LONDON BOROUGH OF TOWER HAMLETS

COUNCIL MEETING

WEDNESDAY 26TH NOVEMBER 2014

2014-15 – MID YEAR REVIEW REPORT FOR TMIS

REPORT OF THE ACTING CORPORATE DIRECTOR, RESOURCES

1. SUMMARY

1.1 This report reviews progress on the Treasury Management and Investment Strategy that was approved by Full Council on 26 February 2014 as prescribed by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (Revised 2011).

1.2 The report reviews how the Treasury Management team has managed the Council's cash balances, investments, borrowings and treasury related risks. The report also sets out the economic environment and how this has impacted on investment returns.

2. DECISIONS REQUIRED

2.1 The Council is recommended to:

- note the contents of this report,
- approve the changes to the minimum credit rating criteria; that is the removal of viability or financial strength rating and support ratings as set out in section 10 and table 1 of Appendix 3;
- approve the updated investment instruments as set out in section 10:15 and table 2 and 3 of Appendix 3; and
- to approve the proposed new prudential indicator limit for investments over one year but no more than three years to £50million from £25million.

3 REASONS FOR DECISIONS

3.1 The Local Government Act 2003 and the Local Authorities (Capital Financing and Accounting) Regulations 2003 requires that regular reports be submitted to Council/Committee detailing the council's treasury management activities.

3.2 The Council also agreed as part of the Treasury Management Strategy Statement to receive a number of reports. Furthermore, the CIPFA Treasury Management Code of Practice requires that Full Council/Committee should receive a Mid-Year Report reviewing Treasury Management/Investment.

4 ALTERNATIVE OPTIONS

4.1 The Council is bound by legislation to have regard to the CIPFA Treasury Management (TM) Code. The Code requires that the Council should receive a mid-year report reviewing treasury management and investment.

4.2 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 Members are kept informed about treasury management activities and to ensure that these activities are in line with the investment strategy approved by the Council.

5 BACKGROUND

5.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2011) has been adopted by the Council.

5.2 One of the requirements of the Code is that Full Council/Committee should receive an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-Year Review Report and an Annual Outturn Report (stewardship report) covering activities during the previous year.

5.3 The Treasury Management Strategy, Investment Strategy and Minimum Revenue Provision reports were included in the Budget Pack that was presented to Full Council on 26 February 2014. The 2013/14 Outturn report was approved by Full Council on 10 September 2014.

5.4 This mid - year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2014/15.
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy, which constitutes the following:
    - The Council's borrowing strategy for 2014/15.
    - The Council's investment strategy for 2014/15.
    - The Council's investment portfolio for 2014/15.
    - The Council's capital expenditure (prudential indicators).
    - A review of compliance with Treasury and Prudential Limits for 2014/15.

6. AN ECONOMIC UPDATE FOR THE FIRST SIX MONTHS OF 2014/15

6.1 GLOBAL ECONOMY

6.1.1 The Eurozone is facing an increasing threat from deflation. In September, the inflation rate fell further, to reach 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June and September to loosen monetary policy in order to promote growth.

6.1.2 In September, the U.S. Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2014. Asset purchases have now fallen from $85bn to $15bn and are expected to stop in October 2014, providing strong economic growth continues. First quarter GDP figures were depressed by exceptionally bad winter weather, but quarter 2 rebounded strongly to 4.6%.

6.2 UK ECONOMY

6.2.1 After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1 and 0.9% in Q2 2014 (annual rate 3.2% in Q2), it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering.

6.2.2 The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance.

6.2.3 This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate.

6.2.4 The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates.

6.2.5 Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

6.2.6 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far this year.

6.3 COUNCILS TREASURY ADVISOR’S VIEW (CAPITA ASSET SERVICES SECTOR)

6.3.1 Capita Asset Services undertook a review of its interest rate forecasts in mid-August, after the Bank of England’s Inflation Report. By the beginning of September, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, had caused a further flight into safe havens like gilts and depressed PWLB rates further. However, there is much volatility in rates as news ebbs and flows in negative or positive ways.

6.3.2 This latest forecast includes a move in the timing of the first increase in Bank Rate from quarter 3 of 2015 to quarter 1 of 2015 as a result of the building momentum of strong GDP growth over the last eighteen months. Confidence has also substantially increased that strong growth will continue into 2015 and 2016. However, the Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual as the MPC is concerned about the impact of increases on many heavily indebted consumers, especially when disposable income is currently being squeezed by wage inflation running significantly under the rate of CPI inflation.

