Annex A

Working Document

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and
Annual Investment Strategy

London Borough of Tower Hamlets
2018/19

1. BACKGROUND

1.1 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.

1.2 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.

1.3 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."

1.4 **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. **An annual 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.

1.5 **SCRUTINY** - The above reports are required to be adequately scrutinised before being recommended to the Council. This role is being undertaken by the Auditee Committee and or Cabinet.

1.6 **Treasury management consultants** - The Council uses Arlingclose Ltd, 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.

1.7 **Training** - 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 responsibe for scrutiny. Training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

1.8 **TREASURY MANAGEMENT STRATEGY FOR 2018/19**

The strategy for 2018/19 covers two main areas:

Capital issues and considerations:

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

Treasury management issues and considerations:

- economic & interest rate forecast;
- 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.

1.9 These 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.

2. MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

2.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP).

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

2.3 The guidance distinguishes between supported borrowing which relates to assumed borrowing which is incorporated into the Government's 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.

2.4 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.

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

2.6 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.

2.7 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.

2.8 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.

2.9 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.

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

2.11 The Council is required under regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 to determine for each financial year an amount of minimum revenue provision which it considers to be prudent.

2.12 **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.**

2.13 Capital expenditure incurred during 2018/19 will not be subject to a MRP charge until 2019/20. Based on the Council's latest estimate of its Capital Financing Requirement, the budget for MRP has been set as follows:

	31.03.2018 Estimated CFR £	**2018/19 Estimated MRP £**
Capital expenditure before 01.04.2008	124,987,090	5,207,795
Supported and unsupported capital expenditure after 31.03.2008	17,119,745	684,969
Finance leases and Private Finance Initiative	52,089,567	1,784,851
Loans to other bodies repaid in instalments	Nil	Nil
Total General Fund	**194,196,402**	**7,469,303**
Assets in the Housing Revenue Account	68,782,301	Nil
Supported and unsupported capital expenditure after 31.03.2008	789,664	14,899
Finance leases and Private Finance Initiative	14,248,672	433,717
Total Housing Revenue Account	**83,820,637**	**448,616**
Total	**278,170,039**	**7,917,920**

THE CAPITAL PRUDENTIAL INDICATORS 2018/19 – 2020/21

3.1 Council's capital expenditure plans are the key driver of treasury management activity. The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.

3.2 The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

3.3 **Estimates of Capital expenditure** - The table below summarises the Council's planned capital expenditure and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital expenditure £m	2016/17 Actual	2017/18 Revised	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
General Fund	30.333	127.105	68.700	113.131	98.656
HRA	51.412	55.322	47.162	55.850	58.340
Total	**81.745**	**182.427**	**115.862**	**168.981**	**156.996**
Financed by:					
Grant	(31.591)	(23.576)	(8.270)	(11.920)	(9.259)
Major Repairs Allowance	(14.517)	(14.968)	(15.016)	(15.099)	(15.097)
Schools Contribution	0.000	(1.693)	0.000	0.000	0.000
Capital Receipts	(7.913)	(37.270)	(46.555)	(62.041)	(58.269)
S106 (Developers Contributions)	0.000	(29.735)	(13.067)	(22.192)	(14.861)
Revenue Financing	(25.627)	(34.432)	(12.929)	(15.329)	(11.966)
Total Financing Requirement	(79.648)	(141.674)	(95.837)	(126.581)	(109.452)
Prudential Borrowing	**2.097**	**40.753**	**20.025**	**42.400**	**47.545**

3.4 **Other long term liabilities** - The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

3.5 **The Council's borrowing need (the Capital Financing Requirement)** - The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

The Council is asked to approve the CFR projections below:

