ANNEX 4

Full Council 24th February 2016	TOWER HAMLETS
Report of: Zena Cooke, Corporate Director Resources	**Classification:** Unrestricted
Treasury Management Strategy Statement For 2016-17	

Originating Officer(s)	Bola Tobun - Investment & Treasury Manager
Wards affected	All wards

Summary

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) a policy statement on the basis of which provision is to be made in the revenue accounts for the repayment of borrowing – Minimum Revenue Provision (MRP) Policy Statement;

   b) a Treasury Management Strategy Statement 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; and

   c) 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.

2) This report also deals with the setting of Prudential Indicators for 2016-17, which ensure that the council's capital investment decisions remain affordable, sustainable and prudent; the proposed indicators are detailed in Appendix 1. Under of the government's self-financing arrangements for the Housing Revenue Account (HRA) there are specific indicators relating to HRA capital investment.

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 2011) which requires the following:

   a) Treasury Management Policy Statement which sets out the policies and objectives of the council's treasury management activities (Appendix 4);

   b) Treasury Management Practices which set out the manner in which the council will seek to achieve those policies and objectives;

   c) Approval by Full Council of Minimum Revenue Provision Policy, an annual Treasury Management Strategy Statement - including the Annual Investment Strategy 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;

d) 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 5.

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 in Appendix 6.

5) The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training will be arranged as required for members of the Audit Committee who are charged with reviewing and monitoring the council's treasury management policies. The training of treasury management officers is also periodically reviewed and enhanced as appropriate.

Recommendations

It is recommended that Full Council to:

i) Adopt the following policy and strategies:

   a) The Minimum Revenue Provision Policy Statement set out in section 2 at annex A attached to this report;

   b) The Treasury Management Strategy Statement set out in sections 5 - 6 at annex A attached to this report;

   c) The Annual Investment Strategy set out in sections 5 - 6 at annex A attached to this report, which officers involved in treasury management, must then follow;

ii) Approve the prudential and treasury management indicators as set out in appendix 1.

1 **REASONS FOR DECISIONS**

1.1 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:

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

2 **ALTERNATIVE OPTIONS**

2.1 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.

2.2 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.

3. **BACKGROUND**

3.1 The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the council's low risk appetite, providing adequate liquidity primarily before considering investment return.

3.2 The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer term cash flow planning to ensure that the council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses.

3.3 CIPFA defines treasury management as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.4 **REPORTING REQUIREMENTS** -The council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

I. **A treasury management strategy statement** (this report) – it covers:
   - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
   - the capital plans (including prudential indicators);
   - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
   - an investment strategy (the parameters on how investments are to be managed).

II. **A mid year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

III. **A treasury outturn report** – This provides details of annual actual prudential and treasury indicators and annual actual treasury operations compared to the annual estimates within the strategy.

3.5 The council uses Capita Asset Services, Treasury solutions as its external treasury management advisors. The council recognises that responsibility for treasury management decisions remains with the organisation at all times and officers will ensure that undue reliance is not placed upon the external service providers.

3.6 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members' responsible for scrutiny. Training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

The 2015/16 Strategy

3.7 The Strategy for 2015/16 was approved by Full Council in February 2015 and set the following objectives:-

a) The use of certificates of deposits (CDs) which allow authorities to invest with highly secure counterparties such as HSBC and Standard Chartered which would not normally be accessed by the council through other means;

b) Given the large cash balances and the difficulty in identifying opportunities to lend at suitable rates within the counterparty list it is necessary to increase the level of investment possible with the most secure organisations. Therefore counterparties money limits were increased, for higher quality banks to £30m, medium quality to £25m and lower to £10m;

c) Increasing each money market funds investment limit to £25m from £15m;

d) Investing up to £50m of core cash for over 1 year if rates were to improve.

e) The use of core cash for internal borrowing if not used for longer term investments.

Current Investment Position and Performance

3.8 The councils have deposit of £100m outstanding with the part nationalised banking groups (Royal Bank of Scotland (£40m) and Lloyds banking group £60) 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.

3.9 The council treasury adviser (Capita) has removed Lloyds group from part nationalised classification as the Government stakes have been reduced to less than 15%. However based on Lloyds banking group current credit ratings the monetary and time limits that applied to this establishment based on the council credit worthiness policy are a monetary limit of £20m and a maximum time limit of 6 months. The council currently has £60m of investment outstanding with the group. No more transactions are being carried out with the group. All deposits are less than one year to maturity; these investments would now be managed down to the council's current monetary and time limits for the institution.

3.10 Barclays Bank S&P Long Term rating was lowered to A- which leaves it one notch below that set in the council's Investment Strategy for 2015/16. The outlook is Stable, which suggests that there is no risk of a further downgrade in the near term. This should offer comfort to the council that the bank is not an immediate risk. We have been advised by Capita that this change is not a reflection of a worsening position of the bank, but the re-assessment of the manner in which the agency treats sovereign support. This is being applied to all UK and global institutions and is not unique to Barclays. The council's remaining investment with the bank matures on 5th April 2016. This was undertaken prior to this change so were transacted when the bank met the council's criteria.

