<table>
<tr><td>TREASURY MANAGEMENT STRATEGY
18

18th January 2017

AUDIT COMMITTEE</td><td>Classification:

Public</td></tr>
<tr><td colspan="2">Ward(s) affected

None</td></tr>
<tr><td colspan="2">Corporate Director

Ian Williams, Group Director of Finance and Resources</td></tr>
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1. INTRODUCTION

1.1 This report introduces the Annual Treasury Management Strategy for 2017/18, for the Audit Committee, setting out the expected treasury operations for the 2017/18 financial year.

2. RECOMMENDATION(S)

2.1 The Audit Committee is recommended to:

- **Approve the draft Treasury Management Strategy 2017/18 to 2019/20 for submission to Council subject to Capital programme updates with delegated powers to the Corporate Director of Finance and Resources to approve the final Treasury Management Strategy for submission to Council.**

3. REASONS FOR DECISION

3.1 The Treasury Management Strategy is required under the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") to be approved by full Council along with the Prudential Indicators.

4. BACKGROUND

4.1 Policy Context

4.1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also incorporates the Investment Strategy as required under the CLG's Investment Guidance.

4.2 Equality Impact Assessment

There are no equality impact issues arising from this report

4.3 Sustainability

There are no sustainability issues arising from this report

5. RISK ASSESSMENT

5.1 Consultations

No consultations have taken place in respect of this report.

5.2 Risk Assessment

The treasury management function is a significant area of risk for the Council if the function is not properly carried out and monitored by those charged with responsibility for oversight of treasury management. This Strategy sets out measures that mitigate that risk and sets the parameters within which the function should be carried out. Regular reporting on treasury ensures that the Committee is kept informed

6. COMMENTS OF THE GROUP DIRECTOR OF FINANCE AND CORPORATE RESOURCES

6.1 The Treasury Management Strategy sets out how the Council's cash flow will be managed during the financial year 2017/18. The actual cost of borrowing and interest on investments will depend on market conditions and timing will be an important factor in decisions to be taken on the debt portfolio. The prudential indicators are still to be finalised as part of the annual budget setting process relating to the capital programme.

6.2 Whilst the financial crisis would appear to be receding, the impacts are still being felt in terms of record low interest rates and also how financial institutions are rated and in particular the steps being taken be governments around the globe to bring about stable growth and ensure that risks from banking failures are avoided in the future. The changes highlighted in this report covering changes to the protections for investors in such institutions are likely to impact the Council's treasury strategy for investment going forward and is covered in this report.

7. COMMENTS OF THE DIRECTOR OF LEGAL

7.1 The Accounts and Audit Regulations 2015 place obligations on the Council to ensure that its financial management is adequate and effective and that it has a sound system of internal control which includes arrangements for management of risk. In addition the Council within its Annual Treasury Management Strategy has agreed to comply with the CIPFA Code of Practice on Treasury Management. This report demonstrates that Treasury Management is meeting these requirements and adapting to changes as they arise.

7.2 There are no immediate legal implications arising from the report.

8. BACKGROUND

8.1 The Treasury Strategy set out below in set in the context of the current macro-economic environment and the continuation of record low interest rates.

8.2 The Council has an increasing Capital Financing Requirement (CFR) due to its capital programme and therefore may need to borrow in future years, depending on the actual level of reserves and capital receipts and other resources available to it

TREASURY MANAGEMENT STRATEGY 2017/18 TO 2019/20

1 SUMMARY

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the CLG's Investment Guidance.

2 RECOMMENDATIONS

2.1 Committee are to:

- Recommend the Treasury Management Strategy for 2017/18 to 2019/20 to Council for approval
- Recommend the criteria for lending and the financial limits set out in this report, which will take effect immediately.
- Recommend the Treasury Management Policy Statement coming into force on 1st April 2017 to Council for approval, as set out in Appendix B.