£m	2016/17 Actual	2017/18 Revised	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Financing Requirement					
CFR – HRA	78.360	232.547	234.855	253.339	259.105
CFR – General Fund	203.342	78.360	82.957	93.548	120.849
Total CFR	**281.702**	**310.907**	**317.812**	**346.887**	**379.954**
Movement in CFR	**19.115**	**29.205**	**6.905**	**29.076**	**33.066**
Movement in CFR represented by					
Net in year financing need	2.096	40.753	20.025	42.400	47.545
MRP/VRP & other Financing movements	17.018	(11.548)	(13.120)	(13.324)	(14.478)
Movement in CFR	**19.115**	**29.205**	**6.905**	**29.076**	**33.066**

3.6 The CFR is forecast to **rise by £68m** over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment.

3.7 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

3.8 The Council has set the following **affordability prudential indicators** as prescribed by the code and these are set out below and detailed in Appendix 1.

3.9 **Ratio of financing costs to net revenue stream -** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

	2016/17 Actual	2017/18 Revised	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
General Fund (GF)	1.06%	0.74%	0.71%	0.71%	0.68%
HRA	4.18%	4.94%	6.01%	7.26%	8.42%

3.10 **Incremental impact of capital investment decisions** - This indicator identifies affordability by showing the impact of capital investment decisions on Council Tax and housing rent levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme summarised earlier in this report. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

£	2016/17 Actual	2017/18 Revised	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
GF – Council tax increase in annual band D	19.079	30.220	34.984	38.361	40.292
HRA increase in weekly housing rent levels	5.837	1.343	1.588	1.921	0.000

4. **ECONOMIC & INTEREST RATE FORECAST**

4.1 The borrowing and investment strategy is in part determined by the economic environment within which it operates. The treasury advisor to the Council is Arlingclose Ltd and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Arlingclose's overall view on interest rates for the next three years.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.19**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.15**
3-month LIBID rate														
Upside risk	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.22**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	-0.10	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.20**
1-yr LIBID rate														
Upside risk	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.27**
Arlingclose Central Case	**0.70**	**0.70**	**0.70**	**0.70**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.77**
Downside risk	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.15	**-0.26**
5-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.80**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**0.89**
Downside risk	-0.20	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.55**	**1.36**
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.85**	**1.85**	**1.85**	**1.85**	**1.85**	**1.90**	**1.90**	**1.95**	**1.95**	**2.00**	**2.05**	**2.05**	**2.05**	**1.93**
Downside risk	-0.20	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.38**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.75**	**1.80**	**1.85**	**1.90**	**1.95**	**1.95**	**1.95**	**1.95**	**1.82**
Downside risk	-0.30	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.39**

Underlying assumptions:

4.2 In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

4.3 Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.

4.4 The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.

4.5 Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.

4.6 Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.

4.7 The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.

4.8 Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.

4.9 Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Forecast:

4.10 The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

4.11 The Arlingclose central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.

4.12 The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

5. TREASURY MANAGEMENT CONSIDERATIONS AND DEVELOPMENT

5.1 The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The Council anticipates its cash balances in 2018/19 to average around £350m, if we persist with the policy of internal borrowing to fund the Council's underlying need to borrow.

5.2 The Pension Fund surplus cash will continue to be invested in accordance with the Council's Treasury Management Strategy agreed by Full Council, under the delegated authority of the Corporate Director, Resources to manage within agreed parameters.

5.3 The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

5.4 **Core funds and expected investment balances** – The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales, etc.).

Detailed below are estimates of the year end balances of investments.

Year End Resources	2016/17 Actual	2017/18 Projected Outturn	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Expected Investments	£381.4m	£450m	£400m	£350m	£300m

5.5 **Current portfolio position** - The Council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	31st March 2017 Actual	31st March 2018 Projected Outturn	31st March 2019 Estimate	31st March 2020 Estimate	31st March 2021 Estimate
HRA CFR	84.269	232.547	234.855	253.339	259.105
General Fund CFR	197.434	78.360	82.957	93.548	120.849
Total CFR	**281.703**	**310.907**	**317.812**	**346.887**	**379.954**
Less: Other debt liabilities *	(36.304)	(34.957)	(33.415)	(31.484)	(29.348)
Borrowing CFR	**245.399**	**275.950**	**284.397**	**315.403**	**350.606**
Less: External Borrowing	(85.936)	(84.296)	(83.293)	(82.289)	(81.534)
Internal Borrowing	**159.463**	**168.165**	**150.615**	**152.625**	**213.583**
Less: Usable reserves	(478.489)	(473.489)	(450.489)	(430.489)	(405.489)
Less: Working capital	(42.338)	(281.8349)	(249.3853)	(197.3746)	(136.4173)
Investments/(New Borrowing)	**361.364**	**450.000**	**400.000**	**350.000**	**300.00**

