COMMITTEE:	DATE:	CLASSIFICATION:	REPORT NO.	AGENDA NO.
Council	**8 December 2010**	**Unrestricted**		

REPORT OF:	TITLE:
Corporate Director of Resources ORIGINATING OFFICER(S): **Oladapo Shonola, Chief Financial Strategy Officer**	**Mid Year Review Report on 2010/11 Treasury Management and Investment Strategy** Ward(s) affected: All

Lead Member	**Not Known**
Community Plan Theme	**All**
Strategic Priority	**One Tower Hamlets**

1. SUMMARY

1.1 This report reviews the Treasury Management and Investment Strategy that was approved by Full Council on 3 March as prescribed by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (Revised 2009).

1.2 The report reviews how the Resources Treasury Management team has managed the Council's cash balances, investments, including the effective management of treasury related risks. The report also sets out in detail the economic environment and how this has impacted on 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 Furthermore, the CIPFA Treasury Management Code of Practice requires that Full Council/Committee should receive a Mid-year Report reviewing Treasury Management/Investment.

4 ALTERNATIVE OPTIONS

4.1 The Council is bound by legislation to have regard to the CIPFA Treasury Management (TM) Code. The Code requires that the Council should receive a mid-year report reviewing treasury management and investment.

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 Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) has been adopted by the Council.

5.2 One the requirements of the Code is that Full Council/Committee should receive an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

5.3 The Treasury Management Strategy, Investment Strategy and Minimum Revenue Provision reports was included in the Budget Pack that was presented to Full Council on 3 March. The Outturn report was included in the Treasury Management Activity Report to 4 July Cabinet.

5.4 This mid year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2010/11
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- A review of the Council's investment portfolio for 2010/11
- A review of the Council's borrowing strategy for 2010/11
- A review of any debt rescheduling undertaken during 2010/11
- A review of compliance with Treasury and Prudential Limits for 2010/11

6. AN ECONOMIC UPDATE FOR THE FIRST SIX MONTHS OF 2010/11

6.1 GLOBAL ECONOMY

6.1.1 The sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit. However, any default or write down of Greek debt would have substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the European Union (EU)and International Monetary Fund (IMF) putting together a €750bn support package in mid May.

6.1.2 Growth in the US, UK and the Euro zone in quarter 2 of 2010 was particularly driven by strong growth in the construction sector catching up from inclement weather earlier in the year and is unlikely to be repeated; general expectations are for much more subdued figures for the remainder of 2010. Market expectations for all three sectors of the economy is that these have all peaked and are pointing downwards, though not necessarily in to negative territory.

6.2 UK ECONOMY

6.2.1 Following the general election in May 2010, the coalition government has put in place an austerity plan to carry out correction of the public sector deficit over the next five years. The inevitable result of fiscal contraction will be major job losses during this period, in particular in public sector services. This will have a knock on effect on consumer and business confidence. UK Gross Domestic Product (GDP) is likely to have peaked at 1.2% in quarter 2, although unemployment seems to be following an opposite trend – rising since July. It remains to be seen whether these gains in employment can be sustained once the expected large scale lay off in the public sector takes place.

6.2.2 **Inflation and Bank Rate** – CPI has remained high so far during 2010. It peaked at 3.7% in April and has fallen back to 3.1% in August. RPI remains high, at 4.7% in August. Although inflation has remained stubbornly above the Bank of England Monetary Policy Committee's 2% target, the MPC is confident that inflation will fall back under the target over the next two years.

6.2.3 The Council's Treasury Advisor, Sector's view is that there is unlikely to be any increase in Bank Rate until the middle of 2011.