6.4 The Council’s treasury advisor, Capita Asset Services, has provided the following forecast:

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Bank rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.50%
10yr PWLB rate	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%
25yr PWLB rate	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%
50yr PWLB rate	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.80%	4.90%	4.90%

7. TREASURY MANAGEMENT STRATEGY STATEMENT

7.1 The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by the Council on 26 February 2014, and it comprised the following:

- Borrowing Strategy
- Minimum Revenue Provision
- Annual Investment Strategy
- Treasury Management Policy statement; and
- Prudential Indicators for Treasury Management

7.2 All the Council's treasury activities have been carried out within this strategy framework

8. Borrowing Strategy

8.1 The Council's approved borrowing strategy is set out at Appendix 1. The strategy remains appropriate to meet the Council's financing needs for its capital programme and loan redemptions.

DEBT PORTFOLIO

8.2 As at the 30 September 2014, £35k of General Fund PWLB (Public Works Loans Board) debt had been repaid. The maturity profile of the external borrowing portfolio as at the 30 September 2014 is shown at Appendix 1.

8.3 The table below sets out the Council's debt as at the beginning of the year and 30 September 2014.

	31 March 2014 Principal £'000	Average rate %	30 September 2014 Principal £'000	Average rate %
Fixed Rate Funding:				
-PWLB	12,064	7.37	12,029	7.37
-Market	13,000	4.37	13,000	4.37
Total Fixed Rate Funding	25,064	5.81	25,029	5.81
Variable Rate Funding:				
-PWLB	-		-	
-Market	64,500	4.32	64,500	4.32
Total Variable Rate Funding	64,500	4.32	64,500	4.32
Total debt	***89,564***	***4.73***	***89,529***	***4.73***
CFR	***220,720***		***235,975***	
Over/ (under) borrowing	***(131,156)***		***(146,446)***	

8.4 **Borrowing Requirement**: The Council has an approved borrowing requirement of £25 million towards financing the 2014/15 Capital Programme and to provide for loan redemptions and replacement. As part of the Council's capital programme £113.7million of capital grants and contributions have also been earmarked to resource internally funded capital schemes.

8.5 Over the next three years, forecasts indicate that investment rates are expected to be below long term borrowing rates. This would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt. This would maximise short term savings

8.6 Hence, there has been no new borrowing during the period 01 April 2014 to 30 September 2014. Total debt outstanding, stands at £89.529m, against estimated CFR of £235.975m for 2014/15, resulting in an under-borrowing of £146.446m

8.7 **Debt Rescheduling:** The debt portfolio is periodically reviewed to see if cashflow benefits can be obtained from rescheduling debt. In the current interest rate environment, PWLB repayment rates are generally not favourable and any rescheduling undertaken would incur a large cash penalty payment, thus limiting opportunities. The portfolio will be kept under review and advice sought from Capita Asset Services as appropriate.

8.8 No debt rescheduling was undertaken during the first six months of 2014/15

9. Minimum Revenue Provision

9.1 The Council has a statutory requirement to repay an element of accumulated General Fund capital expenditure each year through a revenue charge known as the Minimum Revenue Provision (MRP). The Council is required to approve each year a Minimum Revenue Provision Policy Statement and make prudent provision. Revenue

Provision to repay General Fund capital expenditure debt in 2014/15 is £6.2 million and has been calculated in accordance with the policy statement.

9.2 With regard to assets financed under the Public Finance Initiative (PFI) and finance leases that were brought on balance sheet as a result of the accounting changes brought about by the requirement to report in accordance with International Financial Reporting Standards, mitigating regulations allow that MRP be contained within the existing revenue charge so that the effect on the General Fund is neutral. The approved Minimum Revenue Provision Policy Statement for 2014/15 is set out at Appendix 2.

10. **Annual Investment Strategy**.

10.1 The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity; and
- Yield

10.2 **Security**: The Council has in place creditworthiness criteria, which the officers had strictly adhered to when making investment decisions during the first six months of 2014/15. Monetary and Capita duration limits are applied to manage counterparty exposure risk. Global markets have remained uncertain and the Council continues to implement an operational investment strategy which tightens the controls already in place within the approved investment strategy. Investment processes are constantly monitored and are regularly reviewed by Investment and Treasury Manager, Chief Accountant and the Acting Corporate Director of Resources.

10.3 **Liquidity**: The Council is required to have available, or have access to, adequate resources to enable it at all times to have the level of funds which are necessary for the achievement of its service objectives. Cashflow modelling is used to meet this requirement. The liquidity of the investment portfolio is monitored regularly.

10.4 For debt management purposes the Council has in place overdraft facilities with the Council's bankers The Cooperative Bank plc, and has access to the PWLB and the money market to fund capital projects. Internal balances are available to temporarily fund capital expenditure. Whilst this will help reduce the need to invest any surplus cash, this must be balanced against the future requirement to replace these balances, and ensure that sufficient cash is available to meet the Council's liquidity requirements.

10.5 **Yield:** The Council has a good record in managing its investment portfolio and seeks to obtain the best return (yield) available on its investments, but it adheres at all times to the approved investment criteria. The Council compares the return on its investments against the seven day London Interbank Bid (LIBID) rate. Despite the challenging investment environment, as at 30 September 2014 the return on the Council's investments was 0.72%, which compares very favourably against the seven day LIBID rate of 0.35%, which is local authority benchmark.