3.11 Investments over 1 year is standing at £25m and were all invested with Royal Bank of Scotland for two years duration.

3.12 The council has not borrowed short or long term to date.

3.13 The council's budgeted investment return of £2.45m for 2015/16, with average rate of return 0.7% for average portfolio balances of £350m. Just over £2.6m of investment income has been earned year to 31 December 2015.

Benchmark	Council Performance	Investment Interest Earned as at 31 Dec 2015
0.35%	0.78%	£2.615m

TREASURY MANAGEMENT STRATEGY FOR 2016/17

3.14 The strategy for 2016/17 covers two main areas:

Capital issues

- the minimum revenue provision (MRP) policy;
- the capital plans and the prudential indicators.

Treasury management issues

- prospects for interest rates;
- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the council;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy;
- service/policy investments.

3.15 The above elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

Developing the Strategy for 2016/17

3.16 In formulating and executing the strategy for 2016/17, the council will continue to have regard for the DCLG's guidance on Local Government Investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectional Guidance Notes.

3.17 The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the council's low risk appetite, providing adequate liquidity initially before considering investment return.

3.18 The council will also achieve optimum return on its investments commensurate with proper levels of security and liquidity. The borrowing of monies purely to on lend and make a return is unlawful and the council will not engage in such activity.

3.19 The council, in conjunction with its treasury management advisor, Capita Asset Services, will use Fitch, Moodys and Standard and Poors ratings to derive its credit criteria. All credit ratings will be monitored daily. The council is alerted to changes in ratings of all agencies through its use of Capita's creditworthiness service.

3.20 If a downgrade means the counterparty or investment fund no longer meets the council's minimum criteria, its use for further investment will be withdrawn immediately. If funds are already invested with the downgraded institution, a decision will be made by the Corporate Director Resources whether to withdraw the funds and potentially incur a penalty.

3.21 If an institution or fund is placed under negative rating watch (i.e. there is a probability of a rating change in the short term and the likelihood of that change being negative) and it is currently at the minimum acceptable rating for placing investments, no further investments will be made with that institution.

3.22 The Corporate Director Resources will have delegated responsibility to add or withdraw institutions from the counterparty list when ratings change, either as advised by Capita Assets Services (the council's advisors) or from another reliable market source.

3.23 Changes to Credit Rating Methodology: The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level.

3.24 In keeping with the agencies' new methodologies, the rating element of our advisers' credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AAA, apart from United Kingdom.

3.25 It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of legislated and future expected changes to the regulatory environment in which financial institutions operate.

3.26 While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support.

3.27 As a consequence of the above, the minimum Fitch credit ratings for the council's investment policy:

Short Term: 'F1' the same criteria as last year

Long Term: 'A-' a notch down from last year criteria 'A'

3.28 Other market intelligence will also be used to determine institutions' credit worthiness, such as financial press, financial broker advice and treasury management meetings with other authorities, e.g. London Treasury Officers Forum. If this information shows a negative outcome, no further investments will be made with that body.

3.29 The strategy will permit the use of unrated building societies or challenger banks with assets in excess of £1.5bn for investment purposes.

3.30 The strategy proposes the continued use of core cash of up to £50m to be held for longer term investment of over one year, if the rates are appealing.

3.31 To delegate authority to Corporate Director Resources to use alternative forms of investment, should the appropriate opportunity arise to use them, and should it be prudent and of advantage to the council to do so. This delegated authority is subject to prior consultation with the Lead Member for Corporate Finance on any possible use of these instruments.

Capital Programme and Prudential Borrowing

3.32 As part of the development of the prudential indicators attached as Appendix C, which form part of the treasury management strategy, the council must consider the affordability of its capital programme.

3.33 In the past the programme has been financed by the use of capital resources such as receipts from asset sales and grants. The affordability of the programme is therefore calculated by the lost revenue income from the possible investment of the resources.

3.34 The authority to borrow up to £13m in 2016/17, £12m in 2017/18 and £40m in 2018/19 for the financing of capital expenditure is included in the current capital programme and the current prudential indicators. If the council is to borrow, the affordability of the capital programme has been included in assessing the cost of borrowing along with the loss of investment income from the use of capital resources held in cash.

3.35 The current long term borrowing rate from the Public Works Loan Board is 3.53% for 25 years. Were the council to temporarily borrow the necessary resources from its own cash balances rather than complete a further one year investment it would save the equivalent of 2.7% of the amount borrowed. The affordability of the capital programme has been calculated based upon the assumption that internal borrowing would occur initially.

