasury management activity to the Audit Committee at each of its meetings during the year. Additionally, a mid-year and full-year report will be presented to Full Council.More detailed reporting arrangements are shown inAppendix 5.

1.5 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.

2. DECISIONS REQUIRED

The Mayor in Cabinet is requested to:-

2.1 Recommend that Full Council adopt:

2.1.1 The Treasury Management Strategy Statement set out in sections 6-11 of this report.

2.1.2 The Annual Investment Strategy set out in section 12of this report.

2.1.3 The Minimum Revenue Provision Policy Statement set out in section 13 of this report, which officers involved in treasury management must then follow.

2.2 Delegate totheInterim Corporate Director of Resources, after consultation with the Lead Member for Resources, authority to vary the figures in this report to reflect any 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
- Minimum Revenue Provision Policy Statement; and

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 policies and objectives of the treasury management activities together with the policy on the use of an external treasury advisor are detailed in Appendix 3.

5.3 The strategy for 2014-15 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 and projected treasury position to 2016-17;
- the borrowing requirements for both the General Fund and HRA;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the Investment Strategy;
- policy on credit worthiness;and
- the Minimum Revenue Provision strategy.

6 TREASURY LIMITS FOR 2014-15 TO 2016-17

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, with some headroom for unexpected cash movements), 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 prudential indicators reflect the capital programme set which is elsewhere on this agenda.

6.5 The Council has set the following prudential indicatorsas prescribed by the Code and these areset out below and detailed inAppendix 1:

- **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 (CFR)** – Overall capital financing required for all capital expenditure
- **Incremental Impact of Financing Costs** – Measures the impact of capital financing costs on council tax and housing rents.

6.6 Treasury indicators are about setting parameters within which officers can take treasury management decisions. The Council has set the following treasury indicatorsas prescribed by the Code and these are set out below and also detailed inAppendix 1:

- **Authorised Limit for External Debt** – The upper limit on the level of gross external debt 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.Debt includes external borrowings and other long term liabilities.
- **Gross Borrowing** – This is the actual gross external borrowing 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.
- **HRA Debt Limit** – The HRA Self Financing regime came into effect on 01 April 2012. The new regime imposes a maximum HRA CFR on the Council. For the Council this has been set at £184m following repayment of HRA debt totalling £236.2m by Government as part of debt settlement that preceded the implementation of the HRA Self Financing regime.

- **Limits on Interest Rate Exposure** – This indicator sets the limit on the proportion of overall debt that can be fixed/ variable.
- **Upper Limit on Borrowings over 364 days** – This indicator sets the limit on the principal sum that can be invested beyond 364 days.
- **Maturity Structure of Borrowings** – Profile of when loans in the Council's portfolio of debt are expected to mature.

7 CURRENT AND PROJECTED TREASURY POSITION

7.1 The Council's current borrowing and investments as at 30 October 2013 are as follows: external borrowings total £89.9m and investments total £248.2m.

7.2 The 2012-13 outturn and estimates for current and future years are detailed in Table 1 below.

Table 1

£m	2012/13 Actual	2013/14 Estimate	2013/14 Rev Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
External Debt						
Debt at 1 April	91.351	90.406	90.406	99.561	113.962	128.894
Expected change in Borrowing	(0.945)	9.155	9.155	14.401	(1.068)	(1.889)
HRA settlement	0.000	0.000	0.000	0.000	0.000	0.000
Other long-term liabilities (OLTL)	0.000	0.000	0.000	0.000	16.000	0.000
Expected change in OLTL	0.000	0.000	0.000	0.000	0.000	0.000
Actual debt at 31 March	**90.406**	**99.561**	**99.561**	**113.962**	**128.894**	**127.005**
The Capital Financing Requirement	225.848	229.477	229.702	238.628	268.409	262.219
Under / (over) borrowing	135.442	129.916	130.141	124.666	139.515	135.214

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 Capita Asset 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