10.6 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.

10.7 Credit rating information is supplied by Capita Asset Services, our treasury advisers, on all active counterparties that comply with the criteria as shown at table 1 of Appendix 3. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any credit rate 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.

10.8 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.

10.9 The Council uses Fitch ratings (or equivalent from other agencies if Fitch does not provide a rating) to derive its counterparty criteria, but takes into consideration ratings from all three main credit ratings providers when compiling its counterparty list. The Council takes 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.

10.10 We have been advised by the Council's treasury adviser that rating assumptions are to be updated by the three main rating agencies in order to remove the implied sovereign support embedded in the creditworthiness of an institution. The agencies are primarily reacting to the European regulatory changes which aim at ensuring the resolvability of banks without government support (e.g., resolution regimes and recovery and resolution plans).

10.11 One of the main objectives of these revisions has been to increase transparency relating to the impact of external factors on banks' creditworthiness, such as the probability that they will receive support if they encounter difficulty. Massive government interventions during the banking crisis have indeed confirmed that government support can lower the probability that a bank will default. More recently, in the European countries at the centre of the sovereign debt tensions, the link between major banks' creditworthiness and the perceived problems of their respective sovereign has also been evident. These regulations are due to come into effect January 2016.

10.12 The rating changes could happen before this date, as a matter of fact Fitch rating agency has reassessed their overall methodology and Capita, the treasury adviser has stopped using Financial Strength Rating (FSR) and Support Ratings in computing credit worthiness of institutions. Hence we are proposing to amend the Council's basis of formulating counter party template by removing the Viability or Financial Strength Rating (FSR) and Support Rating from the template. As going forward the Financial Strength Rating (FSR) and Support Ratings will, essentially, become irrelevant.

10.13 A key issue that faces the efficient and effective management of the Council's cash portfolio currently is that of counterparty availability. The Councils have deposit of £140m outstanding with the part nationalised banking groups and the challenge ahead will be to address the decline in the Government holding in Lloyds Banking Group and the impact that this could have on the counterparty limit that the Council currently applies to this entity.

10.14 In addressing this issue, a reduction in the nominal and duration limits has been applied to Lloyds Banking Group. The Council is struggling at the moment to place deposit with institutions as there are not many out there that meets the Council current minimum credit rating criteria. However there are some institutions that meet the Council's minimum credit criteria but offering other financial products that are not included in the Council's Investment Strategy based on the advice of the Council's treasury adviser we have decided to introduce new investments products as this will help with liquidity and diversification issue.

10.15 In light of the above points, the preposition to the Council's Investment Policy are as follows:

- The adoption of credit rating criteria as shown at table 1 of Appendix 3 as the minimum credit rating required for an institution to be included in the Council's counterparty list.
- Inclusion of other financial instruments such as Certificates of Deposits, Treasury Bills, Commercial Papers and Corporate Bonds in line with the Council's credit criteria, as shown in Appendix 3; table 2 & 3.
- It is proposed that the Councils increase a prudential indicator limit for investments over one year but no more than three years to £50million from £25million.

10.16 A breakdown of the Council's investment portfolio as at 30 September 2014 is shown at Appendix 5.

10.17 Investments and borrowing during the first six months of the year have been in line with the Strategy, with no deviations.

INVESTMENT PORTFOLIO 2014/15

10.18 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. .in the current In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach including sovereign credit rating and Credit Default Swap (CDS) overlay information.

10.19 Investment rates available in the market have been broadly stable during the quarter and have continued at historically low levels as a result of the ultra-low Bank Rate and other extraordinary measures such as the Funding for Lending Scheme. The average level of funds available for investment purposes during the quarter was £349.95m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

10.20 The Council's budgeted investment return for 2014/15 was £1.6m, with average rate of return 0.8% for average portfolio balances of £200m.

Benchmark	Council Performance	Investment Interest Earned as at 30 Sept 2014
0.35%	0.72%	£1.301m

10.21 As illustrated, the council outperformed the benchmark by 37 bps. The investment interest earned as at 30th September was £1.3m; this was due to the large investment portfolio balances the Council is currently running with, the average investment portfolio balance of £349.95m as at 30th September 2014.