5.6 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

5.7 The Corporate Director of Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

5.8 **Investment treasury indicator and limit** - total principal funds invested for greater than 1 year. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

5.9 **Investments Longer than a Year:** The Code of Practice requires the Council to give consideration to longer-term investment and set an upper limit for principal sums to be invested for longer than one year. The Council currently has £100m limit for investments invested for longer than one year.

5.10 Therefore taking all of the abovementioned into consideration, in order for the Council to have flexibility in investing in high quality and better returns pooled funds, to meet the Council's risk/reward requirements. The Council's treasury adviser focuses on pooled funds that offer consistency of income return and also preferred clients to invest across a range rather than concentrating on one or two as each fund has different risks, given the diversification, however the primary risk is market risk as some funds have volatile capital values. It is therefore recommended that the Council increase and set an upper limit for principal sums to be invested for longer than one year at £150m.

The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 1 year				
£m	**2017/18**	**2018/19**	**2019/20**	**2020/21**
Principal sums invested > 1 year	£100m	£150m	£150m	£150m

5.11 **Treasury Indicators: limits to borrowing activity for 2018-19 to 2020-21** Treasury indicators are about setting parameters within which within which officers can take treasury management decisions. The Council measures and manages its exposures to treasury management risks using the following indicators and also detailed in Appendix 1 of this report.

5.12 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating *or* credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit rating *or* score	A *or* 6.0

5.13 **Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling [three] month period, without additional borrowing.

	Target
Total cash available within [3] months	£100m

Investment returns expectations

5.14 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

5.15 Policy Rate is forecast to remain flat at 0.50%. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.50%
- 2019/20 0.50%
- 2020/21 0.50%

5.16 There are downside risks to these forecasts (i.e. further reduction in Bank Rate) if economic growth weakens. However, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

5.17 Stated below are the estimated average rates of investment earnings for investments placed for this year and available for each financial year for the next three years:

- 2017/18 0.55%
- 2018/19 1.10%
- 2019/20 1.30%
- 2020/21 1.50%

5.18 For its cash flow generated balances, the Council will seek to utilise money market funds and short-dated deposits (overnight to100 days),such as its Santander 95 days call account in order to benefit from the compounding of interest.

5.19 **Provision for Credit-related Losses** - If any of the Council's investments appear at risk of loss due to default, provision would need to be made from revenue for the appropriate amount.

6. BORROWING STRATEGY

6.1 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

6.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Corporate Director, Reources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the anticipated rate to US tapering of asset purchases, or in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

6.3 Any decisions will be reported to the Cabinet and the full Council at the next available opportunity.

6.4 The Council's borrowing strategy will give consideration to new borrowing in the following order of priority: -

- The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years.
- Temporary borrowing from the money markets or other local authorities
- PWLB variable rate loans for up to 10 years
- Short dated borrowing from non PWLB below sources
- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.
- PWLB borrowing for periods under 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt

6.5 The Council will continue to borrow in respect of the following:

- Maturing debt (net of minimum revenue provision).

- Approved unsupported (prudential) capital expenditure.
- To finance cash flow in the short term.

6.6 The type, period, rate and timing of new borrowing will be determined by the Corporate Director Resources under delegated powers, taking into account the following factors:
- Expected movements in interest rates as outlined above.
- Current maturity profile.
- The impact on the medium term financial strategy.
- Prudential indicators and limits.

