COUNCIL 20 February 2019	TOWER HAMLETS
Report of: Neville Murton, Acting Corporate Director, Resources	**Classification:** Unrestricted
Treasury Management Strategy Statement, Investment Strategy Report and Capital Strategy Report For 2019-20	

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

Summary

1) This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the MHCLG Guidance.

2) The Council is required by legislation and guidance to produce three strategy statements in relation to its treasury management arrangements and investment options. The three reports are:

   a) a Capital Strategy Report which sets out an high-level overview of how the Council's capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability;

   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 Investment Strategy Report which sets out the Council's policies for managing its treasury management, service and or commercial investments and for giving priority to the security and liquidity of those investments.

3) This report also covers the requirements of the 2017 Prudential Code, including setting of Prudential Indicators for 2019-20, which ensure that the Council's capital investment decisions remain affordable, sustainable and prudent; the proposed indicators are detailed in Appendix 1.

4) The Ministry of Housing, Communities and Local Government (MHCLG) issued revised Guidance on Local Authority Investments in February 2018 that requires the Authority to approve an investment strategy before the start of each financial year.

5) The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA TM Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

6) The CIPFA TM Code, 2018 MHCLG Investment Guidance and the 2017 Prudential Code requires the following:

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

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 Capital Strategy Report, 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 4.

7) 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 5.

8) 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 Council:

i) Approve and adopt the following policy and strategies:

   a) The high level overview of Capital Strategy Report set out in section 2 at annex A attached to this report;

   b) The Treasury Management Strategy Statement set out in sections 5 - 7 at annex A attached to this report, which officers involved in treasury management, must then follow;

   c) The new Investment Strategy Report set out in section 8 at annex A attached to this report, the Council has committed up to £54.6m of service investments to Seahorse Homes Ltd and Mulberry Housing Society;

ii) Approve the prudential and treasury management indicators as set out in appendix 1 of annex A attached to this report; and

iii) Note section 3.25 latest developments on money market funds (MMF) and pooled funds and section 3.26 - 3.28 on MMF reformation.

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:

- High level Capital Strategy
- 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:
   - the capital plans (including prudential indicators);

- the treasury management strategy (how the investments and borrowings are to be organised,the parameters on how investments are to be managed) including treasury indicators; and
- an investment strategy report (detailing the Council's service investments and commercial investments).

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 Arlingclose Limited 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 2018/19 Strategy and Current Investment Position and Performance

3.7 The Strategy for 2018/19 was approved by Full Council in February 2018 and set the following objectives:-

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

b) The minimum Fitch credit ratings for the Council's investment policy:
   - Short Term: 'F1' the same criteria as last year
   - Long Term: 'A-' the same criteria as last year

c) The Council's budgeted investment return of £4m for 2018/19, with average rate of return 1.1% for average portfolio balances of £350m. Below table show the position of the investment income earned for this financial year to 31 December 2018.

Benchmark (Average 7 day LIBID)	Investment interest Earned	Average Cash Balance	Investment Interest Earned
0.53%	0.75%	£421.87m	£3.164m

d) The above budget was based on investing upto £100m of core cash balances in pooled funds for 3-5 years earning investment rate of 2% per annum, unfortunately the market has been volatile and a more cautious approach has been adopted, to date £76m invested in pooled funds.

e) Investments over 1 year is standing at £96m with £76m invested in pooled funds.

f) The Council repaid £60m RBS loan, its only LOBO loan.

g) The Council has borrowed £30m PWLB long term loan at average rate of 2.65% for its planned capital expenditure.

TREASURY MANAGEMENT STRATEGY FOR 2019/20

3.8 The strategy for 2019/20 covers three main areas:

Capital issues

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

Treasury management considerations:

- economic and interest rates 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.

Investments approach:

- the investment strategy;
- creditworthiness policy;
- service/policy investments.

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

Developing the Strategy for 2019/20

3.10 In formulating and executing the strategy for 2019/20, the Council will continue to have regard for the MHCLG's guidance on Local Government Investments and the 2017 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectional Guidance Notes.

3.11 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.

