Non-Executive Report of the: **Audit Committee** **25th July 2018**	 TOWER HAMLETS
Report of: Zena Cooke, Corporate Director, Resources	**Classification:** Unrestricted
Treasury Management Outturn Report for 2017/18	

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

Summary

This Report is produced in accordance with the CIPFA Treasury Management Code of Practice and covers the financial year ended 31st March 2018	The Treasury Management Strategy Statement and the Treasury Prudential Indicators, for 2017/18 were approved by the Council on 22nd February 2017 as required by the Local Government Act 2003.
Investment returns fluctuate in line with the bank of England base rate. Base rate was 0.25% up to October 2017.	The Council has substantial sums of money invested and is therefore exposed to financial risks including the loss of invested funds and the impact of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy. Risk includes interest rate fluctuations and change to inflation.
When setting the 2018/19 budget in February 2018, the Council approved proposals to increase the returns from its investments by £1.4m.	This Report advises the Audit Committee of the work carried out in this area alongside our Treasury Management advisors and identifies a selection of pooled investment funds that we are proposing to invest in to generate these higher returns over the longer term in accordance with the investment strategy approved in February 2018 by the Full Council. The proposed approach is set out in section 3.9 of this report The risk profile of these investments is an important consideration for the Committee because in order to achieve higher returns, there can be a need to accept higher levels of risk.
A return of 0.68% overall was achieved in 2017/18 which is	The 7 day London Interbank Bid Rate (LIBID) is the performance measure for the Council's investment returns. For this reporting year, this rate was 0.21%. The

marginally above the internal benchmark of 0.63% but lower than the 1.08% average for all investments.	investments portfolio returned 0.68% better than the benchmarking average of 0.63% for internal investments management but substantially below the benchmark average of 1.08% for total investments returnwhich is explained in section 3.7. The credit worthiness of investments has improved from A+ to AA- over the year.
Prudential Indicators (PI) and Treasury Management (TM) indicators have been fully complied with.	Over the reporting period, all treasury management (TM) activities have been carried out in accordance with the approved limits and the prudential indicators (PI) set out in the Council's Treasury Management Strategy statement. No long-term or short-term borrowing has been raised for the reporting financial year 2017/18.

Recommendations:

Members are recommended to:

- note the contents of the treasury management activities and performance against targets for the year ending 31 March 2018;
- note the Council's investments as set out in Appendix 1. The balance outstanding as at 31 March 2018 was £464.82m which includes £24m, pension fund cash awaiting investment and
- note the new investment funds as set out in section 3.9.

1. REASONS FOR THE DECISIONS

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

1.2 This report updates members on both the borrowing and investment decisions made by the Corporate Director, Resources under delegated authority in the context of prevailing economic conditions and considers the Council's Treasury Management performance.

1.3 The regular reporting of treasury management activities assists Members to scrutinise officer decisions and monitor progress on the implementation of its investment strategy as approved by Full Council.

2. ALTERNATIVE OPTIONS

2.1 The Council is bound by legislation to have regard to the Treasury Management (TM) Code. The Code requires that the Council or a sub-committee of the Council (Audit Committee) should receive regular monitoring reports on treasury management activities. If the Council were to deviate from those requirements, there would need to be some good reason for doing so.

3. DETAILS OF REPORT

3.1 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require local authorities to have regard to the Treasury Management Code. The

Treasury Management code requires that the Council or a sub-committee of the Council (Audit Committee) should receive regular monitoring reports on treasury management activities and risks.

3.2 Treasury management is defined 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. Within reason, the Council can vary its treasury management strategy having regard to its own views about its appetite for risk in relation to the financial returns required.

3.3 The Treasury Management Strategy, Investment Strategy and Minimum Revenue Provision reports were included in the Budget Pack that was presented to Full Council on 22 February 2017.

3.4 **ECONOMIC COMMENTARY FROM THE TREASURY ADVISER ARLINGCLOSE**

3.4.1 2017-18 was characterised by the changing expectations of tapering of Quantitative Easing (QE) and the potential for increased interest rates in the US and Europe and from geopolitical tensions, which also had an impact.