6.3 COUNCILS TREASURY ADVISOR'S VIEW

6.3.1 Sector believes that the longer run trend is for gilt yields and Public Works Loans Board (PWLB) rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Sector's interest rate forecast

	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.50%	3.00%	3.25%
5yr PWLB rate	2.20%	2.20%	2.20%	2.40%	2.60%	2.80%	3.00%	3.30%	3.60%	3.80%	4.10%	4.40%
10yr PWLB rate	3.30%	3.30%	3.30%	3.40%	3.70%	3.90%	4.00%	4.30%	4.40%	4.60%	4.60%	4.90%
25yr PWLB rate	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.70%	4.70%	4.80%	5.00%	5.00%	5.00%
50yr PWLB rate	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.70%	4.70%	4.80%	5.00%	5.00%	5.00%

7. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UPDATE

7.1 The Treasury Management Strategy Statement (TMSS) for 2010/11 was approved by the Council on 03 March 2010. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity

7.2 The Council will also aim to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (maximum loan period of 12 months), and only directly invest with highly (AA-) credit rated financial institutions, the UK government or AAA rated money market funds. Definition of credit ratings is attached at Appendix 1 at the end of this report.

Institution	**Minimum High Credit Criteria**	**Use**
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
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)		
Money Market Funds (MMF)	AAA rated	In-house

7.3 A breakdown of the Council's investment portfolio is shown in Section 8 of this report.

7.4 Borrowing rates have been at historically low rates during the first six months of the 2010/11 financial year. Any new external borrowing undertaken has been identified in Section 9 of this report.

7.5 Investments and borrowing during the first six months of the year have been in line with the strategy, and there have been no deviations from the strategy.

7.6 As outlined in Section 6 above, there is still considerable uncertainty and volatility in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy approved on 03 March 2010is still fit for purpose in the current economic climate.

8. INVESTMENT PORTFOLIO 2010/11

8.1 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

8.2 The investment portfolio yield for the first six months of the year is 1.09% against a benchmark of 1.25%.

8.3 A summary of investments held as at 30th September 2010, compared to investments at the start of the year (1 April 2010) is shown below:

Investments as at 01 April 2010		
	Amount	**Average Interest Rate**
Total Investments	**83,100,000**	**1.23%**
Investments as at 30 September 2010		
	Amount	**Average Interest Rate**
Total Investments	**149,636,000**	**1.08%**

8.4 As illustrated in the economic background section above, investment rates available in the market are at a historical low point. The average level of funds available for investment purposes in the first six months of 2010/11 was £148.3m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

Benchmark	Council Performance	Investment Interest Earned at 30 Sept
1.25%	1.08%	£795.5k

8.5 As illustrated, the authority underperformed the benchmark by 0.17 bps. The Council's budgeted investment return for 2010/11 is £1.6m, and performance for the year to date is in line with the budget.

8.6. The current treasury strategy is a risk averse one, which restricts investments to a very narrow range of institutions, and this is affecting investment returns. The investment strategy needs to set an appropriate balance between returns and security in order to optimise returns. The Chief Finance Officer will give further consideration to the risks with the treasury management advisor and consider proposing an easing of the strategy for 2011/12. This is likely to involve no change in strategy as regards institutional ratings.

9. NEW EXTERNAL BORROWING

9.1 The Council's capital financing requirement (CFR) for 2010/11 is £438.1m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing).

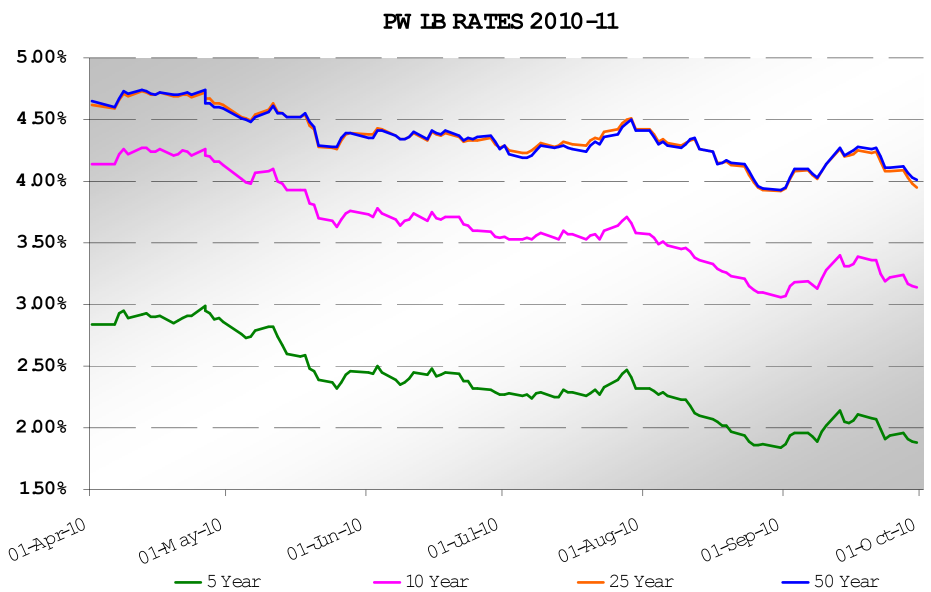
9.2 The Council's treasury advisor's central target rate for new external long term borrowing (25 years) for the first six months of 2010/11 started at 4.65% and fell progressively to 4.20%. Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement - CFR), new external borrowing of £51m was undertaken from the PWLB as per table below.