3 RELATED DECISIONS

3.1 Cabinet and Council will consider the report on the revenue and capital budgets for 2017/18 in Feb/March 2017. That report contains provisions for the cost of borrowing consistent with the Treasury Management Strategy. That report also recommends that the Council sets its Treasury Management and Affordability Prudential Indicators. This report assumes that those recommendations will be approved by Council.

4 COMMENTS OF THE GROUP DIRECTOR OF FINANCE AND CORPORATE RESOURCES

4.1 The Treasury Management Strategy sets out how the Council's cash flows will be managed during the financial year 2017/18. The actual cost of borrowing and interest on investments will depend on market conditions and timing will be an important factor in decisions to be taken on the debt portfolio.

5 BACKGROUND

5.1 The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

5.2 In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

5.3 This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

5.4 The purpose of this TMSS is, therefore, to approve:

- Treasury Management Strategy for 2017/18
- Annual Investment Strategy for 2017/18

5.5 The Council invests large sums of money and therefore, potentially, has exposure to certain financial risks concerning the capital sums invested and the effect of changing interest rates. The successful identification, monitoring and control of risk, is therefore central to the Council's treasury management strategy.

6 ECONOMIC BACKGROUND

6.1 The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

6.2 The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

6.3 Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

6.4 Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates in December 2016. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

6.5 The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

6.6 Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

6.7 Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

7 INTEREST RATE FORECAST

7.1 The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18. The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

7.2 Gilt yields have risen sharply, but remain at low levels. The Arlingclose opinion is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a distinct possibility, to keep long-term interest rates low.

7.3 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

8 CURRENT POSITION AND BALANCE SHEET SUMMARY

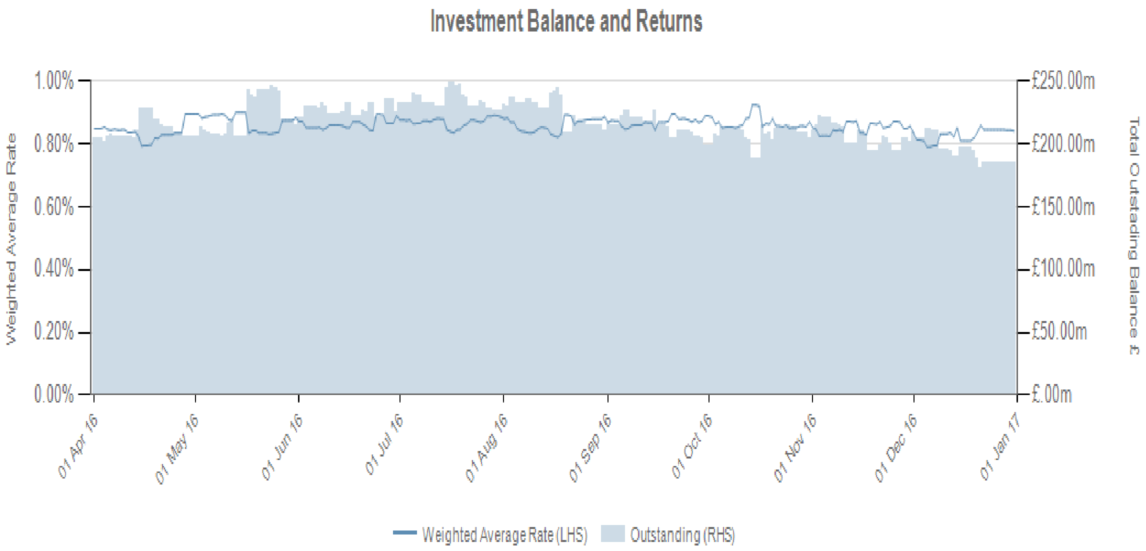
8.1 The Council currently (as at 31.12.16) has one outstanding external borrowing of £3.6m and has £185,578 of investments.