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
March 2014	0.50	2.50	4.40	4.40
June 2014	0.50	2.60	4.40	4.40
September 2014	0.50	2.70	4.50	4.50
December 2014	0.50	2.70	4.50	4.60
March 2015	0.50	2.80	4.60	4.70
June 2015	0.50	2.80	4.70	4.80
September 2015	0.50	2.90	4.80	4.90
December 2015	0.50	3.00	4.90	5.00
March 2016	0.50	3.20	5.00	5.10
June 2016	0.50	3.30	5.10	5.20
September 2016	0.75	3.30	5.10	5.20
December 2016	1.00	3.60	5.10	5.20
March 2017	1.25	3.70	5.20	5.30

8.3 The economic recovery in the UK since 2008 has been the slowest recovery in recent history until 2013. Growth rebounded in quarters 1 and 2 of 2013 (+0.3% and +0.7% respectively), surpassing all expectation. Growth forecast for2013 was consequently upgraded from 1.2% to 1.4% and for 2014, from 1.7% to 2.5% and growth is expected to be strong inthe immediate future.

8.4 Unlike growth, wage inflation remains relatively flat and continues to significantly lag CPI inflation. This puts pressure on disposable income, although,some of this pressure, to some extent, has been ameliorated by cuts income tax. A rebalancing of the UK economy towards exports has started but this will likely face some headwinds given on-going challenges facing the Eurozone and the UK's dependence (40% of UK exports go to the Eurozone) on this geographical sector.

8.5 The Bank of England also issued forward guidance with the Inflation Report which stated that the Bank will not consider raising interest rates until the unemploymentrate has fallen to 7% or below. The forecast is for Bank Rate to start increasing in quarter 3 of 2016 based on a slow projected reduction inunemployment. This is in line with the Bank of England's forecast, but contrary to the prevalent market view where Bank Base rate is expected to rise in early 2015. Although the UK has lost its AAA rating from Fitch and Moody's, this setback has not resulted in a negative reaction from the market or significantly impacted the UK's cost of borrowing

8.6 This challenging and uncertain economic outlook has several key treasury management implications:

- The Eurozone sovereign debt difficulties provide a clear indication of high counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2014/15 and beyond;
- Borrowing interest rates continue to be attractive and may remain relatively low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of carry – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

9 <u>BORROWING STRATEGY</u>

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

- Financing of Capital Expenditure
- Repayment of Maturing Debt (net of Minimum Revenue Provision)
- Short Term Cash Flow Financing

9.2 The Interim Corporate Director, Resources or in his absence the Service Head, Financial Services, Risk and Accountability 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.

10 BORROWING IN ADVANCE OF NEED

10.1 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.

10.2 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 existing debt portfolio that supports the need to take funding in advance of need
- ensure the on-going 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.

11 DEBT RESCHEDULING

11.1 The Interim Corporate Director-Resources or Service Head Financial Services, Risk and Accountability 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
- On-going 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.

11.2 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

11.3 All rescheduling will be reported to the Council, at the earliest meeting following its action.

12 ANNUAL INVESTMENT STRATEGY

Investment Policy

12.1 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM 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.

12.2 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies. Using Sector ratings service, counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

12.3 Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate.

12.4 Other information sources used will include the financial press and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

12.5 The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

12.6 Investment instruments identified for use in the financial year are listed in tables 3 and 4 below, under the 'Specified' and 'Non-Specified' investments categories.

12.7 Officers will continue to work to maintain and strengthen the Council's investment policy and will refer back to Council with any modification thought to be beneficial to the efficient and effective management of the Council's funds.

Creditworthiness Policy

12.8 To achieve these objectives, the Council classifies investment products as either "Specified" or "Non-Specified" as defined within the Guidance.

12.9 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

12.10 TheInterim Corporate Director, Resources or the Service Head, Financial Services, Risk and Accountabilitywill maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered good quality which the Council may use, rather than defining what types of investment instruments are to be used.

12.11 The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits (with the exceptions noted in 12.13 below). This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies and one meets the Council's criteria whilst the other does not, the institution will fall outside the lending criteria.