6.7 **Treasury management limits on borrowing activity** - There are three debt related treasury activity indicators. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- **Upper limits on variable interest rate exposure** - This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- **Upper limits on fixed interest rate exposure** - This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- **Maturity structure of borrowing** - These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

	2018/19 £m	2019/20 £m	2020/21 £m
Interest rate exposures			
Upper limits on fixed interest rates based on net debt	450	450	450
Upper limits on variable interest rates based on net debt	450	450	450
Maturity structure of fixed interest rate borrowing 2018/19			
	Lower	**Upper**	
Under 12 months	0%	10%	
12 months to 2 years	0%	30%	
2 years to 5 years	0%	40%	
5 years to 10 years	0%	80%	
10 years and above	0%	100%	

6.8 The Council measures and manages its exposures to treasury management risks using the following indicators and also detailed in Appendix 1 of this report.

- **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.

The Council is asked to approve the following authorised limit:

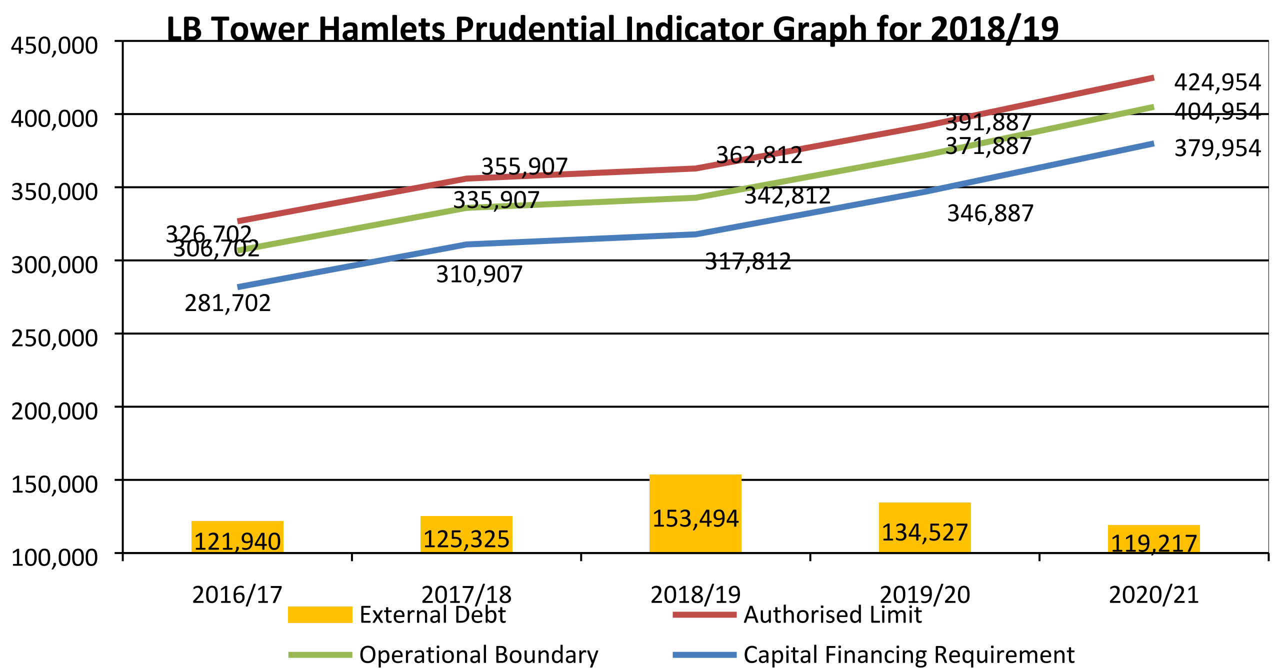
Authorised limit £m	2017/18 Projected Outturn	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Borrowing & OLTL	335.907	342.812	371.887	404.954
Headroom	20.000	20.000	20.000	20.000
Total	**355.907**	**362.812**	**391.887**	**424.954**

- **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 (OLTL).