3.4.2 The UK economy showed signs of slowing with latest estimates showing GDP grew by just 1.8% in calendar 2017, the same level as in 2016. This was a far better outcome than the majority of forecasts following the EU Referendum in June 2016, but it also reflected the international growth momentum generated by the increasingly buoyant US economy and the re-emergence of the Eurozone economies.

3.4.3 The inflationary impact of rising import prices, a consequence of the fall in sterling associated with the EU referendum result, resulted in year-on-year CPI rising to 3.1% in November before falling back to 2.7% in February 2018. Consumers felt the squeeze as real average earnings growth, i.e. after inflation, turned negative before slowly recovering. The labour market showed resilience as the unemployment rate fell back to 4.3% in January 2018. The inherent weakness in UK business investment was not helped by political uncertainty following the surprise General Election in June and by the lack of clarity on Brexit, the UK and the EU only reaching an agreement in March 2018 on a transition which will now be span Q2 2019 to Q4 2020. The Withdrawal Treaty is yet to be ratified by the UK parliament and those of the other 27 EU member states and new international trading arrangements are yet to be negotiated and agreed.

3.4.4 The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25% in November 2017. It was significant in that it was the first rate hike in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. The February Inflation Report indicated the MPC was keen to return inflation to the 2% target over a more conventional (18-24 month) horizon with 'gradual' and 'limited' policy tightening. Although in March two MPC members voted to increase policy rates immediately and the MPC itself stopped short of committing itself to the timing of the next increase in rates, the minutes of the meeting suggested that an increase in May 2018 was highly likely.

3.4.5 In contrast, economic activity in the Eurozone gained momentum and although the European Central Bank removed reference to an 'easing bias' in its market communications and had yet to confirm its QE intention when asset purchases end in

September 2018, the central bank appeared some way off normalising interest rates. The US economy grew steadily and, with its policy objectives of price stability and maximising employment remaining on track, the Federal Reserve Open Market Committee (FOMC) increased interest rates in December 2017 by 0.25% and again in March, raising the policy rate target range to 1.50% - 1.75%. The Fed is expected to deliver two more increases in 2018 and a further two in 2019. However, the imposition of tariffs on a broadening range of goods initiated by the US, which has led to retaliation by China, could escalate into a deep-rooted trade war having broader economic consequences including inflation rising rapidly, warranting more interest rate hikes.

3.5 ECONOMIC OUTLOOK AND INTEREST RATE FORECAST FROM ARLINGCLOSE

3.5.1 The increase in Bank Rate resulted in corresponding higher money markets rates: 1-month, 3-month and 12-month LIBID rates averaged 0.32%, 0.39% and 0.69% and at 31st March 2018 were 0.43%, 0.72% and 1.12% respectively.

3.5.2 Gilt yields displayed significant volatility over the twelve-month period with the change in sentiment in the Bank of England's outlook for interest rates. The yield on the 5-year gilts which had fallen to 0.35% in mid-June rose to 1.65% by the end of March. 10-year gilt yields also rose from their lows of 0.93% in June to 1.65% by mid-February before falling back to 1.35% at year-end. 20 year gilt yields followed an even more erratic path with lows of 1.62% in June, and highs of 2.03% in February, only to plummet back down to 1.70% by the end of the financial year.

3.5.3 The FTSE 100 had a strong finish to calendar 2017, reaching yet another record high of 7688, before plummeting below 7000 at the beginning of 2018 in the global equity correction and sell-off.

3.5.4 We believe the MPC will seek to raise Bank Rate in the short term and perhaps more quickly than expected by the market. Our projected outlook for the UK economy, however, means that we believe monetary tightening in the current environment to be a potential policy error and so maintain the significant downside risks to our interest rate forecast.

3.5.5 The MPC has a definite bias towards tighter monetary policy. While policymakers are wary of domestic inflationary pressures over the next two years, we also believe that MPC members consider both that: 1) ultra-low interest rates result in other economic problems, and that 2) higher Bank Rate will be a more effective weapon should downside Brexit risks crystallise.

3.5.6 The current soft UK economic environment prompted the MPC not to tighten policy in May, despite engineering expectations since the turn of the year for a rise in Bank Rate. The rhetoric around the May decision, however, suggests policymakers see this action as merely postponed. At the time of writing this report, the Base Rate has remained at 0.5%.

3.5.7 As noted previously, the Bank has moved the goalposts around both the forecast horizon and supply capacity of the UK economy in order to justify monetary tightening even in a below-trend economic environment.