Table 1: Existing Investment & Debt Portfolio Position as at 31/12/16

	Portfolio outstanding as at 31/12/2016 £'000
External Borrowing: PWLB – Fixed Rate	0
PWLB – Variable Rate	0
Market – Fixed Rate	3.600
Market – Variable Rate	0
Total External Borrowing	**3.600**
Other Long Term Liabilities: PFI	15.482
Finance Leases	0.422
Total Gross External Debt	**16.902**
Investments: Short-term monies - Deposits/ monies on call/MMFs	132.745
Long-term investments	52.833
Total Investments	**185,578**

8.2 The Council investment balances have fluctuated over the period, initially there was an increase due to the front loading of some grants but this has been followed by a slight downward trend, as these grants are utilised. Weighted average rate (investment return) has steadily increased. This has been the result of effective treasury and cash management. The movement of cash balances (thick grey block) and yield (thin blue line) throughout the year is represented in the graph below:

Graph 1: Investment balance and return



8.3 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. Forecast changes in these sums are shown in the balance sheet analysis in table 2 below.

Table 2: Balance Sheet Summary and Forecast

	31.3.16 Actual £m	31.3.17 Estimate £m	31.3.18 Estimate £m	31.3.19 Estimate £m	31.3.20*** Estimate £m
General Fund CFR	157,918	135,371	217,844	274,657	280,918
HRA CFR	69,770	108,014	158,115	178,353	182,339
Total CFR	**227,688**	**243,385**	**375,959**	**453,010**	**463,257**
Less: Other long-term liabilities *	15,482	14,821	14,112	13,349	12,528
Less: External borrowing **	4,000	3.600	39,142	122,175	15,448
Cumulative Maximum External Borrowing Requirement	**208,206**	**224,964**	**322,705**	**317,486**	**435,281**
Less: Usable reserves***	324,439	180,000	100,000	100,000	100,000
Cumulative Net Borrowing Requirement /(Investments)	**(116,233)**	**44,964**	**222,705**	**217,486**	**335,281**

* finance leases and PFI liabilities that form part of the Authority's debt

** shows only loans to which the Authority is committed and excludes optional refinancing

*****Table 2 is subject to finalisation of the Budget Report**

8.5 The Authority currently has £3.6m in external borrowing. This is made up of a single £3.6m London Energy Efficiency Fund (LEEF) loan from the European Investment Bank to fund housing regeneration.

8.6 Furthermore, the Council has an increasing CFR due to its capital programme and therefore may need to borrow over the forecast period, depending on the actual level of reserves.

8.7 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 2 shows that the Authority expects to comply with this recommendation during 2017/18

8.8 Table 3 set out the operational boundary and authorised limits for the Authority for the coming years:

Table 3: Operational Boundary and Authorised Limit

	31.3.16 Actual £m	31.3.17 Estimate £m	31.3.18 Estimate £m	31.3.19 Estimate £m
Operational Boundary				
Operational Boundary for External Debt	**266,813**	**281,284**	**413,959**	**493,996**
Authorised Limit				
Authorised Limit for External Debt	**295,813**	**210,385**	**442,959**	**522,996**

9 BORROWING STRATEGY

9.1 The balance sheet forecast in Table 2 shows that the Authority expects to borrow up to £222,705 2017/18. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £442,959 million in 2017/18.

9.2 The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

9.3 Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

9.4 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 2-3 years as official interest rates remain low, it is unlikely to be sustained in the medium-term. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Undertaking regular reviews regarding borrowing options, such as cost of carry and breakeven analysis will help determine whether the Authority borrows additional sums at long-term fixed rates in 2017/18 with a view to keeping future interest costs low, even if this causes additional costs in the short-term.

9.5 Alternatively, the Authority may arrange forward starting loans during 2017/18, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

9.6 In addition, the Authority may borrow short-term loans (normally for up to three month) to cover unexpected cash flow shortages.

The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board and any successor body
- UK local authorities
- any institution approved for investments (see below)
- any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
- Municipal Bond Agency
- UK public and private sector pension funds (except London Borough of Hackney Pension Fund)
- capital market bond investors
- special purpose companies created to enable joint local authority bond issues.

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase

- Private Finance Initiative
- sale and leaseback

9.7 The Council has previously raised the majority of its long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

9.8 Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators in point 12.4 below.