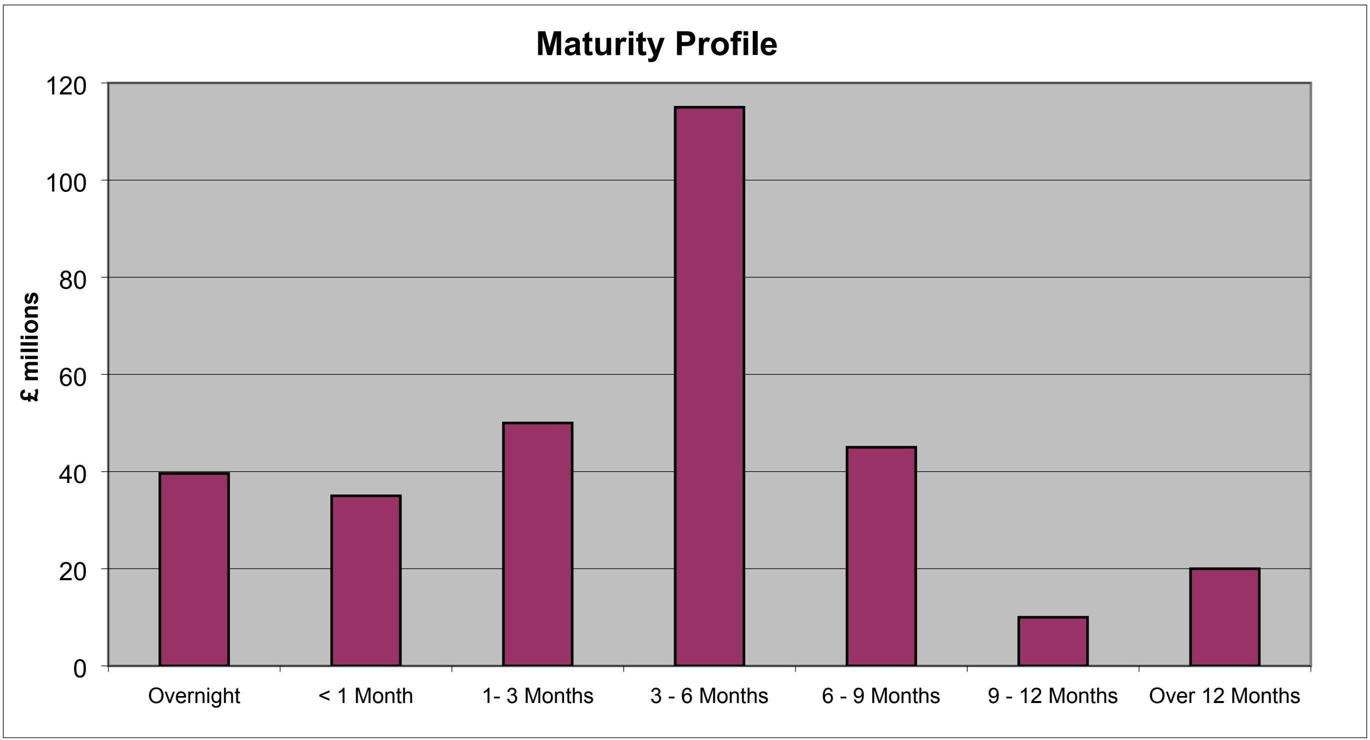
10.22 It has also not been possible to re-invest matured investments at favourably rates due to the low interest rate environment and the limited list of counterparties.

10.23 The council held £314.6m of investments as at 30 September 2014 (£292.45m at 31 March 2014) and the investment portfolio yield for the first six months of the year is 0.72% against a benchmark of 0.35%.

10.24 At the end of September, we have 13% of outstanding investments of £314.6m as overnight money and 27% maturing within 1-3 months, 37% maturing within 3-6 months, 14% maturing within 6-9 months, 3% maturing within 9-12 months and 6% to mature after 12months.

10.25 The Weighted Average Time to Maturity for outstanding investment portfolio is 162.4 days. This is the average time, in days, from reporting date until the portfolio matures, weighted by principal amount.

10.26 The below chart illustrates the maturity structure of deposits as at 30th September 2014 with a detailed list of current investments attached as Appendix 5 of this report.



11. The Council's Capital Position (Prudential Indicators)

11.1 Prudential Indicator for Capital Expenditure - This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at February Council. The programme has been revised to take account of updated profiles; new schemes approved in-year and new capital grant receipts.

Capital Expenditure By Service	**2014/15 Original Estimate £m**	**2014/15 Revised Estimate £m**
Education, Social Care and Wellbeing	*28.611*	*22.329*
Building Schools for the Future	*12.791*	*6.073*
Communities, Localities and Culture	*10.165*	*10.896*
Development & Renewal (Excluding HRA)	*3.486*	*20.217*
Chief Executive & Resources	*0.000*	*0.000*
Corporate General Fund Provision for Schemes under development	*12.000*	*12.000*
Total Non - HRA	67.152	71.515
HRA	99.760	126.214
Total	**166.913**	**197.729**

11.2 **Changes to the Financing of the Capital Programme**

The table below draws together the main strategic elements of the capital expenditure plans, highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

Capital Expenditure	2014/15 Original Estimate £m	2014/15 Revised Estimate £m
Total Spend	**166.913**	**197.729**
Financed By:		
Capital receipts	26.008	25.358
Capital Grants, Developers & SC	115.630	139.908
Capital Reserves	0.000	0.000
Revenue	10.020	17.208
Total Financing	**151.658**	**182.474**
Supported	0.000	0.000
Unsupported	15.255	15.255
Total Borrowing Need	**15.255**	**15.255**

11.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary are detailed in the below table. The Capital Financing Requirement has been amended in line with the borrowing requirement to support the 2014/15 approved capital programme.