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

3.13 The Council, in conjunction with its treasury management advisor, Arlingclose, will use Fitch, Moodys and Standard and Poor's ratings to derive its credit criteria. The Council's treasury adviser alerted officers to changes in ratings of all agencies.

3.14 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 Acting Corporate Director, Resources whether to withdraw the funds and potentially incur a penalty.

3.15 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.

3.16 The Acting Corporate Director, Resources has delegated responsibility to add or withdraw institutions from the counterparty list when ratings change, either as advised by Arlingclose Limited (the Council's advisors) or from another reliable market source.

3.17 The minimum Fitch credit ratings for the Council's investment policy for this financial year remain the same as last year. Consideration has not been given to short term rating element and the long term credit rating minimum criteria is the same as 2018/19:

- Long Term: 'A-'

3.18 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.

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

3.20 The strategy proposes the continued use of core cash of up to £150m to be held for investment over one year (longer term) into higher yielding asset classes during 2019/20.

3.21 The cash balances, not immediately required to finance expenditure, are lent to the money market for the most appropriate periods as indicated by the cash flow model and current market and economic conditions;

a) Liquidity is maintained by the use of overnight deposits, MMF and call accounts;

b) The minimum amount of short-term cash balances required to support monthly cash flow management is £50 million;

c) The upper limit for investments longer than one year is £200 million;

d) The maximum period for longer term lending for banks, financial institutions and local authorities has been increased to 5 years;

e) All investment with institutions and investment schemes is undertaken in accordance with the Council's creditworthiness criteria as set out at section 7 of annex A attached to this report;

f) More cautious investment criteria are maintained during times of market uncertainty;

g) 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 of annex A, and professional advice continues to be sought where appropriate;

h) All investment is managed within the Council's approved investment/asset class limits.

3.22 The Acting Corporate Director, Resources and his officers have been investing in pooled funds. These investment funds are step up from simple money market funds, where the fund manager takes a modest increase in credit and/or duration risk in order to deliver a modest increase in return. The advantages of pooled fund investments are listed below:

- Potentially enhanced investment returns
- Diversifies opportunity and risk
- More appropriate to prevailing economic conditions
- Access to experienced fund managers and their resources
- Resource-efficient management

3.23 It is worth noting that these funds operate on a Variable Net Asset Value (VNAV) basis, so there is no guarantee that the sale price will be equal to or above the purchase price, not all the funds have credit ratings, although the majority do.

3.24 Most of the funds offer distributing (i.e. income paying) share classes but some only offer accumulating. Under IFRS9, the Council will need to make a provision available for possible credit losses.

3.25 The Government has accidentally legislated most money market funds (MMFs) and Pooled Funds to be Capital Expenditure for local authorities in England. If the legislation is not further amended, then the vast majority of MMFs and other pooled funds will become capital expenditure when the UK leaves the EU, currently scheduled for 29th March 2019.The Council currently has £76m invested in pooled funds and officers are having meetings with the Council's treasury adviser with the view of selling funds with substantial unrealised gains to crystallise capital gains into revenue.

3.26 On 30th June 2017, the European Union Regulation on money market fund (MMF) reform was published in the Official Journal of the European Union, introducing new rules for MMFs domiciled, managed or marketed in the EU. This reform is offering more protection to investors and requires most of the MMFs that operates has stable/constant Net Asset Value (NAV) to be label based on their true attributes.

3.27 So the existing MMFs are required to comply with a Public Debt Constant Net Asset Value (NAV), Low Volatility NAV or Variable NAV category by 21st January 2019. There was a technical arrangement that was withdrawn (connected to negative interest rates) with Euro denominated funds hence the transition date has been extended by two months, so the final transition date is now 21st March 2019.

3.28 All the Council's MMFs are branded as constant NAV products but the proportions of Government instruments in all these funds are very low to justify their NAVs to be stable or constant, hence they are all converting to LVNAV. However these money market funds have never exhibited price volatilities. We have been assured by the MMF managers and the Council's treasury advisor that stable price/NAV would still be maintained to avoid price volatility going forward.