9.9 The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Some bank lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

10 INVESTMENT RISK MANAGEMENT

10.1 Both the CIPFA Code and the CLG Guidance require the Authority 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 Authority'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 receiving unsuitably low investment income.

10.2 As a result of the 2008 financial crisis, there has been a major effort by governments and regulators to make legislative and regulatory changes to the banking environment. These changes were undertaken with the aim of preventing the future failures of banks and to move away from tax payer funded bail outs, as was the case for Lloyds and RBS, and move towards a bail in scenario.

10.3 Bail in is whereby a levy on deposits within banks would be made to lower the amount of external bail out needed. It would take place before a bankruptcy with regulators imposing losses on shareholders, bond holders and unsecured deposits.

10.4 Bail in was first introduced during the Cypriot financial crisis in March 2013, when the Cypriot government was to able to re-finance its banks and the EU did not provide the finance to bail the banks out. Subsequently, the Cypriot banks were bailed-in via a levy on all unsecured depositors of more than £100,000.

10.5 The Banking Reform Act (2013) delivered significant reform to the UK banking sector and introduced into law the bail in process as a pre-emptive measure to stop failing banks. This means that unsecured depositors, such as Local Authorities, would be subject to a levy on their deposits if that counterparty was bailed in.

10.6 In addition to the Banking reform Act, the transposition of two European Union directives into UK legislation in the coming months will place the burden of rescuing failing EU banks via bail-in disproportionately onto unsecured local authority investors. The Bank Recovery and Resolution Directive promotes the interests of individual and small businesses covered by the Financial Services Compensation Scheme and similar European schemes, while the recast Deposit Guarantee Schemes Directive includes large companies into these schemes. The combined effect of these two changes is to leave public authorities and financial organisations (including pension funds) as the only senior creditors likely to incur losses in a failing bank after July 2015.

10.7 To reduce and manage this risk, it is recommended that the Council continues with its current investment strategy for high diversification and hold some investments in more secured instruments (those instruments excluded from bail in risk) such as Covered Bonds and Tri-party Repos, as well as looking at non-financial counterparties such as corporations. For unsecured deposits, the Council will continue to ensure high diversification amongst the Banks and Building Societies which will help to reduce single exposure to one organisation and increase diversification.

11 INVESTMENT STRATEGY

11.1 The Authority holds varying levels of invested funds at varying lengths of duration. These investments represent income received in advance of expenditure plus balances and reserves held.

11.2 For the 2016/17 financial year the Council is estimated to have had an average investment balance of £201million (as of 31.12.16), down from £255m for the same period last year. It is expected that investment levels will continue to decrease in forthcoming years as balances are used to fund the capital programme.

11.3 Given the increasing risk as detailed in section 10, the Authority aims to further diversify into more secure asset classes during 2017/18. During 2016/17 the Council has made a conscious effort to reduce its exposure to bail-in risk via bank deposits. Consequently, the majority of Council investments are no longer in unsecure bank deposits. Instead the majority of the Authorities surplus cash is currently invested in money market funds, deposits in Local authorities and Housing Associations. In the next year the Council will continue to look to increase its exposure to investments exempt form Bail in, such as covered and corporate bonds and Tri-party repos. This increased diversification in both instruments and counterparties will represent a substantial change in strategy over the coming year.

11.4 The Council's 2017/18 Lending Policy reflects this approach by setting separate limits for secured and unsecured investments. Appendix 1 details the Council's lending policy and limits.

11.5 Investment regulations require the Council to determine what specified and non-specified investments it will use. 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".

The Authority defines "high credit quality" organisations as those having a credit rating of A- (or equivalent) or higher, that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

11.6 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. Limits on non-specified investments are shown in Table 4 below.

Table 4: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£90m
Total investments without credit ratings or rated below [A-] which includes non-rated banks and building societies	£45m
Total investments in foreign countries rated below [AA+]	£45m

11.7 The Council understands that credit ratings are a good predictor of investment default but are rating agencies' expressed opinions and not a perfect indicator.