3.36 Should rates move quicker than the forecast predicts, the current and proposed strategies do allow the Corporate Director Resources to take advantage of external borrowing.

Investment Return Budget to 2018/19

3.37 A cash flow projection up to March 2019 has been created reflecting the spending proposals in the Budget Strategy 2016/17 onwards. The cash flow projection and the interest rates forecast shows that anticipated investment income of £2.7m for 2016/17, based on average cash balance of £300m and average investment return of 0.9%. The anticipated investment income of £2.5m with average cash balance of £250m is budgeted for 2017/18 and £2.5m with average cash balance of £200m for 2018/19. The council may need to accept a higher level of risk in order to achieve these targets, whilst maintaining due regard for security of capital and liquidity.

3.38 With reference to the proposal to use internal borrowing to finance the capital programme, as set out in the Capital Programme and Prudential Borrowing in annex A, the investment income suggested by the cash flow projection may be provided in part from internal charges or through the surplus generated by commercialisation projects.

Minimum Revenue Provision 2016/17

3.39 Where spend is financed through the creation of debt, the council is required to pay off an element of the accumulated capital spend each year. The total debt is identified as the capital financing reserve and ensures that the council includes external and internal borrowing along with other forms of financing considered to be equivalent to borrowing.

3.40 The payment is made through a revenue charge (the minimum revenue provision - MRP) made against the council's expenditure, although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

3.41 The assumption is to borrow up to a maximum of £35m through the most economically advantageous method, as decided by the Corporate Director Resources, from: internal borrowing of core cash balances; PWLB loans; or other reputable sources of lending.

3.42 It is recommended that because of budget constraints in the medium term the adoption 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) as the basis of the councils MRP relating to supported borrowing

3.43 The council will use the asset life method for the calculation of the Minimum Revenue Provision on all future unsupported borrowing.

3.44 Council could utilise the resources invested in expenditure on key priority outcomes. However the core cash held by the council is either set aside for future expenditure, such as the capital programme, or held as a form of risk mitigation, such as the minimum level of revenue balances. To utilise these resources for alternative projects would put the council at future risk should an unforeseen event occur.

4 <u>COMMENTS OF THE CHIEF FINANCIAL OFFICER</u>

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

5. <u>LEGAL COMMENTS</u>

5.1 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.

5.2 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.

5.3 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.

5.4 The report proposes that the treasury management strategy will incorporate prudential indicators. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 also requires the council to have regard to the CIPFA publication "Prudential Code for Capital Finance in Local Authorities" ("the Prudential Code") when carrying out its duty under the Act to determine an affordable borrowing limit. The Prudential Code specifies a minimum level of prudential indicators required to ensure affordability, sustainability and prudence. The report properly brings forward these matters for determination by the council. If after having regard to the Prudential Code the council wished not to follow it, there would need to be some good reason for such deviation.

5.5 The Local Government Act 2000 and regulations made under the Act provide that adoption of a plan or strategy for control of a local authority's borrowing, investments or capital expenditure, or for determining the authority's minimum revenue provision, is a matter that should not be the sole responsibility of the authority's executive and, accordingly, it is appropriate for the Cabinet to agree these matters and for them to then be considered by Full Council.

5.6 The report sets out the recommendations of the Corporate Director Resources in relation to the council's minimum revenue provision, treasury management strategy and its annual investment strategy. The Corporate Director Resources has responsibility for overseeing the proper administration of the council's financial affairs, as required by section 151 of the Local Government Act 1972 and is the appropriate officer to advise in relation to these matters.

5.7 When considering its approach to the treasury management matters set out in the report, the council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't (the public sector equality duty). A proportionate level of equality analysis is required and there is information relevant to this in section 6 of the report.

6 ONE TOWER HAMLETS CONSIDERATIONS

6.1 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.

7. BEST VALUE (BV) IMPLICATIONS

7.1 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.

7.2 Assessment of value for money is achieved through:

- Monitoring against benchmarks

- Operating within budget

8 SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

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

9 RISK MANAGEMENT IMPLICATIONS

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

9.2 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.

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

9.4 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 Capita Treasury Services who specialise in Council treasury issues.

10 CRIME AND DISORDER REDUCTION IMPLICATIONS

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

ANNEX

Annex A – Treasury Management Strategy Statement For 2016-17

APPENDICES

Appendix 1 – Prudential and Treasury Indicators

Appendix 2 – Definition of Fitch Credit Ratings

Appendix 3 – Counter Party Credit Rating List

Appendix 4 – Treasury Management Policy Statement

Appendix 5 – Treasury Management Scheme of Delegation

Appendix 6 – Treasury Management Reporting Arrangement

Appendix 7 – Glossary

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

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

Brief description of "background papers"	Name and telephone number of holder and address where open to inspection.
	Bola Tobun, x4733, Mulberry Place