Capital Programme and Prudential Borrowing

3.29 The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

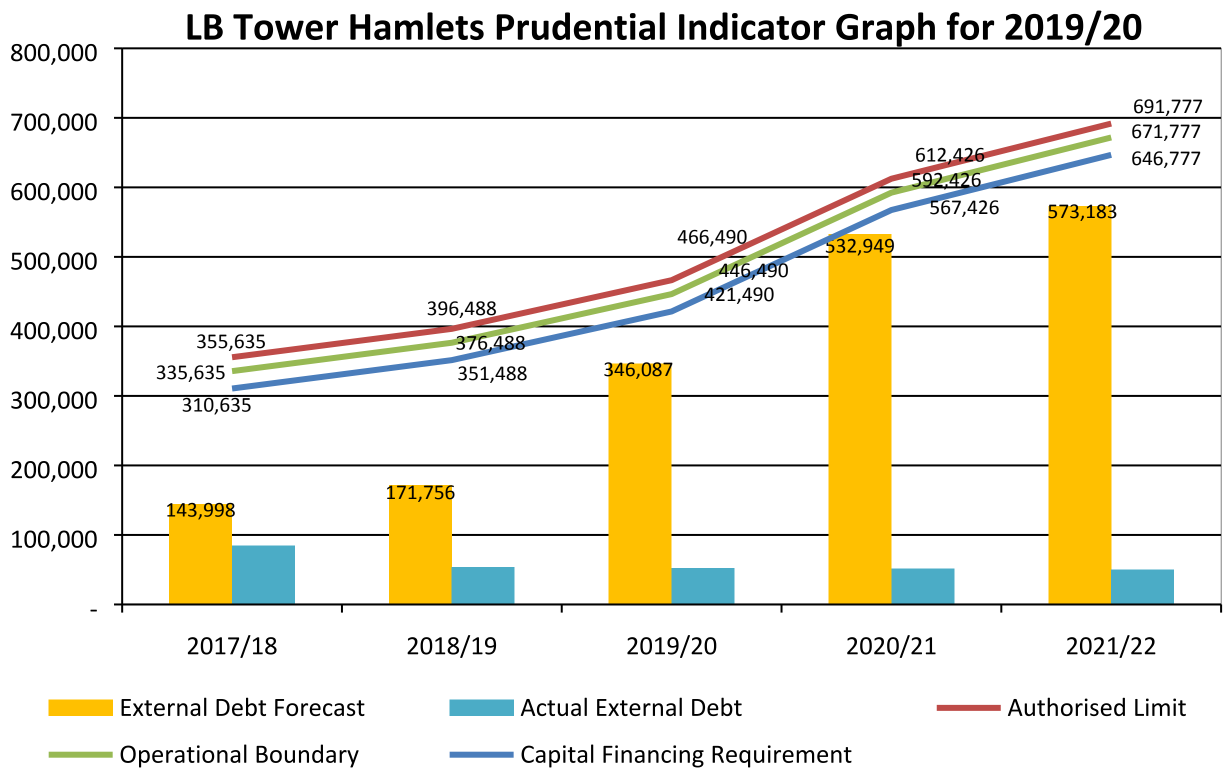
Capital expenditure £m	2017/18 Actual	2018/19 Revised	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
General Fund	90.384	83.805	176.117	149.013	81.746
HRA	34.152	61.888	84.940	99.904	80.687
Total	**124.536**	**145.693**	**261.057**	**248.917**	**162.432**
Financed by:					
Grant	(26.924)	(31.161)	(9.736)	(6.773)	(6.030)
Major Repairs Reserve	(22.013)	(17.616)	(29.354)	(26.051)	(24.980)
Capital Receipts	(20.340)	(29.583)	(76.040)	(27.055)	(21.307)
Developers Contributions	(7.822)	(15.586)	(54.618)	(25.631)	(7.464)
Direct Revenue Financing	(10.573)	(0.406)	(6.564)	0.000	0.000
Prudential Borrowing	**36.770**	**51.342**	**84.745**	**163.407**	**102.652**

3.30 As part of the development of the prudential indicators attached as appendix 1 of annex A, which form part of the treasury management strategy, the Council must consider the affordability of its capital programme. 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.