	2014/15 Original Estimate £m	2014/15 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement		
CFR – Non-HRA	155.606	146.068
CFR – HRA	89.907	89.907
Total CFR	245.513	235.975
Net movement in CFR	**25.061**	**15.255**
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	270.513	260.975
Other long term liabilities	0.000	0.000
Total debt 31 March	**270.513**	**260.975**

11.4 Limits to Borrowing Activity

11.4.1 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2014/15 and next two financial years. This allows some flexibility for limited early borrowing for future years.

	2014/15 Original Estimate £m	2014/15 Revised Estimate £m
Gross borrowing	119.872	104.185
Less investments	200.000	200.000
Net borrowing / (Investments)	(80.128)	(95.815)
CFR (year - end position)	**245.513**	**235.975**

11.4.2 The Corporate Director, Resources reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

11.4.3 A further prudential indicator limits the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and can only be set and revised by Members. It reflects the level of borrowing which though not needed, could be afforded in the short term but unsustainable long term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2013/14 Original Indicator	2014/15 Revised Indicator
Borrowing	270.513	260.975
Headroom	20.000	20.000
Other long term liabilities*	0.000	0.000
Total	**290.513**	**280.975**

* Excludes PFI schemes and finance leases etc.

12. COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

12.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved TMSS.

12.2 During the financial year to date, the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in Appendix 6 at the end of this report.

13. COMMENTS OF THE CHIEF FINANCIAL OFFICER

13.1 The comments of the Acting Corporate Director of Resources are incorporated in the report.

14 LEGAL COMMENTS

14.1 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.

14.2 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.

14.3 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 review performance against the strategies and policies it has adopted.

14.4 When discharging its treasury management functions, 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. Information is contained in section 15 of the report relevant to these considerations.

15 ONE TOWER HAMLETS CONSIDERATIONS

15.1 Interest on the Council's cash flow has historically contributed significantly towards the budget.

16 SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

16.1 There are no Sustainable Actions for A Greener Environment implications.

17 RISK MANAGEMENT IMPLICATIONS

17.1 Any form of investment inevitably involves a degree of risk. To minimise risk the investment strategy has restricted exposure of council cash balances to UK backed banks or institutions with the highest short term rating or strong long term rating.

18 CRIME AND DISORDER REDUCTION IMPLICATIONS

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

19 EFFICIENCY STATEMENT

19.1 Monitoring and reporting of treasury management activities ensures 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.

LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D

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***
Investment Reports; Capita Treasury Advisory Services	*Bola Tobun(Investment & Treasury) Ext.4733* *Mulberry Place, 3rd Floor.*

Appendix 1: BORROWING STRATEGY

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

2. The Acting 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

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.

BORROWING IN ADVANCE OF NEED

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.

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 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.