Operational Boundary £m	2017/18 Projected Outturn	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Debt	300.950	309.397	340.403	375.606
OLTL	34.957	33.415	31.484	29.348
Total	**335.907**	**342.812**	**371.887**	**404.954**

- **HRA Debt Limit** – The HRA Self Financing regime came into effect on 1 April 2012. The new regime imposes a maximum HRA CFR on the Council. For this Council this has been set at £184m following repayment of HRA debt totalling £236.2m by the Government as part of debt settlement that preceded the implementation of the HRA Self Financing regime. In 2014, as part of the Local Growth Fund LBTH was awarded £8.225m of additional HRA borrowing capacity, so in effect the HRA debt cap is currently £192m.

HRA Debt Limit £m	2017/18 Projected Outturn	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
HRA debt cap	192.000	192.000	192.000	192.000
HRA CFR	78.360	82.957	93.548	120.849
HRA Headroom	**113.640**	**109.043**	**98.452**	**71.151**



6.8 **Policy on borrowing in advance of need** - 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 within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

6.9 Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 75% of the expected increase in borrowing need (CFR) over the three year planning period; and
- Would not look to borrow more than 18 months in advance of need.

6.10 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual outturn reporting mechanism.

6.11 **Debt rescheduling** - As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

6.12 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

6.13 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.

6.14 All rescheduling will be reported to the Cabinet and Council, at the earliest meeting following its implementation.

7. ANNUAL INVESTMENT STRATEGY

7.1 **Investment policy -** 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 will be security first, liquidity second, then return.

7.2 In order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

7.3 Ratings will not be the sole determinant of the quality of an institution as 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. The assessment will also take account of information that reflects the opinion of the markets. The Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

7.4 Other information sources used will include the financial press, share price 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.

7.5 Investment instruments identified for use and the criteria for selecting counterparty for this financial year are stated in section 7.10 to 7.34.

7.6 **In summary –** considering the factors set out in Paragraphs 4-7, the recommended Investment Strategy is that:

I. The cash balances, not immediately required to finance expenditure, are lent to the money market or invested in pooled funds for the most appropriate periods as indicated by the cash flow forecast and current market and economic conditions;
II. Liquidity is maintained by the use of overnight deposits, MMF and call accounts;
III. The minimum amount of short-term cash balances required to support monthly cash flow management is £75 million;
IV. The upper limit for investments longer than one year is £150 million;
V. The maximum period for longer term lending is 5 years;
VI. All investment with institutions and investment schemes is undertaken in accordance with the Council's creditworthiness criteria as set out at section 7;
VII. More cautious investment criteria are maintained during times of market uncertainty;
VIII. All investment with institutions and investment schemes is limited to the types of investment set out under the Council's approved "Specified" and "Non-Specified" Investments detailed at section 7, and that professional advice continues to be sought where appropriate;
IX. All investment is managed within the Council's approved investment/asset class limits.

Creditworthiness Policy

7.7 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.

7.8 The Corporate Director, Resources will 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 high quality which the Council may use, rather than defining what types of investment instruments are to be used.

7.9 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

7.10 **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

7.11 **Banks secured**: Covered bonds, reverse repurchase agreements (Repo) and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

7.12 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

7.13 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made following an internal or external credit assessment to a maximum of £5m per company as part of a diversified pool in order to spread the risk widely.

7.14 **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services; they retain the likelihood of receiving government support if needed.

7.15 Pooled funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as well as instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

7.16 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

7.17 **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

7.18 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

7.19 **Other information on the security of investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations, in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

7.20 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

7.21 Specified investments: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

7.22 The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AAA. For money market funds "high credit quality" is defined as those having a credit rating of AAA and for other pooled funds and enhanced cash funds "high credit quality" is defined as those having a credit rating of A- or higher.

7.23 **Non-specified investments**: Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality.

7.24 Credit rating information is supplied by Arlingclose Ltd, the Council treasury adviser, on all active counterparties that comply with the criteria mentioned above. 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. This does not apply to the unrated building societies or banks whereby they are selected based on enhanced credit analysis.