3.5.8 The treasury advisor view is that the UK economy still faces a challenging outlook as the minority government continues to negotiate the country's exit from the European

Union. Economic data has been on a declining trend and, while a case can be made that recent weakness is overstated and temporary, our unchanged opinion is that growth is likely to be weaker over the medium term than currently envisaged.

3.5.9 Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Downside risk	0.00	-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75
3-mth money market rate													
Upside risk	0.05	0.10	0.10	0.10	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.60	0.85	0.90	1.10	1.15	1.35	1.35	1.35	1.35	1.35	1.35	1.35	1.35
Downside risk	-0.05	-0.30	-0.35	-0.55	-0.60	-0.80	-0.80	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75
1-yr money market rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	0.90	1.05	1.10	1.20	1.30	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Downside risk	-0.20	-0.35	-0.40	-0.50	-0.60	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75
5-yr gilt yield													
Upside risk	0.15	0.15	0.15	0.20	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	1.20	1.30	1.40	1.50	1.60	1.65	1.65	1.65	1.65	1.60	1.55	1.55	1.55
Downside risk	-0.25	-0.30	-0.40	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60
10-yr gilt yield													
Upside risk	0.20	0.20	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	1.55	1.65	1.75	1.85	1.90	1.90	1.90	1.90	1.90	1.85	1.85	1.85	1.85
Downside risk	-0.30	-0.35	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
20-yr gilt yield													
Upside risk	0.20	0.20	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	1.95	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Downside risk	-0.35	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45
50-yr gilt yield													
Upside risk	0.20	0.20	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	1.80	1.85	1.85	1.85	1.85	1.85	1.85	1.85	1.85	1.85	1.85	1.90	1.90
Downside risk	-0.30	-0.35	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45

3.6 TREASURY MANAGEMENT STRATEGY 2017/18

3.6.1 The Treasury Management Strategy was approved on 22 February 2017 by Council. The Strategy comprehensively outlined how the treasury function would operate throughout the financial year 2017/18 including the limits and criteria for selecting institutions to be used for the investment of surplus cash and the council's policy on

long-term borrowing and limits on debt. The Council complied with the strategy throughout the reporting period and all investments were made to counterparties within the Council's approved lending list.

3.6.2 On 31st March 2018, the Council had net investments] of £355.9m arising from its revenue and capital income and expenditure, a decrease on 2017 of £5.51m. 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. These factors and the year-on-year change are summarised in table 1 below.

Table 1: Balance Sheet Summary

	31st March 2017 Actual £m	Movement over the Year £m	31st March 2018 Actual £m
General Fund CFR	197.434	29.381	226.815
HRA CFR	84.269	(0.870)	83.820
Total CFR	**281.703**	**28.932**	**310.635**
Less: Other debt liabilities *	(36.304)	(1.347)	(34.957)
Borrowing CFR	**245.399**	**30.279**	**275.678**
Less: Usable reserves	(478.489)	(37.184)	(515.673)
Less: Working capital	(128.274)	(31.545)	(159.819)
Net (investments)	**(361.364)**	**(5.51)**	**(355.854)**

* finance leases, PFI liabilities and transferred debt that form part of the Council's total debt

3.6.3 The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing, in order to reduce risk and keep interest costs low. The balance sheet summary position at 31st March 2017 is shown in Table 1 below, with the treasury management position as at 31st March 2018 shown in table 2 below. The extent of internal borrowing which stood at £190.8m at the end of the financial year 2017/18 is the difference between the Borrowing CFR (£275.7m) and the level of external borrowing (£84.9m).

Table 2: Treasury Management Summary

	31.03.17 Balance £m	Movement over the Year £m	31.03.18 Balance £m	31.03.18 Rate %
Long-term borrowing	85.936	(0.970)	84.966	4.49
Short-term borrowing	Nil	Nil	Nil	Nil
Total borrowing	**85.936**	**(0.970)**	**84.966**	**4.49**
Long-term investments	25.000	42.000	67.00	
Short-term investments	295.500	(4.500)	291.000	
Cash and cash equivalents**	126.800	(43.980)	82.820	
Total investments	**447.300**	**(6.480)**	**440.820**	**0.68**
Net investments	***361.364***	**(5.510)**	***355.854***	

**excluding pension fund balance of £24.8m as at 31/03/208

Borrowing Strategy for the year ending 31st March 2018

3.6.4 The Council held £84.966m of external loans at 31st March 2018 which is £970k lower than 31st March 2017 position of £85.936m. No borrowing has been undertaken and no debt rescheduling opportunities arose during the reporting financial year as the cost of premiums outweighs savings that could be made from the lower PWLB borrowing rates. The borrowing position as at 31st March 2018 is shown in table 3 below.