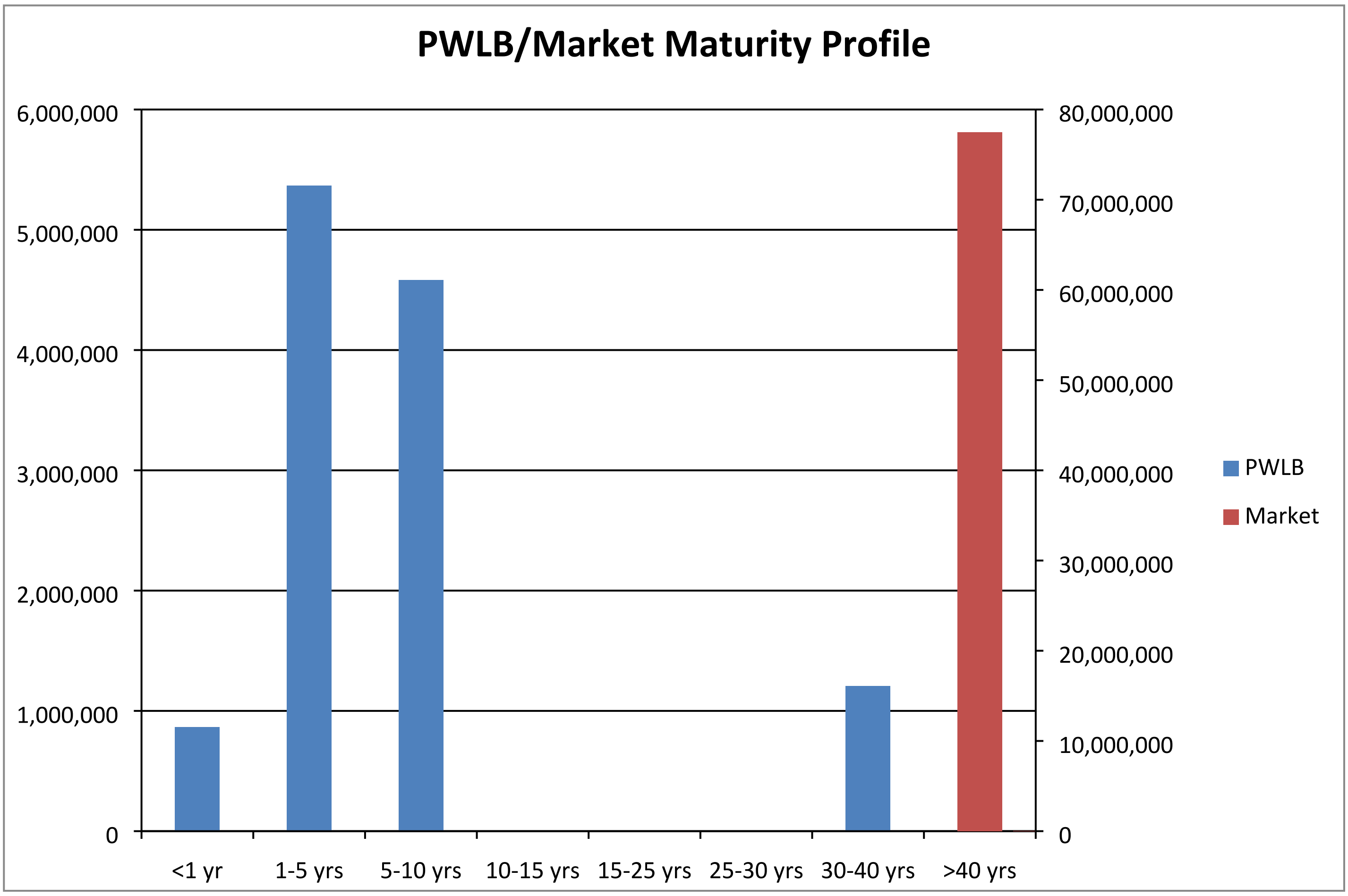
DEBT RESCHEDULING

6. The Interim Head of Finance - 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
    - 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.

7. 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.

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

The Maturity Profile of External Borrowing as at 30th September 2014



Appendix 2: MINIMUM REVENUE PROVISION POLICY STATEMENT

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.

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.

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.

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.

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

13. 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.
-

14. 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.

15. 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.

16. 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.

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

18. 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.

Appendix 3: Creditworthiness Policy

1 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.

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

i. Good credit quality – the Council will only use banks which:

1. are UK banks; and/or
2. 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 Poor's credit ratings, see Table 1)

i. Short term – 'F1'
ii. Long term – 'A'

- 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, treasury bills and the Debt Management Account Deposit Facility);
- Local Authorities (including parish councils, Police and Fire Authorities).
- Non UK Government
- Supranational Institutions
- Corporate Bonds

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 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.

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.

5 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 associated counterparty limits as set through the Council's Treasury Management Practices – Schedules.

Specified Investments:

6 It is recommended that the Council should make Specified investment as detailed below in Table 2.

7 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 1.

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

Table 1

Agency	Long-Term	Short-Term
Fitch	A	F1
Moody's	A2	P-1
Standard & Poor's	A	A-2
Sovereign Rating	AAA	
Money Market Fund	AAA	

Specified Investments:

9 The current strategy is that 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 2

Institution	Minimum High Credit Criteria	Term Limit	Monetary Limit
Debt Management Office (DMO) Deposit Facility	Not applicable	N/A	No Limit
Local Authorities	Not applicable	1 year	£10m
Term deposits – banks and building societies	Short-term F1+, Long-term AA-	1 year	£30m
Term deposits – banks and building societies	Short-term F1, Long-term A+	1 year	£15m
Term deposits – banks and building societies	Short-term F1, Long-term A	6 months	£10m

UK Government Gilts and Treasury Bills	Long Term AAA	1 year	£50m
UK Government – Part Nationalised Banks	Per group	1 year	£70m or 30% of the portfolio
Certificates of Deposits issued by banks and building society	Short-term F1+, Long-term AA-	1 year	£30m
Non-UK Government Bonds	Sovereign rating Long Term AAA	1 year	£10m
Supranational Bonds	Sovereign rating Long Term AAA	1 year	£10m
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)			
Money Market Funds	AAA rated	Liquid	£15m

Definitions of credit ratings are attached at **Appendix 4**.