3.31 As shown in table above, there is a need to borrow up to £351m in total from 2019-2022. There is still a need to borrow £51m for 2018/2019 and £85m for 2019/20, £163m for 2020/21 and £102.65m for 2021/22 for financing of capital expenditure as 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.

3.32 The current long term borrowing rate from the Public Works Loan Board is 2.64% 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 1.84% of the amount borrowed. The affordability of the capital programme has been calculated based upon the assumption that internal borrowing would occur initially.

3.33 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 from 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 still an issue that needs to be considered.



3.34 From the above graph it can be seen that the CFR as at 31st March 2018 was £310.635m and the actual external debt was £84.3m, capital expenditure has been supported by internal borrowing of some £226.3m. For 2018/19, the CFR forecast is £351.488 and the external debt forecast is £171.756m but the actual external debt is £53.3m, if no further borrowing is done, this would be creating internal borrowing position of some £298.2m.

3.35 Under the current market and economic circumstances and given the risks within the economic forecast, a prudent approach will be adopted with the 2019/20 treasury operations. The Acting Corporate Director, Resources and his officers will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

3.35 Should rates move quicker than the forecast predicts, the current and proposed strategies do allow the Acting Corporate Director, Resources to take advantage of external borrowing. Any decisions will be reported to the appropriate decision making body at the next available opportunity.

3.36 The assumption is to borrow up to a maximum of £50m for 2018/19 and £100m for 2019/20, through the most economically advantageous method, as decided by the Acting Corporate Director, Resources, from internal borrowing of core cash balances; PWLB loans; or other reputable sources of lending.

3.37 In summary the Council's borrowing strategy will give consideration to new borrowing in the following order of priority: -

a) The most cost effective 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.

b) Temporary borrowing from the money markets or other local authorities

c) PWLB variable rate loans for up to 10 years

d) Short dated borrowing from non PWLB below sources

e) 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.

f) 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

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

a) Maturing debt (net of minimum revenue provision).

b) Approved unsupported (prudential) capital expenditure.

c) To finance cash flow in the short term.

Investment Strategy

3.39 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £350m and £500m, and the levels are expected to reduce by £50m - £100m in the forthcoming year due to capital expenditure programme.

3.40 **Objectives:** Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

3.41 **Negative interest rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

3.42 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for the estimated £150m that is available for longer-term investment. Majority of the Council's surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds.

This diversification will represent a continuation of the new strategy adopted in 2018/19.

Investment Return Budget to 2021/22

3.43 The cash flow projection and the interest rates forecast for 2018/19 shows that anticipated investment income of £4m, based on average cash balance of £350m and average investment return of 1.10% is not on target due to the current market volatility. As at 31st December 2018 investment income receivable was £3.164m on average cash balance of £421.87m.

3.44 A cash flow projection up to March 2022 has been created reflecting the spending proposals in the Budget Strategy 2019/20 onwards. The anticipated investment income for 2019/20 is budgeted as £4.5m with average rate of 1.3% on cash balance of £350m, whereby £100m of core cash balances to be invested in pooled funds for over 3-5 years earning investment rate of 2% per annum. For 2020/21, £4.5m is the budgeted income, with average rate of 1.5% on average cash balance of £300m and for 2020/21; £4.5m is the budgeted income, with average rate of 1.5% on average cash balance of £300m. 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.

Year-End	Estimated Average Cash Balance £m	Investment Income Forecast £m	Average Interest Rate
31st March 2020	400.00	4.40	1.10%
31st March 2021	350.00	4.50	1.30%
31st March 2022	300.00	4.50	1.50%

3.45 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 2019/20

3.46 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.

3.47 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).

3.48 It is recommended that because of budget constraints in the medium term the continue 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

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

3.50 The Government abolished HRA debt cap and in order to ensure that all of the Council's capital expenditure funded from borrowing are prudent and sustainable. Officers are proposing that the Council Housing HRA should elect to adopt a Voluntary Revenue Provision (VRP) to be charged to revenue along with the interest cost of the borrowing over the lifespan of the asset funded from borrowing for HRA capital investment - termed the Capital Financing requirement (CFR), this is in-line with risks under consideration, the impact, and potential impact, on the Council's overall fiscal sustainability.