12.12 Credit rating information is supplied by Capita Asset Services our treasury advisers, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

12.13 The criteria for providing a pool of high quality investment counterparties (both Specified and Non-Specified investments) is:

- Good credit quality – the Council will only use banks which:
  - i. are UK banks; and/or
  - ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA; and

  Where rated, have as a minimum, the following Fitch ratings, (for equivalent Moody's and Standard and Poors credit ratings, see Table 5)
  - i. Short term – 'F1'
  - ii. Long term – 'A'
  - iii. Viability / financial strength – 'a' (Fitch/Moody'sonly)
  - iv. Support – '1'

- Part nationalised/wholly owned UK banks (i.e. Lloyds Banking Group and Royal Bank of Scotland). These banks can be included if they continue to be part nationalised/wholly owned or they meet the ratings in Banks (i) above;
- The Council's own banker (The Co-operative Bank) for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time;
- Building Societies – The Council will use all building societies which meet the ratings for banks outlined above;
- Money Market Funds – UK, AAA (Sterling);
- UK Government (including gilts and the Debt Management Account Deposit Facility);
- Local Authorities (including parish councils, etc).

12.14 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 considers that specified investments have the following characteristics: -

- denominated in Sterling and have a term of less than one year;
- have "good" credit ratings as determined by the Council itself.

12.15 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.

12.16 Investment instruments identified for use in the financial year are listed in tables 3 and 4 below under the 'Specified' and 'Non-Specified' Investments categories with the associatedcounterparty limits as set through the Council's Treasury Management Practices – Schedules.

<u>Specified Investments:</u>

12.17 Itis recommended that the Council should make Specified investment as detailed below in Table 3.

12.18 All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum credit quality criteria where applicable. The Council will continue its policy of lending surplus cash to counterparties that meet the Council's minimum credit ratings as outlined in below table.

Table 3

Institution	**Minimum High Credit Criteria**	**Money Limit**	**Term Limit**
Debt Management Office (DMO) Deposit Facility	Not applicable	No Limit	N/A
Local Authorities	Not applicable	£30m*	1 year
Bank/Building Society- (High Credit Quality)	Short-Term F1 Long-Term AA-	£30m	1 year
Bank/Building Societies - (Medium Credit Quality)	Short-Term F1 Long-Term A+	£15m	1 year
Bank/Building Societies - (Lower Credit Quality)	Short-Term F1 Long-Term A	£10m	6 months
Part Nationalised / Wholly Owned Banks	N/A	Lesser of £70m or 40% of portfolio**	1 year
Council's Own Banker***	N/A	£10m	7 days
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)			
Money Market Funds	AAA rated	£15m	Liquid

Definitions of credit ratings (which now incorporate Fitch's viability ratings) are attached at **Appendix 2**.
* The group limit for local authorities has been set at £100m.
** Percentage of portfolio at the time of investing.
*** Limit applied where bank's rating is below minimum required for external investment

Non-Specified Investments:

12.19 It is recommended that the Council should make Non-Specified investment as outlined in Table 4.

Table 4

Institution	**Minimum High Credit Criteria**	**Money Limit**	**Term Limit**
Bank /Building Society (High Credit Quality)	Sovereign rating AAA Short-term F1+, Long-term AA-	£25m	3 years
Part Nationalised/ Wholly Owned Banks	N/A	£25m	3 years
Structured Deposits: Fixed term deposits with variable rate and variable maturities	Sovereign rating AAA Short-term rating F1+ Long-term rating AA-	£25m	3 years
UK Government Gilts	Long Term AAA	£20m	5 years

12.20 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	Viability	Support
Fitch	A	F1	a	1
Moodys	A2	P-1	C-	N/A
Standard &Poors	A	A-2	N/A	N/A
Sovereign Rating	AAA			
Money Market Fund	AAA			

12.21 The Council will lend to the UK Government and its banking sector and to overseas banks from countries with a AAA sovereign rating from Fitch and other credit reference agencies.Based on current lowest available rating, the following countries are currently rated AAA and are therefore approved for investment:

- Australia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

12.22 All credit ratings will be monitored on a proactive basis and the Council's counterparty list will be updated to take account of alerts 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 12.13, 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 12.13, then no further investments will be made with that body.

12.23 Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties.

12.24 The Council anticipates its fund balances in 2014-15 to average approximately £200m,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

12.25 It is proposed that the Council adopts a prudential indicator limit of £25m for 2014-15 for term deposits over one year (but no more than 3 years) although only £15m can be invested between 2 to 3 years maturity.

13 MINIMUM REVENUE PROVISION POLICY STATEMENT

13.1 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.