Type of Loan	Amount	Date of Borrowing	Interest Rate	Term
Maturity	£30,000,000	10 May 2010	4.20%	25 Years
Maturity	£21,000,000	10 May 2010	4.24%	25 Years

9.3 As outlined below, the general trend has been a reduction in interest rates during the six months, across all bands, with the low points occurring in the middle to end of August. The high points were in early to mid April.

9.4 It is anticipated that further borrowing will not be undertaken during this financial year.

9.5 The graph and table below show the movement in PWLB rates for the first six months of the year and provide benchmarking data showing high and low points etc:



PWLB BORROWING RATES 2010/11 FOR 1 to 50years

	1	2	3	4	5	10	25	50
01-Apr-10	**0.81%**	**1.37%**	**1.91%**	**2.40%**	**2.84%**	**4.14%**	**4.62%**	**4.65%**
30-Sep-10	**0.64%**	**0.91%**	**1.22%**	**1.55%**	**1.88%**	**3.14%**	**3.95%**	**4.01%**
HIGH	**0.93%**	**1.52%**	**2.07%**	**2.56%**	**2.99%**	**4.27%**	**4.73%**	**4.74%**
LOW	**0.60%**	**0.89%**	**1.20%**	**1.52%**	**1.84%**	**3.06%**	**3.92%**	**3.93%**
spread	**0.33%**	**0.63%**	**0.87%**	**1.04%**	**1.15%**	**1.21%**	**0.81%**	**0.81%**
average	**0.73%**	**1.15%**	**1.58%**	**1.99%**	**2.37%**	**3.65%**	**4.35%**	**4.35%**
high date	26/04/10	26/04/10	26/04/10	26/04/10	26/04/10	12/04/10	12/04/10	26/04/10
low date	15/06/10	24/08/10	25/08/10	31/08/10	31/08/10	31/08/10	31/08/10	31/08/10

10. DEBT RESCHEDULING

10.1 No debt rescheduling was undertaken during the first six months of 2010/11

11. COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

11.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved TMSS.

11.2 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in appendix 3 at the end of this report.

12. COMMENTS OF THE CHIEF FINANCIAL OFFICER

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

13 CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL)

13.1 The Committee is asked to note the information in the report concerning the Councils treasury transactions undertaken by the Corporate Director of resources under delegated powers.

14 ONE TOWER HAMLETS CONSIDERATIONS

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

15 SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

15.1 There are no Sustainable Actions for A Greener Environment implications.

16 RISK MANAGEMENT IMPLICATIONS

16.1 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.

17 CRIME AND DISORDER REDUCTION IMPLICATIONS

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

18 EFFICIENCY STATEMENT

18.2 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.

LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D

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

Brief description of "background papers"	***Name and telephone number of holder And address where open to inspection***
Investment Reports; Sector Treasury Advisory Services	*Oladapo Shonola Ext. 4733* *Mulberry Place, 4th 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	**Highest credit quality.** Indicates the strongest capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.
F2	**Good credit quality.** A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.
F3	**Fair credit quality.** The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

Long-term Ratings

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

Individual Ratings

Rating	
A	A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment or prospects.
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
C	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.
D	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.
E	A bank with very serious problems, which either requires or is likely to require external support.