3.51 Based on the Council's latest estimate of its capital financing requirement, the budget for MRP for 2018/19 is £8.639m based on 2017/18 CFR of £310.635m and the budgeted MRP for 2019/20 is £8.754m based on estimated CFR for 2018/19 of £301.996m.

Other Treasury Management Issues

3.52 **Credit outlook:** The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

3.53 The Bank of England (BoE) released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

3.54 European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

3.55 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

3.56 **Negative interest rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

3.57 **Accounting Standard:** Under the Regulations, local authorities must follow CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom, as amended or reissued, as a code of practice containing proper accounting practices. This Statutory Code is reissued in every financial year. The code applies only to principal authorities.

3.58 The Government can modify local authorities' duties to follow the proper practices as set out in the Code on Local Authority Accounting, by including specific provisions in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. The Government regularly reviews all new accounting standards and how these have been introduced into proper practices, to see if any new statutory overrides are necessary. However, statutory overrides are only normally introduced by the Government in strictly limited circumstances where they are absolutely necessary.

3.59 Under the new IFRS 9 standard, the accounting for certain investments at fair value through profit and loss may introduce "more income statement volatility." And this may impact upon balanced budget calculations and may mean "less money available to fund services.

3.60 Local authorities previously made representations to Government, raising concerns that some of the provisions in IFRS 9 Financial Instruments will have negative impacts. The Government therefore consulted on potential mitigations to those provisions.The consultation lasted from 25th July to 28th September 2018, and the Government received a total of 107 responses.

3.61 Having considered the consultation responses the Government announced it will implement a five-year override, and keep the situation under review, therefore it will:

- Require local authorities to account for fair value movements in financial instruments in accordance with proper practices as set out in the Code on Local Authority Accounting published by CIPFA.
- Introduce a mandatory statutory override requiring local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective from financial year commencing 1 April 2018
- Extend the proposed period for which the statutory override applies to five years. The Government will keep use of the override under review.
- Require Local Authorities to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override

- Introduce a 2 year extension of the unequal pay regulation.

3.62 There will be no override for the expected loss model or for the extra disclosures that the new standard requires.

3.63 Using its “Henry VIII” powers under the European Union (Withdrawal) Act 2018 to alter legislation without consultation, the government is changing which pooled funds are capital expenditure for local authorities in England. If the legislation is not further amended, then the vast majority of our money market funds and other pooled funds will become capital expenditure when the UK leaves the EU, currently scheduled for 29th March 2019. The Council’s treasury advisor – Arlingclose is currently in discussion with MHCLG about further amendments to these rules but cannot guarantee that any changes will be effective before Brexit.

3.64 Capital gains on capital expenditure funds are received as capital receipts instead of revenue income upon eventual sale. Hence the Council is considering selling the funds with unrealised gains to ensure the capital growth is taken to revenue.

4. COMMENTS OF THE CHIEF FINANCIAL OFFICER

4.1 This report provides Treasury Management budget for 2019/20 and forecasts for 2020/21 and 2021/22 financial year.

4.2 The Council held outstanding investments of £387.9m as at 31st December 2018. This portfolio has receivable interest of £3.16m to the date. However, the Council has an investment income target of £4m for 2018/19; this target might not be met due to current market volatility.

4.3 The Council has committed up to £54m of service investments in Seahorse Homes Ltd and Mulberry Housing Society for 2019/20.

5. LEGAL COMMENTS

5.1 The Local Government Act 2003 (‘the 2003 Act’) 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 (‘the 2003 Regulations’) 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 2003 Act. 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 2003 Regulations 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 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).

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 Arlingclose who specialise in Local Authority treasury issues.

10 CRIME AND DISORDER REDUCTION IMPLICATIONS

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

ANNEX & APPENDICES

ANNEX

Annex A – Treasury Management Strategy Statement (Working Document) for 2019-20

APPENDICES

Appendix A – Counter Party Credit Rating List

Appendix 1 – Prudential and Treasury Indicators

Appendix 2 – Definition of Fitch 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