7.25 The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) are:

1) Banks with 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 have, as a minimum, Fitch Long Term; 'A-', or Moody's A3, or Standard and Poor's A-.

2) Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings for financial institutions as stated above.

3) The Council's own banker 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.

4) Unrated/Challengers Banks – The Council in conjunction with the advisers' parameters and methodology will use unrated banks with assets in excess of £1.5bn. When investing with such institution, the Council or and its adviser will carry out an enhanced credit analysis in understanding the institution, its financials and credit capabilities.

I. The "RAG" framework will be used for Building societies as well as Banks, for the Council to evaluate and compare security and liquidity of investment opportunities.
II. The "RAG" (Red, Amber or Green) indicator framework is generally used to identify the strength of a company's financial numbers.
III. For example, all the financials there will be pre-set categories which will classify institutions outcomes as Red, Amber or Green. These pre-set categories are industry dependent; e.g. a retail company is expected to generate higher cash flow than a bank.

5) Building societies - The Council will use all building societies in the UK which:

iii. Meet the ratings for banks outlined above;

iv. Have assets in excess of £1.5bn; or meet both criteria.

6) Money Market Funds (MMF) – AAA

7) Enhanced Money Market Funds (EMMFs) – AA

8) Certificates of Deposits (CDs)

9) Floating Rate Notes (FRN), Corporate Bonds and Loans

10) Reverse Repurchase (Repo)

11) Pooled Funds (Property, Bond, Equity, Income, Growth & Diversified Funds)

12) Covered Bonds

13) Commercial Papers

14) Asset Backed Securities

15) Registered Social Landlord

16) UK Government (including gilts, treasury bills and the Debt management Account Deposit Facility, (DMADF))

17) Local authorities, parish councils, Police and Fire Authorities

18) Supranational institutions

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

Agency	Long-Term
Fitch	A-
Moody's	A3
Standard & Poor's	A-
Sovereign Rating	AAA
Money Market Fund	AAA

7.27 **Country and Product considerations** - Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks above. In addition:

- No more than a maximum amount of £120m or 25% of the investments portfolio will be placed with any non-UK country with AAA sovereign rating at any time;
- limits in place above will apply to a group of institutions within a non UK country;
- Product limits will be monitored regularly for appropriateness.

7.28 **Use of additional information other than credit ratings –** Additional requirements under the Code requires 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. This additional market information are for example Credit Default Swaps, negative rating watches/outlooks, these will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments

7.29 **Specified Investments:** It is recommended that the Council should make Specified investment as detailed below, 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 A- Fitch long-term credit rating or equivalent Moody's or Standard and Poor's rating.

Specified Investments	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Term Deposits (Banks - higher quality)	*Long-term AA*	£30m	1 year

Term Deposits (Banks – medium (high) quality)	*Long-term A+*	£30m	1 year
Term Deposits (Banks – medium (low) quality)	*Long-term A*	£30m	1 year
Term Deposits (Banks - lower quality)	*Long-term A-*	£20m	6 months
Banks - part nationalised (per group)	N/A	£70m	1 year
Council's banker (not meeting lending criteria)	XXX	£30m	1 day
DMADF	N/A	Unlimited	6 months
Local authorities, Police & Fire Authorities and Parish Councils,	N/A	£30m	1 year
Treasury Bills (Non UK)	Long Term AA	£30m	1 year
UK Government Gilts	N/A	No Limit	1 year
Corporate Bonds & Loans, FRN and Asset Backed Securities	As Term Deposits above	As Term Deposits above	As Term Deposits above
Certificates of Deposits, Commercial paper & Repo	As Term Deposits above	As Term Deposits above	As Term Deposits above
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)			
	Fund rating	**Money Limit (per fund)**	**Time Limit**
Money market funds (Sterling)	AAA	£25m	liquid
Enhanced Cash Funds	AAA/V1- AA/V2	£20m	liquid
Pooled Funds (Bonds, Equity, Property, Diversified, Growth & Income Funds etc.)	N/A	£20m	liquid

<u>Non-Specified Investments:</u>

7.30 All investments that do not qualify as specified investments are termed non-specified investments. The table below details the total percentage of the Annual Principal Sums that can be Invested for more than 1 year and can be held in each category of investment, for example 100% of the Principal Sums limit can be held with the UK Government at any one time.