Table 3: Borrowing Position

	31.03.18 Balance £m	31.03.18 Rate %	31.03.18 WAM* years
Public Works Loan Board	7.466	6.26	7.5
Banks (LOBO)	60.000	4.32	42.3
Banks (fixed-term)	17.500	4.34	60.0
Total borrowing	**84.966**	**4.49**	**42.5**

*Weighted average maturity

3.6.5 The Council takes a low risk approach to its borrowing strategy. This means that the principal objective when borrowing has been to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The secondary objective being to have flexibility to renegotiate loans should the Council's long-term plans change.

3.6.6 The Council continues to hold £60m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates. The Council has the option to either accept the new rate or to repay the loan at no additional cost. No banks exercised their option during this reporting quarter or since the start of this financial year.

Investment Activity

3.6.7 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. For the reporting financial year, the Council's investment balance ranged between £440m to £530m due to timing differences between income and expenditure. The investment position at the year end is shown in table 4 below.

3.6.8 Both the CIPFA Code and government 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.

Investments Outstanding & Maturity Structure

3.6.9 The table below shows the amount of investments outstanding at the end of March 2018 split according to the financial sector.

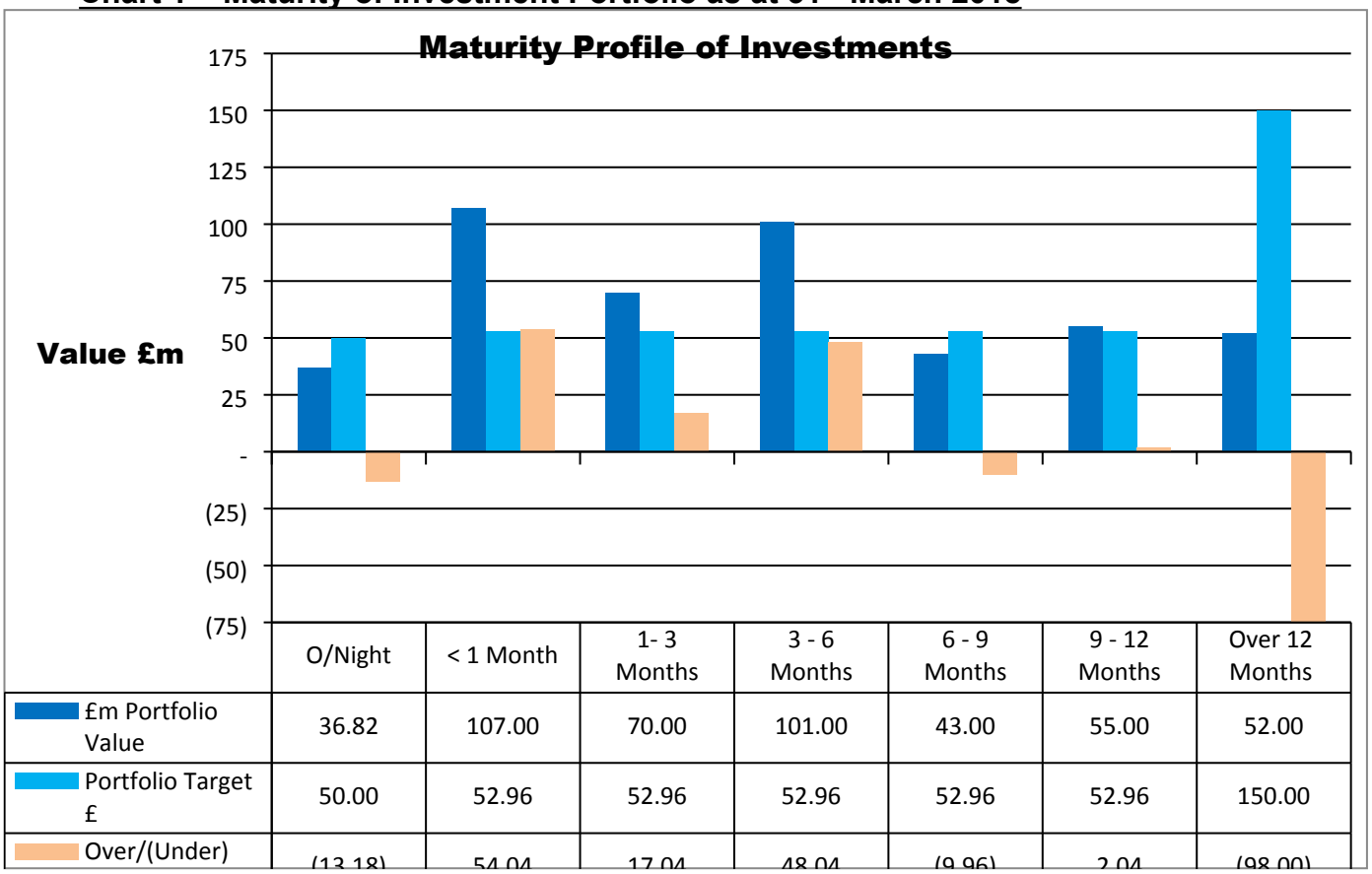
Table 4 Outstanding Investments by financial sector