Therefore, Officers will use other sources of information; including credit default swap ratings and equity prices, to determine the credit quality of an organisation. These are detailed in the Appendix 1, section 4 of the proposed Lending Policy.

11.8 No investments will be made with an organisation if there are substantive doubts about its credit quality even though it may meet the Lending Policy criteria. This means the Lending Policy applied operationally may at times be more restrictive than it formally allows.

11.9 When deteriorating financial market conditions affect the creditworthiness of all organisations but these are not generally reflected in credit ratings, then the Council will restrict its investments in those organisations to maintain the required level of security. These restrictions may mean that insufficient commercial organisations of “high credit quality” are available for investment and so any cash surplus will be deposited with the government’s Debt Management Office or with other local authorities. This may result in a reduction in the level of investment income earned but will protect the principal sums invested.

11.10 The proposed 2017/18 Treasury Management Strategy has considered a full range of risks and Officers will apply the strategy to ensure that security of deposits is the prime consideration. However, in agreeing the proposed strategy, Members should be aware that there is always a risk of default of counterparties other than the Debt Management Office which is guaranteed by the government.

11.11 The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority’s medium term financial plan and cash flow forecast.

12 TREASURY MANAGEMENT INDICATORS

12.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.

12.2 **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating 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.

	Target
Portfolio average credit rating	A-

12.3 **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 3 month period, without additional borrowing.

	Target
Target total cash available within 3 months	£30m

12.4 **Interest Rate Exposures**: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the net amount of interest payable will be:

	2017/18 £'000	**2018/19 £'000**	**2019/20 £'000**
Upper limit on fixed interest rate exposure	100,000	100,000	100,000
Upper limit on variable interest rate exposure	20,000	20,000	20,000

12.5 Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

12.6 **Maturity Structure of Borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	**Lower**
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

12.7 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

12.8 **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2017/18	**2018/19**	**2019/20**
Limit on principal invested beyond year end	£90m	£90m	£90m

13 OTHER ITEMS

13.1 There are a number of additional items that the Authority is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

13.2 **Policy on Use of Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

13.3 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

13.4 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

13.5 **Policy on Apportioning Interest to the HRA:** The Council has adopted a two pooled approach following the self-financing settlement in March 2012. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. Where the HRA needs to borrow from the General Fund to meet its remaining borrowing requirement the General Fund is compensated based on what the Council would have to borrow from the PWLB, with rates based on a best decision from a treasury management perspective and the current interest rate outlook. This will be determined annually following advice from the Council's treasury advisers and the interest transferred between the General Fund and the HRA at the year end.

13.6 **Investment Training:** The needs of the Authority's treasury management staff for training in investment management are assessed as part of individual staff appraisal processes, and additionally when the responsibilities of individual members of staff change.

13.7 Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

13.8 **Investment Advisers:** The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. Arlingclose are an independent treasury advisory company providing unbiased financial advice and capital financing expertise for the public sector. They provide advice on investment trends, developments and opportunities consistent with the Council's chosen strategy relating to investments, debt repayment and restructuring, and also for economic information and data interpretation.

13.9 Although the Council uses the expertise of an external provider for treasury management advice relating to investing, borrowing and restructuring of the portfolios, the Council remains fully accountable for any decisions made.

13.10 Regular communications are received in relation to economic data releases, interest rate forecast and debt structuring opportunities with, sometimes, daily communications in respect of counterparties. Officers also attend training sessions facilitated by Arlingclose relating to Prudential Code, Treasury Management Code of Practice and Accounting.

13.11 Meetings are held on a quarterly basis with Officers of the Council, including the t Director Financial Management, to discuss treasury management strategies, which may, from time to time, include discussions in regard to enhancement of the service provision if required.

13.12 **Investment of Money Borrowed in Advance of Need**: The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

13.13 The total amount borrowed will not exceed the authorised borrowing limit of **£442,959 million in 2017/18.** The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

14 Other Options Considered

14.1 The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Group Director of Finance and Corporate Resources, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Reduced risk of losses from credit related defaults
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

Appendix A – Arlingclose Economic & Interest Rate Forecast November 2016

Underlying assumptions:

- The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.