7.31 **Unrated banks, building societies and other institutions** are classed as non-specified investments irrespective of the investment period. When investing with this institution, the Council will carry out an enhanced credit analysis in understanding the institution, its financials and credit capabilities.

Minimum Criteria for considering Unrated Institutions with money and time limits:

	Institution Assets Value	Money Limit	Time Limit
Unrated UK Building Societies & Challenger Banks with assets in excess of:	£1.5bn £2.5bn	£3m £5m	6 months 12 months

7.32 It is considered that the maximum nominal value of overall investments that the Council should hold for more than one year and less than 5 years is £150m. (Investments with maturity over one year) **The prudential indicator figure of £150m is therefore recommended.**

7.33 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 5 years	n/a	n/a
AAA	£20m 5 years	£30m 5 years	£30m 5 years	£20m 5 years	£20m 5 years
AA+	£20m 5 years	£30m 5 years	£30m 5 years	£20m 5 years	£20m 5 years
AA	£20m 4 years	£30m 5 years	£30m 5 years	£20m 5 years	£20m 5 years
AA-	£20m 3 years	£30m 4 years	£30m 5 years	£20m 4 years	£20m 5 years
A+	£20m 2 years	£30m 3 years	£20m 5 years	£20m 3 years	£20m 5 years
A	£20m 13 months	£30m 2 years	£20m 5 years	£20m 2 years	£20m 5 years
A-	£20m 6 months	£30m 13 months	£20m 5 years	£20m 13 months	£20m 5 years
None	£3m - £5m 6 -12 months	n/a	£20m 5 years	£5m 5 years	£20m 5 years
Pooled funds	£20m per fund				
Money Market Funds	£25m per fund				

7.34 **Country limits:** The Council has determined that it will only use approved counterparties from non UK countries with a minimum sovereign credit rating of AAA from Fitch (or equivalent). A counterparty list will be compiled based on this sovereign rating of AAA and in accordance with the Council's minimum credit rating criteria policy for institutions and qualified institutions will be added to this list, and unqualified institutions will be removed from the list, by officers as deemed appropriate. Please see Appendix A for qualified countries and their institutions as of 31/01/2018.

APPENDICES

Appendix A – Counter Party Credit Rating List

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

Appendix 6 - 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

APPENDIX 1

PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS FOR 2018/19

Prudential Indicators	2016/17	2017/18	2017/18	2018/19	2019/20	2020/21
Extract from Estimate and rent setting reports	**Actual**	**Original Estimate**	**Revised Estimate**	**Estimate**	**Estimate**	**Estimate**
	£m	£m	£m	£m	£m	£m
Capital Expenditure						
General Fund	30.333	103.151	127.105	68.700	113.131	98.656
HRA	51.412	113.120	55.322	47.162	55.850	58.340
TOTAL	**81.745**	**216.271**	**182.427**	**115.862**	**168.981**	**156.996**
Ratio of Financing Costs to Net Revenue Stream						
General Fund	1.06%	0.88%	0.74%	0.71%	0.71%	0.68%
HRA	4.18%	6.10%	4.94%	6.01%	7.26%	8.42%
	£m	£m	£m	£m	£m	£m
Gross Debt and Capital Financing Requirement						
Gross Debt	121.940	119.317	158.215	134.166	148.146	128.830
Capital Financing Requirement	281.702	271.605	310.907	317.812	346.887	379.954
Over/(Under) Borrowing	(159.762)	(152.288)	(152.692)	(183.645)	(198.741)	(251.124)
In Year Capital Financing Requirement						
General Fund	0.000	1.855	36.156	9.434	15.099	19.402
HRA	0.000	21.804	0.000	4.597	10.591	27.301
TOTAL	**0.000**	**23.659**	**36.156**	**14.031**	**25.690**	**46.703**
Capital Financing Requirement as at 31 March						
General Fund	203.342	171.441	232.547	234.855	253.339	259.105
HRA	78.360	100.164	78.360	82.957	93.548	120.849
TOTAL	**281.702**	**271.605**	**310.907**	**317.812**	**346.887**	**379.954**
Incremental Impact of Financing Costs (£)						
Increase in Council Tax (band D) per annum	19.079	30.220	30.220	34.984	38.361	40.292
Increase in average housing rent per week	5.837	2.858	1.343	1.588	1.921	0.000