Financial Sector	31.03.17 Balance £m	Movement over the Year £m	31.03.18 Balance £m	% Portfolio
UK Banks	80.000	(30.000)	50.000	11.35
UK Building Societies	35.000	(20.000)	15.000	3.40
Government (incl. local authorities)	165.500	112.500	278.000	63.06
Oversea Banks	125.000	(40.000)	85.000	19.28
Money Market Funds	41.800	(28.980)	12.820	2.91
Total investments	**447.300**	**(6.480)**	**440.820**	

3.6.10 Given the increasing risk and falling returns from short-term unsecured bank investments, the Council is looking to further diversify its investment portfolio into more secure and/or higher yielding asset classes. There is currently £200m that is available for longer-term investment and this will be moved from local authorities, bank and building society deposits into covered bonds, corporate bonds and also into pooled property/bond/equity funds. This action will diversify the investment risk and as a consequence, the average rate of return of investment will increase.

3.6.11 Chart 1 below illustrates the maturity structure of deposits at 31st March 2018; we have £36.82m as overnight deposits including £24m pension fund cash awaiting investments, and this is predominantly Money Market Funds.

Chart 1 – Maturity of Investment Portfolio as at 31st March 2018



Performance Report

3.6.12 The Council measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 5 below. The Council's budgeted investment return for 2017/18 is **45bps** (0.45%) with average cash balance of £350m**,** the performance for the year to reporting period is **68bps** with average cash balance of £435m.

Table 5: Investment performance for financial year to 31st March 2018

Period	Benchmark Return	LBTH Performance	Over/(Under) Performance
Full Year 2016/2017	0.30%	0.63%	0.33%
Quarter 1	0.11%	0.42%	0.31%
Quarter 2	0.11%	0.53%	0.42%
Quarter 3	0.27%	0.57%	0.30%
Quarter 4	0.36%	0.68%	0.32%
Full Year 2017/18	0.21%	0.68%	0.40%

3.7 **Investment Benchmarking**

3.7.1 LBTH participates in a benchmarking club being run by Arlingclose to enable officers to compare the Council's treasury management / investment returns against those of similar authorities. The model takes into account a combination of credit, duration and returns achieved over the duration, and it includes data from 135 local authorities. The progression of risk and return metrics are shown in table 5 below.