- The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump's victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends. The potential rise in protectionism could dampen global growth prospects and therefore inflation. Financial market volatility will remain the norm for some time.

- However, following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than earlier in the year. US fiscal stimulus is also a possibility following Trump's victory.

- Recent data present a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending.

- Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.

- The currency-led rise in CPI inflation (currently 1.0% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to a sharp decline in real wage growth.

- The depreciation in sterling will, however, assist the economy to rebalance away from spending. The negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.

- Given the pressure on household spending and business investment, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.

- Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further monetary loosening looks less likely.

Forecast:

- Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short term than previously expected.

- The likely path for Bank Rate is weighted to the downside. The Arlingclose central case is for Bank Rate to remain at 0.25%, but there is a 25% possibility of a drop to close to zero, with a very small chance of a reduction below zero.

- Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50.

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	**0.12**
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**
Downside risk	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.40**
3-month LIBID rate														
Upside risk	0.05	0.05	0.10	0.10	0.10	0.15	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.18**
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.29**
Downside risk	0.20	0.25	0.25	0.25	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.34**
1-yr LIBID rate														
Upside risk	0.10	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.60**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.60**	**0.70**	**0.85**	**0.90**	**0.90**	**0.90**	**0.65**
Downside risk	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.24**
5-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**0.50**	**0.40**	**0.35**	**0.35**	**0.35**	**0.40**	**0.40**	**0.40**	**0.45**	**0.50**	**0.55**	**0.60**	**0.65**	**0.45**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.47**
10-yr gilt yield														
Upside risk	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.15**	**0.95**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.90**	**0.95**	**1.00**	**1.05**	**1.10**	**1.15**	**0.96**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.47**
20-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.70**	**1.50**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.65**	**1.70**	**1.75**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.57**

London Borough of Hackney's Lending Policy - Appendix B

1. Policy for determining which institutions and instruments are included in the lending policy

1.1 The Council will lend to the following types of institutions;

- UK Central Government
- UK Local Authorities
- UK Police and Fire Authorities
- UK Banks and Building Societies
- Corporate Institutions
- Banks domiciled in other countries or their subsidiaries domiciled in the UK providing the country has a sovereign rating of at least AA+ from each of the three credit rating criteria set out below. If the ratings of a parent bank fall below the minimum criteria, no lending will be undertaken with its subsidiaries even if their ratings continue to meet the minimum criteria (excepting Santander UK)
- Supranational Banks
- AAA rated Money Market Funds
- Pooled Funds
- UK registered providers for Social Housing

1.2 The Council will lend using the following types of instruments

- Call and Notice Account
- Fixed Term deposits
- Treasury bills
- Bonds
- Certificate of deposits
- Money Market Funds
- Commercial Papers
- Pooled Funds
- Revolving Credit Facility
- Repurchasing agreements
- Alternatives

1.3 The Council may invest its surplus funds with any of the counterparty detailed in paragraph 1.1, subject to the cash limits (per counterparty) and the time limits shown in table 1.

Table 1: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	The Authority's account bank (Lloyds Bank)	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£20 m 5 years	£25m 5 years	£20 m 5 years	£20 m 50 years	£10 m 20 years	£10 m 20 years
AA+	£20 m 5 years	£25m 5 years	£20 m 4 years	£15 m 25 years	£10 m 10 years	£10 m 10 years
AA	£20 m 4 years	£25m 5 years	£20 m 3 years	£15 m 15 years	£10 m 5 years	£10 m 10 years
AA-	£20 m 3 years	£25m 5 years	£20 m 2 years	£10m 10 years	£7.5 m 4 years	£5 m 10 years
A+	£20 m 2 years	£25m 5 years	£15 m 13 months	£10m 5 years	£7.5 m 3 years	£5 m 5 years
A	£15 m 13 months	£20m 5 years	£20 m 5 years	£5 m 5 years	£7.5 m 2 years	£5 m 5 years
A-	£10 m 6 months	£15m 5 years	£10m 13 months	£5m 5 years	£7.5 m 13 months	£5 m 5 years
BBB+	£5 m 100 days	£10m 2 years	£5m 6 months	£2.5m 2 years	£5 m 6 months	£5 m 2 years
BBB or BBB-	£2.5 m next day only	£5m 6 months	£2.5m 100 days	n/a	n/a	n/a
None	£2 m 6 months	n/a	n/a	n/a	£1m 5 years	£5 m 5 years
Pooled funds	£ 15m per fund but not to exceed 0.5% of the individual fund size.					

