

<b>COMMITTEE:</b> <b>Audit Committee</b>	<b>DATE:</b> <b>24 September 2010</b>	<b>CLASSIFICATION:</b> <b>Unrestricted</b>	<b>REPORT NO.</b>	<b>AGENDA NO.</b> <b>5.4</b>
<b>REPORT OF:</b> <b>Corporate Director of Resources</b>		<b>TITLE:</b> <b>Treasury Management Activity for Period Ending 31 August 2010</b>		
<b>ORIGINATING OFFICER(S):</b> <b>Oladapo Shonola, Chief Financial Strategy Officer</b>		<b>Ward(s) affected:</b> N/A		

<b>Lead Member</b>	<b>Cllr David Edgar – Resources</b>
<b>Community Plan Theme</b>	<b>All</b>
<b>Strategic Priority</b>	<b>One Tower Hamlets</b>

## **1. SUMMARY**

- 1.1 This report advises the Committee of treasury management activity for the current financial year up to 31 August 2010 as required by the Local Government Act 2003.
- 1.2 The report details the current credit criteria adopted by the Corporate Director of Resources, the investment strategy for the current financial year and the projected investment returns.

## **2. DECISIONS REQUIRED**

- 2.1 Members are recommended to note the contents of this report.

## **3 REASONS FOR DECISIONS**

- 3.1 The Local Government Act 2003 and the Local Authorities (Capital Financing and Accounting) Regulations 2003 requires that regular reports be submitted to Council/Committee detailing the council's treasury management activities.
- 3.2 The regular reporting of treasury management activities should assist in ensuring that Members are able to scrutinise officer decisions and monitor progress on implementation of investment strategy as approved by Full Council.

## **4 ALTERNATIVE OPTIONS**

- 4.1 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.
- 4.2 If the Council were to deviate from those requirements, there would need to be some good reason for doing so. It is not considered that there is any such reason, having regard to the need to ensure that Members are kept informed about treasury management activities and to ensure that these activities are in line with the investment strategy approved by the Council

## 5 **BACKGROUND**

- 5.1 The Local Authorities (Capital Finance and Accounting) (England) Regulation 2003 requires local authorities to have regard to the TM Code. The TM 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.
- 5.2 These reports are in addition to the mid-year and annual treasury management activity reports that should be presented to Council midway through the financial year and at year end respectively.
- 5.3 This report details the current credit criteria/risk level adopted by the Corporate Director of Resources, the investment strategy for the current financial year and the projected investment returns.

## 6. **TREASURY ACTIVITY FOR PERIOD 1 April to 31 August 2010**

- 6.1 This section of the report sets out:
- The current credit criteria being operated by the Council.
  - The treasury investment strategy for the current financial year and the progress in implementing this.
  - The transactions undertaken in the period and the investment portfolio outstanding as at 31 August 2010.

## 7 **CREDIT CRITERIA**

- 7.1 The following credit criteria for investment counterparties were established by the Council in February 2010 as part of the budget setting exercise. Explanation of credit ratings criteria is attached at Appendix I.

<b>Institution</b>	<b>Minimum High Credit Criteria</b>	<b>Use</b>
Debt Management Office (DMO) Deposit Facility	Not applicable	In-house
Term deposits – Other Local Authorities	Not applicable	In-house
Term deposits – banks and building societies	Short-term F1+, Long-term AA-	In-house
Institutions with Government guarantee on ALL deposits by high credit rated (sovereign rating) countries.	Sovereign rating	In-house
Institutions with UK Government support.	Sovereign rating	In-house
<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)</b>		
Money Market Funds (MMF)	AAA rated	In-house

## **8 INVESTMENT STRATEGY**

- 8.1 Sector provides cash management services to the Council, but the Council retains control of the credit criteria and the investments, so that Sector's role is purely advisory.
- 8.2 In addition to provide cash management services, Sector also provides treasury consultancy/advisory service to the Council.
- 8.3 Sector's interest rate projections are that base rate will remain static at 0.5% for the current financial year with no movement in rates until we are well into Q4 of 2010. Against this macro-economic perspective Sector has developed a strategy which delivers enhanced performance through maximising the investment term of the portfolio. This will enable the portfolio to obtain exposure to the higher rates associated with investment in the longer term.
- 8.4 Sector initially calculated that the Council will have an effective investment balance of £100million for 2010-11. However, this is likely to be revised upwards, but average balances will vary throughout the year.
- 8.5 The current balance of £152.736M is higher than anticipated at the start of the year due to increased business rates collection in the early part of the financial year and funds that are as yet unspent but have been earmarked to fund the 2010-11 capital programme. It is envisaged that the cash balance will reduce in the medium term especially toward the end of the financial year.
- 8.6 The Council's bankers, the Co-operative Bank plc, are used as depositors of last resort for investment of additional funds received after the treasury transactions have been completed and the money markets have closed.
- 8.7 The current investment strategy within the constraints of the Councils credit criteria and liquidity requirement is as set out below.