Non-Specified Investments:

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

Table 3

Institution	Minimum High Credit Criteria	Use	Limit
Term deposits – Banks and Building Societies	Sovereign rating AAA Short-term F1+, Long-term AA-	3 years	£25m or 10%of Investment Portfolio
Structured Deposits: Fixed term deposits with variable rate and variable maturities	Sovereign rating AAA Short-term rating F1+ Long-term rating AA-	3 years	£25m or 10%of Investment Portfolio
UK Government Gilts and treasury bills	Long Term AAA	5 years	£25m or 10%of Investment Portfolio
Certificates of Deposits issued by banks and building society	Sovereign rating AAA Short-term rating F1+ Long-term rating AA-	3 years	£25m or 10%of Investment Portfolio

Certificates of Deposits	A certificate of deposit (CD) is a time deposit, a financial product. CDs are similar to savings accounts in that they are insured and thus virtually risk free; they are "money in the bank." They are different from savings accounts in that the CD has a specific, fixed term (often monthly, three months, six months, or one to five years) and, usually, a fixed interest rate. It is intended that the CD be held until maturity, at which time the money may be withdrawn together with the accrued interest.
Commercial paper	Commercial paper is a money-market security issued (sold) by large corporations to obtain funds to meet short-term debt obligations (for example, payroll), and is backed only by an issuing bank or corporation's promise to pay the face amount on the maturity date specified on the note. Since it is not backed by collateral, only firms with excellent credit ratings from a recognized credit rating agency will be able to sell their commercial paper at a reasonable price. Commercial paper is usually sold at a discount from face value, and carries higher interest repayment rates than bonds
Corporate bonds	A corporate bond is a bond issued by a corporation. It is a bond that a corporation issues to raise money effectively in order to expand its business.[1] The term is usually applied to longer-term debt instruments, generally with a maturity date falling at least a year after their issue date.
Gilt	Gilt-edged securities are bonds issued by certain national governments. The term is of British origin, and originally referred to the debt securities issued by the Bank of England, which had a gilt (or gilded) edge. Hence, they are known as gilt-edged securities, or gilts for short. Today the term is used in the United Kingdom as well as some Commonwealth nations, such as South Africa and India. However, when reference is made to "gilts", what is generally meant is "UK gilts," unless otherwise specified.
Supranational bonds	Supranational bonds are issued by institutions that represent a number of countries, not just one. Thus, organisations that issue such bonds tend to be the World Bank or the European Investment Bank. The issuance of these bonds are for the purpose of promoting economic development
Treasury bills (or T-bills)	Treasury bills (or T-bills) mature in one year or less. Like zero-coupon bonds, they do not pay interest prior to maturity; instead they are sold at a discount of the par value to create a positive yield to maturity. Many regard Treasury bills as the least risky investment available.

Appendix 4: Definition of Credit Ratings

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
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 capacities for timely payment of financial commitments are 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 5 – Investment Portfolio as at 30th September 2014

Time to Maturity	Counterparty	From	Maturity	Amount £m	Rate
Overnight	IGNIS		**MMF**	15.00	0.48%
	Blackrock		**MMF**	15.00	0.46%
	BNP Paribas		**MMF**	9.60	0.40%
	SUB TOTAL			**39.60**	
< 1 Month	Lloyds Banking Group	07/10/2013	07/10/2014	5.00	0.98%
	Royal Bank of Scotland	09/10/2013	09/10/2014	10.00	0.59%
	Nationwide Building Society	11/04/2014	13/10/2014	5.00	0.56%
	Nationwide Building Society	16/04/2014	16/10/2014	5.00	0.56%
	Lloyds Banking Group	29/10/2013	29/10/2014	5.00	0.98%
	Deutsche Bank	29/04/2014	29/10/2014	5.00	0.60%
1 - 3 Months	Lloyds Banking Group	13/11/2013	13/11/2014	5.00	0.98%
	Skandinaviska Enskilda Banken	29/04/2014	14/11/2014	5.00	0.56%
	Canadian Imperial Bank of Commerce	18/08/2014	18/11/2014	15.00	0.42%
	Lloyds Banking Group	04/12/2013	04/12/2014	5.00	0.98%
	Royal Bank of Scotland	09/07/2013	09/01/2015	5.00	0.95%
	Santander		Call - 95N	10.00	0.45%
	Royal Bank of Scotland	27/01/2012	27/01/2015	5.00	3.35%
3 - 6 Months	Lloyds Banking Group	04/02/2014	04/02/2015	5.00	0.95%
	Lloyds Banking Group	13/02/2014	13/02/2015	5.00	0.95%
	Commonwealth Bank of Australia	15/08/2014	13/02/2015	5.00	0.48%
	DZ Bank	26/08/2014	26/02/2015	5.00	0.71%
	Skandinaviska Enskilda Banken	29/08/2014	27/02/2015	5.00	0.64%
	Lloyds Banking Group	04/09/2014	04/03/2015	5.00	0.70%
	Lloyds Banking Group	05/03/2014	05/03/2015	10.00	0.95%
	Barclays	05/09/2014	05/03/2015	10.00	0.61%
	Commonwealth Bank of Australia	15/09/2014	16/03/2015	5.00	0.53%
	National Australia Bank	18/03/2014	18/03/2015	10.00	0.57%
	National Australia Bank	03/04/2014	02/04/2015	10.00	0.60%
	Lloyds Banking Group	11/04/2014	10/04/2015	5.00	0.95%
	Lloyds Banking Group	11/07/2014	13/04/2015	10.00	0.80%
	Lloyds Banking Group	15/04/2014	15/04/2015	5.00	0.95%
	Royal Bank of Scotland	16/04/2013	16/04/2015	5.00	0.88%
	Royal Bank of Scotland	16/04/2014	16/04/2015	5.00	0.67%
	Lloyds Banking Group	17/07//2014	17/04/2015	5.00	0.80%
	Skandinaviska Enskilda Banken	29/04/2014	29/04/2015	5.00	0.71%
6 - 9 Months	National Australia Bank	14/05/2014	14/05/2015	10.00	0.63%
	DZ Bank	26/08/2014	26/05/2015	5.00	0.86%
	Royal Bank of Scotland	15/07/2014	15/07/2015	20.00	0.97%
	Commonwealth Bank of Australia	15/07/2014	15/07/2015	5.00	0.83%
	Commonwealth Bank of Australia	17/07/2014	17/07/2015	5.00	0.82%
9 - 12 Months	Commonwealth Bank of Australia	12/08/2014	12/08/2015	5.00	0.81%
	DZ Bank	26/08/2014	26/08/2015	5.00	0.98%
> 12 Months	Royal Bank of Scotland	27/02/2013	26/02/2016	10.00	1.15%
	Royal Bank of Scotland	20/03/2014	20/03/2016	5.00	1.25%
	Royal Bank of Scotland	10/01/2014	09/01/2017	5.00	1.74% *
	SUB TOTAL			**275.00**	
	TOTAL			**314.60**	