Please see appendix 2 for definition of counterparties

1.4 As well as the above limitations, no investment will exceed 10% of total investments at the point of the investment being made. This level will be monitored on an ongoing basis.

1.5 UK Local governments with no credit rating will be treated in line with the credit rating of the UK central government

1.6 For secured investments, where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits.

1.7 Overseas subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. However, Santander UK plc (subsidiary of Spain's Banco Santander) and Clydesdale Bank plc (a subsidiary of National Australia bank) will be classed as UK banks due to their substantial UK franchise and the arms-length nature of the parent-subsidiary relationship.

1.8 Sovereign credit rating criteria will not apply to investment s in multilateral development banks (e.g. the European Investment bank and the World Bank) or other subsidiaries.

1.9 The table 1 shows the minimum credit rating for the Fitch agency. When determining whether the Council should lend to a counterparty, it must have at least the minimum credit rating shown above for all of the agencies which provide a rating. The lowest available credit rating will be used to determine credit quality

1.10 As well as assessing credit rating as an indicator of risk, the Council will also analyse the following sources of information:

- Credit default Swap
- Equity Prices
- Economic output
- Counterparty's financial Statements and financial ratios
- News

1.11 In order to ensure security of the sums invested and to limit the sums that would be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government organisations) will be £25 million. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts, foreign countries and industry sectors as set out in the table below:

Table 2: Investment Limits

	Cash limit	**% limits**
Any single organisation, except the UK Central Government	£25m each	10 %
UK Central Government	unlimited	unlimited
Any group of organisations under the same ownership	£25m per group	10%

Any group of pooled funds under the same management	£20m per manager	10%
Negotiable instruments held in a broker's nominee custodian account	£60m per broker	50%
Foreign countries	£25m per country	10%
Registered Providers	£25m in total	10%
Building Societies	£40m in total	20%
Loans to small businesses	£3m in total	5%
Money Market Funds	£120m in total	75%

Glossary of Terms – Appendix C

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.

Banks Secured: Covered bonds, reverse repurchase agreements 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. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

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.

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 as part of a diversified pool in order to spread the risk widely.

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 a high likelihood of receiving government support if needed.

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. Money Market Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to 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.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority 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 Authority's investment objectives will be monitored regularly.

Appendix D

TREASURY MANAGEMENT POLICY STATEMENT

1. Approved Activities

In accordance with the Council's Constitution and Delegated Powers, the Group Director of Finance and Corporate Resources and Officers authorised by the Group Director, may arrange all investments, borrowing, repayment of debt outstanding and leasing required and permitted by the Local Government Act 2003.

Borrowing must be contained within the limit determined under the Authorised Limit of the Prudential Code and used solely for the purpose of the Council's statutory functions. Treasury management operations will comply with the CIPFA Code of Practice.

1. Treasury Management Policy Objectives

The Council defines its treasury management activities as:

"The management of the Council'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."

The Council 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, and any financial instruments entered into to manage these risks.

The Council 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 value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

The treasury management activities of the Council will be conducted to achieve the following policy objectives: -

(a) To ensure that risk to the Council's financial position is minimised by the adoption of sound debt management and investment practices;

(b) The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

(c) The overall average rate of interest on short-term investments to be greater than the average seven-day LIBID rate (source: Bloomberg), whilst having regard to the security of funds and the minimisation of risk;

(d) To have a policy to repay debt, take opportunities to make premature debt repayments, and restructuring of debt when and where it is advantageous to the Council to do so.