## Investment Strategy

Projection			Actual Deal			
Term	Amount £M	Rate %	Counterparty	Maturity	Amount £M	Rate
Overnight	10.000	0.80%	Santander UK	Call	5.000	0.80%
Overnight	10.000	0.75%	Clydesdale Bank plc	Call	24.536	0.75%
Overnight		0.80%	Alliance & Leicester	Call	0.000	
Overnight		0.75%	Bank of Scotland plc	Call	8.900	0.75%
Overnight		0.25%	Debt Mgt Office (DMO)	01 June 2010	0.000	0.25%
			<b>SUB TOTAL</b>		<b>38.436</b>	
1 Month	5.000	0.45%	Bristol City Council	23 September 2010	4.300	0.30%
			Cardiff City Council	03 September 2010	15.000	0.33%
2 Months						
3 Months	20.000	0.85%				
6 Months	20.000	0.99%	Royal Bank of Scotland	10 November 2010	25.000	0.92%
			Nationwide	15 July 2010	5.000	0.95%
			Nationwide	15 October 2010	5.000	0.85%
			Barclays	03 December 2010	5.000	0.95%
9 Months	15.000	1.30%	Nationwide	10 January 2011	10.000	1.02%
			Barclays	10 February 2011	10.000	1.15%
12 Months	20.000	2.00%	Cater Allen (Santander)	13 May 2011	3.000	1.50%
			Cater Allen	18 August 2011	5.000	2.50%
			Cater Allen (Santander)	13 January 2011	5.000	2.20%
			Cater Allen (Santander)	11 April 2011	5.000	2.20%
			Cater Allen (Santander)	14 May 2011	2.000	2.10%
			Nationwide	03 June 2011	5.000	1.35%
			Barclays	03 June 2011	10.000	1.40%
			<b>SUB TOTAL</b>		<b>114.300</b>	
	<b>£100.000</b>		<b>TOTAL</b>		<b>£152.736</b>	

## **9 INVESTMENT RETURNS**

- 9.1 Investment returns since inception of the new arrangement with Sector has been consistently above the portfolio benchmark and the London Interbank Bid Rate (LIBID). Performance has improved from the last reporting date (31 May) from 0.93% average return to 1.03%.
- 9.2 Although there has been an improvement in return this year in the average return on investment at 1.03% (as at 31 August), this is below the benchmark of 1.25%. However, it is above the LIBID rate by 0.47% and represents good performance given the issues around level of additional funds that need to be invested under the current investment strategy.
- 9.3 Other factors affecting average return on investment include the increase in available for investment cash balances and the contraction in counterparty list due to stricter counterparty criteria. Consequently, a higher than envisaged percentage of the portfolio has had to be placed with DMO on an ongoing basis at low rates of return of 0.25%.
- 9.4 Officers are always looking to maximise returns on investment within the confines of the approved investment strategy. Following a recent review, it was decided that funds that would have previously been deposited with the DMO should now be invested in AAA rated UK money market funds. Investing in money market funds should push returns up by 0.25% when compared against placements with the DMO, whilst still maintaining a secure and liquid portfolio of short term investments.

## **10. COMMENTS OF THE CHIEF FINANCIAL OFFICER**

- 10.1. The comments of the Corporate Director Resources have been incorporated into the report.

## **11 CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL)**

- 11.1 The Committee is asked to note the information in the report concerning the Council's treasury transactions undertaken by the Corporate Director of resources under delegated powers.

## **12. ONE TOWER HAMLETS CONSIDERATIONS**

- 12.1 Interest on the Council's cash flow has historically contributed significantly towards the budget.

## **13. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

- 13.1 There are no Sustainable Actions for A Greener Environment implications.

## **14. RISK MANAGEMENT IMPLICATIONS**

- 14.1 Any form of investment inevitably involves a degree of risk. To minimise risk the investment strategy has restricted exposure of council cash balances to UK backed banks or institutions with the highest short term rating or strong long term rating.

## **15 CRIME AND DISORDER REDUCTION IMPLICATIONS**

- 15.1 There are no crime and disorder reduction implications arising from this report.

## **16 EFFICIENCY STATEMENT**

- 16.1 Monitoring and reporting of treasury management activities ensures 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.

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### **LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D**

#### **LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT**

***Brief description of "background papers"***

*Directorate Submissions*

***Name and telephone number of holder  
And address where open to inspection***

*Oladapo Shonola Ext. 4733  
Mulberry Place, 4<sup>th</sup> Floor.*

## Appendix 1: Definition of Credit Ratings

### Support Ratings

Rating	
1	A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-term rating floor of 'A-'.
2	A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-term rating floor of 'BBB-'.
3	A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'BB-'.
4	A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'B'.
5	A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-term rating floor no higher than 'B-' and in many cases no floor at all.

### Short-term Ratings

Rating	
F1	<b>Highest credit quality.</b> Indicates the strongest capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.
F2	<b>Good credit quality.</b> A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.
F3	<b>Fair credit quality.</b> The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

## Long-term Ratings

Rating	Current Definition (August 2003)
<b>AAA</b>	<b>Highest credit quality.</b> 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
<b>AA</b>	<b>Very high credit quality.</b> 'AA' ratings denote a very low expectation of credit risk. They indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
<b>A</b>	<b>High credit quality.</b> 'A' ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.
<b>BBB</b>	<b>Good credit quality.</b> 'BBB' ratings indicate that there is currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. This is the lowest investment-grade category

## Individual Ratings

Rating	
<b>A</b>	A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment or prospects.
<b>B</b>	A strong bank. There are no major concerns regarding the bank. Characteristics may include strong profitability and balance sheet integrity, franchise, management, operating environment or prospects
<b>C</b>	An adequate bank, which, however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects.
<b>D</b>	A bank, which has weaknesses of internal and/or external origin. There are concerns regarding its profitability, substance and resilience, balance sheet integrity, franchise, management, operating environment or prospects. Banks in emerging markets are necessarily faced with a greater number of potential deficiencies of external origin.
<b>E</b>	A bank with very serious problems, which either requires or is likely to require external support.