Appendix 6 – 2014-15 Prudential and Treasury Management Indicators

Prudential Indicators	2013/14	2014/15	2014/15	2015/16	2016/17
Extract from budget and rent setting reports	**Actual**	**Original Budget**	**Revised Budget**	**Budget**	**Budget**
	£m	£m	£m	£m	£m
Capital Expenditure					
Non – HRA	80.112	67.153	71.515	47.975	10.810
HRA	50.255	99.760	126.214	101.611	15.000
TOTAL	**130.367**	**166.913**	**197.729**	**149.586**	**25.810**
Ratio of Financing Costs To Net Revenue Stream					
Non – HRA	2.40%	2.89%	2.50%	3.05%	3.55%
HRA	3.67%	4.04%	4.00%	3.95%	3.95%
	£m	£m	£m	£m	£m
Gross Debt and Capital Financing Requirement					
Gross Debt	89.564	88.893	104.185	123.081	121.192
Capital Financing Requirement	220.720	245.513	235.975	255.975	255.975
Over/(Under) Borrowing	(145.950)	(130.848)	(131.156)	(183.131)	(131.790)
In Year Capital Financing Requirement					
Non – HRA	(5.396)	4.829	(4.977)	20.000	0.000
HRA	0.000	20.232	20.232	0.000	0.000
TOTAL	**(5.396)**	**25.061**	**15.255**	**20.000**	**0.000**
Capital Financing Requirement as at 31 March					
Non - HRA	151.045	155.606	146.068	166.068	166.068
HRA	69.675	89.907	89.907	89.907	89.907
	0.000	0.000	0.000	0.000	0.000
TOTAL	**220.720**	**245.513**	**235.975**	**255.975**	**255.975**
Incremental Impact of Financing Costs (£)					
Increase in Council Tax (band D) per annum	0.000	0.000	0.000	0.000	0.000
Increase in average housing rent per week	0.053	0.054	0.056	0.054	0.089

Treasury Management Indicators	2013/14	2014/15	2014/15	2015/16	2016/17
	Actual	Original Budget	Revised Budget	Budget	Budget
	£m	£m	£m	£m	£m
Authorised Limit For External Debt -					
Borrowing & Other long term liabilities	245.720	270.513	260.975	280.975	280.975
Headroom	20.000	20.000	20.000	20.000	20.000
TOTAL	**265.720**	**290.513**	**280.975**	**300.975**	**300.975**
Operational Boundary For External Debt -					
Borrowing	245.720	270.513	260.975	280.975	264.975
Other long term liabilities	0.000	0.000	0.000	0.000	16.000
TOTAL	**245.720**	**270.513**	**260.975**	**280.975**	**280.975**
Gross Borrowing	**89.564**	**119.872**	**104.185**	**123.081**	**121.192**
HRA Debt Limit*	**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%**
Upper Limit For Variable Rate Exposure					
Net interest payable on variable rate borrowing / investments	**20%**	**20%**	**20%**	**20%**	**20%**
Upper limit for total principal sums invested for over 364 days					
(per maturity date)	**£25m**	**£50m**	**£50m**	**£50m**	**£50m**

Maturity structure of new fixed rate borrowing during 2014/15	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%