2. Adoption of the CIPFA Code of Practice

The Council has adopted the key recommendations of CIPFA Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of that Code.

Accordingly, this organisation will create and maintain, as the cornerstones for effective treasury management:

- A Treasury Management Policy Statement, stating policies and objectives of its treasury management activities.
- Suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, prescribing how the Council will manage and control those activities.

The contents of the Policy Statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Council. Such amendments will not result in the Council materially deviating from the Code's key recommendations.

- The Council will receive reports on its treasury management policies practices and activities, including, as a minimum, an annual strategy and plan in advance of the year. An annual outturn report will be submitted to Cabinet after close of the previous year, in the form prescribed in the TMPs.
- The Council delegates responsibility for the implementation, monitoring of its treasury management policies and practices to Audit Sub-Committee, and for the execution and administration of treasury management decisions to the Corporate Director of Finance and Resources, who will act in accordance with the policy statement, TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

3. Investment of Cash Balances

Investment of all balances arising from day to day cash flows, capital receipts, minimum revenue provisions and other financial reserves and provisions will be in accordance with Government regulations or guidelines to produce a maximum return having regard to the security of funds and the minimisation of risk.

The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations.

The spread of risk will be controlled by reference to the approved criteria and financial limits. Investment liquidity will be structured with regard to cash flow projections maintained under the authority of the Corporate Director of Finance and Resources.

4. Investment Names/Financial Limits

Investments are to be made only to those institutions, which meet the approved criteria for lending, and within the current maximum financial limits as approved, by the Cabinet and Council. Where investments in any of these institutions were made at a time where a higher maximum limit applied, the new maximum limit will be applied as existing investments mature.

Between reports to the Cabinet, the Group Director of Finance and Corporate Resources, under delegated powers, is authorised to revise, and further restrict or relax, the investment names/limits to reflect changes in market sentiment, information and credit ratings.

5. Risk Appetite Statement

The Council's objectives in relation to debt and investment is to assist the achievement of the Council's service objectives by obtaining funding and managing the potential debt and investments at a net cost which is as low as possible , consistent with a degree of interest cost stability and a very low risk to sums invested

This means that the Council takes a low risk position but it no totally risk averse. Treasury management staff have the capability to actively manage treasury risk within the scope of the council's treasury management policy and strategy.

6. Legal Issues

Borrowing and investment will be arranged efficiently through a range of brokers practising in the money markets and, in addition, the Director of Finance and Corporate Resources is authorised to deal directly with counterparties where it is advantageous to do so. The requirements of the Bank of England Non-Investment Products Code (NIPS) (November 2011) will be met in all the above arrangements.

7. Use of Bankers

Approved agreements are currently in place with the Lloyds Bank and the RBS/Natwest Bank for the conduct of banking business for the Council and schools respectively.

The Group Director of Finance and Corporate Resources is authorised to negotiate appropriate changes to the mandates which may be needed to cover any exceptional market circumstances to protect the Council's finances.

8. Review

The Group Director of Finance and Corporate Resources will report to the appropriate committee on the Treasury Management performance as follows:

- **TM Outturn Report** –

  Frequency - once a year against the TM Strategy and Prudential Indicators approved for the previous financial year, no later than September of the current financial year

  To – Cabinet via the OFP (Overall Financial Position) and Audit Committee

- **TM Half-Year Activity and Performance Report** –

  Frequency – a report on its treasury activity and performance, it is anticipated to be no later than October/November of the current financial year

  To – Cabinet via OFP and Audit Committee

- **TM Quarterly Activity Report** –

  Frequency - report to be submitted on treasury activity for the previous quarter

  To – Audit Committee

- **Ad-hoc** –

  Additional reports will be submitted to the appropriate committee as required, in order to react to extreme fluctuations in market conditions and/or increased levels of treasury activity

The Group Director of Finance and Corporate Resources will make such arrangements as are necessary for monitoring daily activities in the treasury functions.

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