Table 6: Investment Benchmarking

	Tower Hamlets		12 London & Metropolitan Average	135 Local Authorities (LAs) Average
	30.09.2017	31.03.2018		
Internal Investments	£447.1m	£464.8m	£107.9m	£57.1m
External Funds	£0.0m	£0.0m	***£3.9m***	***£10.2m***
Average Credit Score	4.53	4.28	4.29	4.24
Average Credit Rating	A+	AA-	AA-	A+
Number of Counterparties & Funds	30	37	17	15
Proportion Exposed to Bail-in	38%	26%	54%	55%
Proportion Available within 7 days	24%	16%	51%	42%
Proportion Available within 100 days	52%	54%	77%	69%
Average Days to Maturity	149	161	131	35
Internal Investment Return	***0.53%***	***0.68%***	***0.64%***	***0.63%***
External Funds - Income			***1.84%***	***3.41%***

Return				
Total Investments - Total Return	**0.53%**	**0.68%**	**0.78%**	**1.08%**

3.7.2 It can be seen that as at 31st March 2018 LBTH investment portfolio was delivering 0.68%, outperforming the benchmarking average of 0.63% under internal investment management but this return is substantially below the level of income posted by the average for 135 LAs income (1.08%), whilst average for 12 London Boroughs and Metropolitan Boroughs generated income of 0.78% for total investments reurns including external funds..

3.7.3 The reason why the investment income is lower than the average achieved but other LAs is because those authorities have external pooled fund investments generating an average income of 3.41% per annum. The Council's Officers and Arlingclose are working with fund managers to look at external pooled funds that the Council can invest in. This fits with the approach that is required in order to generate the additional income was part of 2018/19 budget setting process. This process is discussed further in section 3.9 of this report.

3.7.4 Based on the advice received from Arlingclose the investment portfolio credit worthiness has improved from A+ to AA- and the proportion of investments exposed to bail-in has reduced from 38% to 26%, this proportion is halved the benchmark average of 55%.

3.7.5 it can also be seen from the above table that the number of counterparties the Council had as at 31st March 2018 was 37, this was more than double the benchmarking average of 15. This shows the Council is managing the counterparty risk and concentration risk of the investments portfolio by investing with many quality institutions and local authorities.

3.8 **Compliance Report**

3.8.1 All treasury management activities undertaken from the beginning of the financial year 2017/18 to the current reporting period complied fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

3.8.2 Compliance with the authorised limit and operational boundary for external debt is set out in table 8 below.

Table 7: Debt Limits

	31.03.17 Actual £m	2017/18 Forecast £m	31.03.18 Actual £m	2017/18 Operational Boundary £m	2017/18 Authorised Limit £m	Complied
Borrowing	85.936	90.833	84.966	245.299	265.256	✓
PFI & finance leases	36.304	34.957	34.957	34.957	35.000	✓
Total debt	**122.240**	**125.790**	**119.923**	**280.256**	**300.256**	✓

3.8.3 The Council measures and manages its exposures to treasury management risks using a range of indicators.

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

	30.09.17 Actual	31.03.18 Actual	2017/18 Target	Complied
Portfolio average credit rating	A+	AA-	A-	✓

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

	30.09.17 Actual	31.03.18 Actual	2017/18 Target	Complied
Total cash available within [3] months	£176.10m	£82.82m	£75m	✓
Total sum borrowed in past [3] months without prior notice	Nil	nil	Nil	✓

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

	31.03.18 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	£0.669m	10%	0%	✓
12 months and within 24 months	£1.004m	30%	0%	✓
24 months and within 5 years	£1.004m	40%	0%	✓
5 years and within 10 years	£3.580m	80%	0%	✓
10 years and above*	£78.709m	100%	0%	✓

*This includes £60m LOBO with maturity date over 60 years and it could be call for repayment within the next 6 months following the last interest payment date ,but there is a very slim chance of this happening hence it is included in this category

3.8.8 **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2017/18	2018/19	2019/20
Actual principal invested beyond year end	£40m	£40m	£20m
Limit on principal invested beyond year end	£100m	£100m	£100m
Complied	✓	✓	✓

3.9 **Strategic Investment Update**

3.9.1 The Council's investment strategy was amended during 2016 to increase the scope to invest £100m for periods of longer than one year and up to five years. Given that returns from cash deposits and similar products are likely to remain low for many years to come, the advice of the Arlingclose has been sought on long-term cash balances

that we could actively invest in alternative asset classes. Pooled property, bond and equity funds which typically generate income returns of 3% to 7% and have the potential for capital appreciation.

3.9.2 Arlingclose has a Fund Suite which has a catalogue range of different (over 25) research pooled funds, which is being monitored by the advisers by meeting with the fund managers regularly to discuss their performance and strategies.