Appendix 2 – Investment Portfolio

Investments as at 01 April 2010		
Bank or Building Society	**Amount**	**Interest**
Bank of Scotland	20,000,000	0.75%
Abbey	15,000,000	0.80%
Clydesdale	8,100,000	0.75%
Nationwide	5,000,000	0.80%
Barclays	10,000,000	2.15%
Cater Allen	5,000,000	3.00%
Nationwide	5,000,000	0.79%
Nationwide	5,000,000	0.99%
Lloyds	5,000,000	1.82%
Cater Allen	5,000,000	2.20%
Total Investments	**83,100,000**	**1.23%**
Investments as at 30 September 2010		
Bank or Building Society	**Amount**	**Interest**
Bank of Scotland	20,100,000	0.75%
Abbey	5,000,000	0.80%
Clydesdale	24,536,000	0.75%
Nationwide	5,000,000	0.85%
Lancashire CC	5,000,000	0.32%
RBS	25,000,000	0.92%
Barclays	5,000,000	0.95%
Nationwide	10,000,000	1.02%
Cater Allen	5,000,000	2.20%
Nationwide	5,000,000	0.95%
Barclays	10,000,000	1.15%
Cater Allen	5,000,000	2.20%
Cater Allen	3,000,000	1.50%
Cater Allen	2,000,000	2.10%
Nationwide	5,000,000	1.35%
Barclays	10,000,000	1.40%
Cater Allen	5,000,000	2.50%
Total Investments	**149,636,000**	**1.08%**

Appendix 3 - 2010-11 Prudential and Treasury Indicators

Prudential indicators	2008/09	2009/10	2010/11	2011/12	2012/13
	actual	outturn	estimate	estimate	estimate
	£'000	£'000	£'000	£'000	£'000
Capital Expenditure					
Non - HRA	160,218	161,570	160,784	159,353	157,979
HRA (applies only to housing authorities)	261,480	276,480	301,075	316,075	331,075
TOTAL	421,698	438,050	461,859	475,428	489,054
Ratio of financing costs to net revenue stream					
Non - HRA	1.38%	2.90%	2.96%	3.08%	3.27%
HRA (applies only to housing authorities)	16.10%	17.34%	18.82%	21.50%	24.29%
Net borrowing requirement					
brought forward 1 April	3,016	1,352	-786	-1,431	-1,374
carried forward 31 March	-39,737	15,000	24,595	15,000	15,000
in year borrowing requirement	-36,721	16,352	23,809	13,569	13,626
In year Capital Financing Requirement					
Non - HRA	160,218	161,570	160,784	159,353	157,979
HRA (applies only to housing authorities)	261,480	276,480	301,075	316,075	331,075
TOTAL	421,698	438,050	461,859	475,428	489,054
Capital Financing Requirement as at 31 March					
Non - HRA	160,218	161,570	160,784	159,353	157,979
HRA (applies only to housing authorities)	261,480	276,480	301,075	316,075	331,075
TOTAL	421,698	438,050	461,859	475,428	489,054
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p
Increase in Council Tax (band D) per annum *	19.57	8.46	5.77	2.87	8.09
Increase in average housing rent per week (housing authorities only)	0.00	0.00	0.00	0.00	0.00

* or increase in precept for police, fire and other authorities

TABLE 4: Treasury management indicators	2008/09	2009/10	2010/11	2011/12	2012/13
	actual	**probable out-turn**	**estimate**	**estimate**	**estimate**
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
borrowing	465,000	515,000	565,000	595,000	615,000
other long term liabilities	0	0	0	0	0
TOTAL	465,000	515,000	565,000	595,000	615,000
Operational Boundary for external debt -					
borrowing	445,000	495,000	545,000	575,000	595,000
other long term liabilities	0	0	0	0	0
TOTAL	445,000	495,000	545,000	575,000	595,000
Actual external debt	251,785	302,475	353,666	353,639	353,622
Upper limit for fixed interest rate exposure					
expressed as either:-					
Net principal re fixed rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
expressed as either:-					
Net principal re variable rate borrowing / investments	20%	20%	20%	20%	20%
Upper limit for total principal sums invested for over 364 days	0	0	0	0	0
(per maturity date)					

TABLE 5: Maturity structure of new fixed rate borrowing during 2010/11	upper limit	lower limit
under 12 months	10%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	25%	0%
5 years and within 10 years	90%	0%
10 years and above	100%	0%