13.2 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.

13.3 The guidance distinguishes between supported borrowing which relates to assumed borrowing which is incorporated into the Governments FormulaGrant 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.

13.4 There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made pending finalisation of transitional arrangements following introduction of Self-Financing.

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

13.6 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.

13.7 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.

13.8 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.

13.9 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.

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

13.11 The Council is required under 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.

14 COMMENTS OF THE CHIEF FINANCIAL OFFICER

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

15 LEGAL COMMENTS

15.1 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.

15.2 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require the Councilto 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 functionsunder 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.

15.3 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.

15.4 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.

15.5 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 Mayor in Cabinet to agree these matters and for them to then be considered by Full Council.

15.6 When considering its policies and strategies, 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.

16 ONE TOWER HAMLETS CONSIDERATIONS

16.1 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.

17 SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

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

18 RISK MANAGEMENT IMPLICATIONS

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

18.2 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.

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

18.4 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.

19 CRIME AND DISORDER REDUCTION IMPLICATIONS

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

20 EFFICIENCY STATEMENT

20.1 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.

21 APPENDICES

Appendix 1 – Prudential and Treasury Indicators

Appendix 2 – Definition of Credit Ratings

Appendix 3 – Treasury Management Policy Statement

Appendix 4 – Treasury Management Scheme of Delegation

Appendix 5 – Treasury Management Reporting Arrangement

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

Brief description of "background papers"	Name and telephone number of holder and address where open to inspection.
None	N/A

APPENDIX 1

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS

Prudential indicators	2012/13	2013/14	2013/14	2014/15	2015/16	2016/17
Extract from budget and rent setting reports	**Actual**	**Original Estimate**	**Revised Estimate**	**Estimate**	**Estimate**	**Estimate**
	£m	£m	£m	£m	£m	£m
Capital Expenditure						
Non – HRA	110.254	107.212	118.307	26.525	30.980	30.980
HRA	39.045	78.481	103.027	76.590	39.000	39.000
TOTAL	**149.299**	**185.693**	**221.334**	**103.115**	**69.980**	**69.980**
Ratio of Financing Costs To Net Revenue Stream						
Non – HRA	2.51%	2.89%	2.50%	3.05%	3.55%	3.94%
HRA	3.98%	4.04%	4.00%	3.87%	4.66%	3.87%
	£m	£m	£m	£m	£m	£m
Gross Debt and Capital Financing Requirement						
Gross Debt	90.406	99.561	99.561	113.962	128.894	127.005
Capital Financing Requirement	225.848	229.477	229.702	238.628	268.409	262.219
Over/(Under) Borrowing	(129.916)	(135.442)	(130.141)	(124.666)	(139.515)	(135.214)
In Year Capital Financing Requirement						
Non – HRA	(5.887)	3.628	3.854	(6.146)	(6.219)	(6.190)
HRA	0.000	0.000	0.000	15.072	36.000	0.000
TOTAL	**(5.887)**	**3.628**	**3.854**	**8.926**	**29.781**	**(6.190)**
Capital Financing Requirement as at 31 March						
Non - HRA	156.173	159.802	160.027	153.881	147.662	141.472
HRA	69.675	69.675	69.675	84.747	120.747	120.747
HRA Settlement	0.000	0.000	0.000	0.000	0.000	0.000
TOTAL	**225.848**	**229.477**	**229.702**	**238.628**	**268.409**	**262.219**
Incremental Impact of Financing Costs (£)						
Increase in Council Tax (band D) per annum	0.000	0.000	0.000	0.000	0.000	0.000
Increase in average housing rent per week	0.000	0.059	0.000	1.080	1.451	0.000