3.9.3 Further to the previous discussion with the Committee at their last meeting in March 2018, officers have continued to work with Arlingclose to identify suitable funds for the Council's strategic portfolio, the funds were selected from the adviser's Fund Suite based on their risk characteristics and historic performance.

3.9.4 With the Council holding over £400m of investment balances at present, there is scope to invest £100m to £150m into these longer term investment funds. This is estimated to generate returns averaging between 2% and 3%, and so an additional £2.m to £4.5m of investment income might be possible. The budget proposal tasked officers with delivering an additional £1.4m from this approach.

3.9.5 Work is being undertaken with our advisors (Arlingclose) to identify investment options that deliver the target returns and meet the aspirations of ethical investment, without also unduly impacting on the Council's risk exposure. Potential investment options include property, diversified income, equity and bonds funds which would have approximately 2% (£2m - £3m) invested in fossil fuel related shares.

3.9.6 The initial intention is to have these investment funds operational for the Council and then to rebalance having regard to guidance from the advisor and future reports to the Committee will highlight progress and performance of these funds separately.

3.9.7 Note that the allocation to these funds will be reviewed and amended to lock in achieved returns. Investments such as property and equities (company shares) do not generate linear returns – there will be periods of over and under performance which will be managed through the medium term financial plan over the longer term. Property and equities have performed well in recent years and given that there is concern that equities in particular will continue to outperform without some losses at some point a cautious approach will be adopted initially in respect to equities.

3.9.8 Generating a steady return and preserving the capital that has been invested is the primary focus of the funds that we will invest in. Pooled funds in particular are subject to almost daily changes as fund managers respond to market conditions and so exposure to underlying carbon exposure through pooled funds is difficult to measure other than at a single point in time.

3.9.9 Divestment is only one way in which the Council can influence investment in the low carbon economy. Having a combined approach which also seeks to manage the risk posed by climate change by allocating capital to sustainable developments aligned with the low carbon economy is seen as equally powerful as simple divestment.

4. COMMENTS OF THE CHIEF FINANCIAL OFFICER

4.1 This report provides an update on Treasury Management activities for 2017/18 financial year.

4.2 The Council held an outstanding internally managed investments portfolio of £464.82m as at 31st March 2018. This portfolio earned an average rate of return of 0.68%. However, inflation is currently eroding the value of this asset.

4.3 The Council has an investment income target of £2.525m for 2017/18 and generated an investment income of £2.791m.

4.4 The Council is adopting a revised approach to its investment activities in line with approvals given in the 2018/19 Treasury management Strategy and its MTFS to increase the level of investment income it generates during 2018/19 and is taking steps to achieve this through the strategy detailed in section 3.9 above. Consequently a higher investment income target of £3.983m has been set for 2018/19.

5. LEGAL COMMENTS

5.1 The Local Government Act 2003 provides a framework for the capital finance of local authorities. It provides a power to borrow and imposes a duty on local authorities to determine an affordable borrowing limit. It provides a power to invest. Fundamental to the operation of the scheme is an understanding that authorities will have regard to proper accounting practices recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) in carrying out capital finance functions.

5.2 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require the Council to have regard to the CIPFA publication "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes" ("the Treasury Management Code") in carrying out capital finance functions under the Local Government Act 2003.

5.3 This noting report of the Corporate Director, Resources advises the Committee of the Council's borrowing and investment activities for the quarter ending 31st December 2017 and is consistent with the key principles expressed in the Treasury Management Code. 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.

5.4 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 Capita Treasury Services who specialise in Council treasury issues.

10 CRIME AND DISORDER REDUCTION IMPLICATIONS

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

APPENDICES

Appendix 1 – Investments Outstanding at 31st March 2018

Appendix 2 – Glossary

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

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

Arlingclose LTD - Treasury Management Benchmarking Report and Quarter 4 2017/18 and Treasury Management Outturn Report Template