Treasury Management Indicators	2016/17	2017/18	2017/18	2018/19	2019/20	2020/21
	Actual	Original Estimate	Revised Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
Authorised Limit For External Debt -						
Borrowing & Other long term liabilities	306.702	296.605	335.907	342.812	371.887	404.954
Headroom	20.000	20.000	20.000	20.000	20.000	20.000
TOTAL	**326.702**	**316.605**	**355.907**	**362.812**	**391.887**	**424.954**
Operational Boundary For External Debt -						
Borrowing	270.398	261.648	300.950	309.397	340.403	375.606
Other long term liabilities	36.304	34.957	34.957	33.415	31.484	29.348
TOTAL	**306.702**	**296.605**	**335.907**	**342.812**	**371.887**	**404.954**
Gross Borrowing	**121.940**	**119.317**	**158.215**	**134.166**	**148.146**	**128.830**
HRA Debt Limit*	**192.000**	**192.000**	**192.000**	**192.000**	**192.000**	**192.000**
Upper Limit For Fixed Interest Rate Exposure						
Net principal re fixed rate borrowing / investments	**100%**	**100%**	**£450m**	**£450m**	**£450m**	**£450m**
Upper Limit For Variable Rate Exposure						
Net interest payable on variable rate borrowing / investments	**50%**	**50%**	**£450m**	**£450m**	**£450m**	**£450m**
Upper limit for total principal sums invested for over 364 days (per maturity date)	**£100m**	**£100m**	**£100m**	**£150m**	**£150m**	**£150m**

Maturity structure of new fixed rate borrowing during 2018/19	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%

Support Ratings

Rating	Current Definition (December 2014)
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	Current Definition (December 2014)
F1	**Highest short-term 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 short-term 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 short-term 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 (December 2014)
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 is more likely to impair this capacity. This is the lowest investment-grade category.
BB	**Speculative** - ‘BB’ ratings indicate an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time; however, business or financial flexibility exists which supports the servicing of financial commitments.
B	**Highly speculative -** ‘B’ ratings indicate that material default risk is present, but limited margin of safety remains. Financial commitments are currently being me however, capacity for continued payment is vulnerable to deterioration in th business and economic environment.
CCC	**Substantial credit risk – ‘**CCC’ Default is a real possibility.
CC	**Very high levels of credit risk –** ‘CC’ Default of some kind appears probable
C	**Exceptionally high levels of credit risk** Default is imminent or inevitable, or the issuer is in standstill. Conditions that are indicative of a ‘C’ category rating for an issuer include: a. the issuer has entered into a grace or cure period following non-payment of a material financial obligation; b. the issuer has entered into a temporary negotiated waiver or standstill agreement following a payment default on a material financial obligation; or c. Fitch Ratings otherwise believes a condition of ‘RD’ or ‘D’ to be imminent or inevitable, including through the formal announcement of a distressed debt exchange. (RD – stands for restricted default and D – default).

Note:

The modifiers “+” or “-” may be appended to a rating to denote relative status within major rating categories. Such suffixes are not added to the ‘AAA’ Long-Term IDR category, or to Long-Term IDR categories below ‘B’.

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.

Appendix 4

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

Appendix 5

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

Appendix 6 - GLOSSARY

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

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

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