Treasury Management Indicators	2012/13	2013/14	2013/14	2014/15	2015/16	2016/17
	Actual	Original Estimate	Revised Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
Authorised Limit For External Debt -						
Borrowing & Other long term liabilities	250.848	255.409	255.409	263.628	293.409	293.409
Headroom	20.000	20.000	20.000	20.000	20.000	20.000
TOTAL	**270.848**	**275.409**	**275.409**	**283.628**	**313.409**	**313.409**
Operational Boundary For External Debt -						
Borrowing	250.848	255.409	255.409	263.628	277.409	293.409
Other long term liabilities	0.000	0.000	0.000	0.000	16.000	0.000
TOTAL	**250.848**	**255.409**	**255.409**	**263.628**	**293.409**	**293.409**
Gross Borrowing	**99.561**	**90.406**	**99.561**	**113.962**	**128.894**	**127.005**
HRA Debt Limit*	**184.381**	**184.381**	**184.381**	**184.381**	**184.381**	**184.381**
Upper Limit For Fixed Interest Rate Exposure						
Net principal re fixed rate borrowing / investments	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Upper Limit For Variable Rate Exposure						
Net interest payable on variable rate borrowing / investments	**20%**	**20%**	**20%**	**20%**	**20%**	**20%**
Upper limit for total principal sums invested for over 364 days (per maturity date)	**£25m**	**£25m**	**£25m**	**£25m**	**£25m**	**£25m**

Maturity structure of new fixed rate borrowing during 2013/14	Upper Limit	Lower Limit
Under 12 months	10%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	80%	0%
10 years and above	100%	0%

Appendix 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.

Conversion/Comparison Table of Individual Ratings to Viability Ratings

Individual Rating	Viability Rating	Definitions
A	aaa	Highest fundamental credit quality 'aaa' ratings denote the best prospects for on-going viability and lowest expectation of failure risk. They are assigned only to banks with extremely strong and stable fundamental characteristics, such that they are most unlikely to have to rely on extraordinary support to avoid default. This capacity is highly unlikely to be adversely affected by foreseeable events.
A/B	aa	Very high fundamental credit quality 'aa' ratings denote very strong prospects for on-going viability and expectations of very low failure risk. Fundamental characteristics are very strong and stable, such that it is considered highly unlikely that the bank would have to rely on extraordinary support to avoid default. This capacity is not significantly vulnerable to foreseeable events.
B/C	a	High fundamental credit quality 'a' ratings denote strong prospects for on-going viability and expectations of low failure risk. Fundamental characteristics are strong and stable, such that it is unlikely that the bank would have to rely on extraordinary support to avoid default. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
C/D	bbb	Good fundamental credit quality 'bbb' ratings denote good prospects for on-going viability and indicate that expectations of failure risk are currently low. The bank's fundamentals are adequate, such that there is a low risk that it would have to rely on extraordinary support to avoid default. However, adverse business or economic conditions are more likely to impair this capacity.
C/D	bb	Speculative fundamental credit quality 'bb' ratings denote moderately weak prospects for on-going viability and indicate an elevated vulnerability to failure risk, particularly in the event of adverse changes in business or economic conditions over time; however, a moderate degree of fundamental financial strength exists, which would have to be eroded before the bank would have to rely on extraordinary support to avoid default.
D/E	b	Highly speculative fundamental credit quality 'b' ratings denote weak prospects for on-going viability. Material failure risk is present but a limited margin of safety remains. The bank is currently operating without reliance on extraordinary support; however, capacity for continued unsupported operation is vulnerable to deterioration in the business and economic environment.
D/E	ccc	Substantial fundamental credit risk Failure of the bank is a real possibility. The capacity for continued unsupported operation is highly vulnerable to deterioration in the business and economic environment.
E	cc	Very high levels of fundamental credit risk Failure of the bank appears probable.
E	c	Exceptionally high levels of fundamental credit risk Failure of the bank is imminent or inevitable.
F	f	'f' ratings indicate an issuer that, in Fitch's opinion, has failed, and that either has defaulted or would have defaulted had it not received

		external support.

Appendix 3

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."

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.

Treasury Management Scheme of Delegation

1. Full Council / Cabinet

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

2. Cabinet /Section 151 Officer

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

3. Audit Committee

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

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
Mid-Year Treasury Management Report	Full Council	Semi-Annually in the financial year to which policies relate
Updates or revisions to the Treasury Management Strategy Statement/ Annual Investment Strategy/ Minimum Revenue Provision Policy	Audit Committee or Full Council	As necessary
Annual Treasury Outturn Report	Audit Committee and Full Council	Annually by 30 September after the year end to which the report relates
Treasury Management Practices	Corporate Director-Resources	N/A
Scrutiny of Treasury Management Strategy Statement	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