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

Appendix 1: Investments Outstanding as at 31st March 2018

Time to Maturity	Counterparty	From	Maturity	Amo3nt £m	Rate
Overnight	Amundi MMF*		**MMF**	25.00	
	BNP Paribas MMF		**MMF**	4.72	
	Standard Life MMF		**MMF**	7.10	
	SUB TOTAL			**36.82**	
< 1 Month	Rushmoor Borough Council	21/12/2017	03/04/2018	12.00	0.53%
	Principality Building Society	06/04/2017	06/04/2018	5.00	0.78%
	Cherwell District Council	08/01/2018	09/04/2018	10.00	0.55%
	North Lanarkshire Council	13/11/2017	13/04/2018	5.00	0.55%
	Toronto Dominion Bank	16/10/2017	16/04/2018	20.00	0.50%
	Eastleigh Borough Council	25/01/2018	25/04/2018	5.00	0.52%
	Middlesbrough Council	26/02/2018	26/04/2018	10.00	0.65%
	Newcastle Building Society	28/04/2017	27/04/2018	5.00	0.80%
	Royal Bank of Scotland	28/04/2017	30/04/2018	5.00	1.79%
	Birmingham City Council	30/01/2018	30/04/2018	10.00	0.52%
	London Borough of Barking & Dagenham	30/01/2018	30/04/2018	20.00	0.52%
	SUB TOTAL			**107.00**	
1 - 3 Months	Nottingham Building Society	09/05/2017	08/05/2018	5.00	0.77%
	Buckinghamshire County Council	14/03/2018	14/05/2018	5.00	0.85%
	Commonwealth Bank of Australia	17/05/2017	16/05/2018	15.00	0.53%
	Australia & New Zealand Banking Group	17/05/2017	16/05/2018	10.00	0.52%
	Australia & New Zealand Banking Group	17/05/2017	16/05/2018	10.00	0.52%
	Royal Bank of Scotland	22/12/2016	22/06/2018	5.00	0.79%
	London Borough of Newham	26/03/2018	26/06/2018	10.00	0.90%
	Commonwealth Bank of Australia	03/07/2017	02/07/2018	10.00	0.52%
	SUB TOTAL			**70.00**	
3 - 6 Months	Santander	00/01/1900	CALL 95	20.00	0.00%
	Nottingham Building Society	09/05/2017	08/05/2018	5.00	0.77%
	Buckinghamshire County Council	14/03/2018	14/05/2018	5.00	0.85%
	Commonwealth Bank of Australia	17/05/2017	16/05/2018	15.00	0.53%
	Australia & New Zealand Banking Group	17/05/2017	16/05/2018	10.00	0.52%
	Australia & New Zealand Banking Group	17/05/2017	16/05/2018	10.00	0.52%
	Royal Bank of Scotland	22/12/2016	22/06/2018	5.00	0.79%
	London Borough of Newham	26/03/2018	26/06/2018	10.00	0.90%
	Commonwealth Bank of Australia	03/07/2017	02/07/2018	10.00	0.52%
	Lancashire County Council	25/09/2017	24/09/2018	10.00	0.55%
	Enfield Council	25/09/2017	24/09/2018	15.00	0.55%
	SUB TOTAL			**101.00**	
6 - 9 Months	Southampton City Council	02/10/2017	01/10/2018	10.00	0.60%
	Rabobank	06/10/2017	05/10/2018	20.00	0.68%
	Lancashire County Council	06/10/2017	05/10/2018	10.00	0.58%
	Staffordshire Moorlands DC	08/02/2018	08/11/2018	3.00	0.65%
	SUB TOTAL			**43.00**	
9 - 12 Months	Isle of Wight Council	07/02/2018	06/02/2019	3.00	0.77%
	London Borough of Ealing	20/02/2018	19/02/2019	10.00	0.85%
	Monmouthshire County Council	23/02/2018	22/02/2019	5.00	0.85%
	Coventry City Council	26/02/2018	26/02/2019	10.00	1.00%
	Cambridgeshire County Council	27/02/2018	27/02/2019	10.00	0.85%
	Blackpool Council	16/03/2018	15/03/2019	17.00	0.85%
	SUB TOTAL			**55.00**	
> 12 Months	Bournemouth Borough Council	25/09/2017	25/09/2019	20.00	0.75%
	Thurrock Borough Council	08/11/2017	08/11/2019	20.00	1.05%
	Middlesbrough Council	26/01/2018	27/01/2020	10.00	1.08%
	Isle of Wight Council	07/02/2018	07/02/2020	2.00	1.05%
	SUB TOTAL			**52.00**	

*MMF balance includes £24m of Pension Fund cash awaiting investments.

Appendix 2 – Glossary

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

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

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