

COMMITTEE: Audit Committee	DATE: 20 March 2012	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO. 5.5
REPORT OF: Corporate Director, Resources ORIGINATING OFFICER(S): Peter Hayday, Interim Service Head, Finance, Risk & Accountability Oladapo Shonola, Chief Financial Strategy Officer		TITLE: Treasury Management Investment Activity to 31 January 2012 Ward(s) affected: N/A		

1. Summary

- 1.1 This report is one of a number through the financial year that advises the Committee on the treasury management activity relating to the investment of cash balances: this report covers the ten months to 31 January 2012.
- 1.2 The report details the credit criteria that govern the investments and which form part of the Council's Annual Treasury Management Strategy together with an analysis of the investment portfolio and the projected investment returns.

2. Recommendations

- 2.1 The Committee is asked to note the report.

3. Reasons for Decisions

- 3.1 The Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting) Regulations 2003 require 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 Council's Treasury Management Strategy was approved on 8 March 2011 and subsequently updated at 25 January 2012 Full Council. The strategy sets out the criteria which govern the treasury management activity for prudential borrowing to fund the capital programme and the investment of cash balances over the financial year 2011-12 and covers the following:

- Treasury limits in force which will limit the treasury risk and activities of the Council;
- Prudential and Treasury Indicator;
- The current treasury position;
- Prospects for interest rates;
- The borrowing strategy (including policy on borrowing in advance of need);
- Debt Rescheduling;
- The Investment Strategy;
- Credit Worthiness Policy'
- Policy on use of external service providers; and
- The Minimum Revenue Provision (MRP) Strategy

- 5.2 This report focuses on the investment of cash balances which are governed by the criteria set out as part of the investment strategy. The principles that underpin both the strategy and criteria are:

- the security of capital;
- the liquidity of investments to ensure that the Council has cash available to discharge its liabilities as necessary and that;
- within these priorities, the Council will also aim to achieve the optimum return on its investments commensurate with appropriate levels of security and liquidity; and
- all investments will be in Sterling.

- 5.3 The criteria classify investment products as either "specified" or "non-specified" as defined within the Department of Communities and Local Government's Guidance on Local Government Investments.

Specified Investments:

- 5.4 All specified investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high credit' quality criteria where applicable. The council will continue its policy of lending surplus cash to counterparties that have high credit ratings, defining 'high credit rating' as being F1+ Fitch short-term and AA- long-term credit rating.

Table 1

Institution	Minimum High Credit Criteria	Use	Limit
Debt Management Office (DMO) Deposit Facility	Not applicable	In-house	£100m*
Term deposits – Other Local Authorities	Not applicable	In-house	£10m**
Term deposits – banks and building societies	Short-term F1+, Long-term AA-	In-house	£30m
Institutions with Government guarantee on ALL deposits by high credit rated (sovereign rating) countries.	Sovereign rating	In-house	£30m
UK Government Gilts	Long Term AAA	In-house	£20m
Institutions with UK Government support.	Sovereign rating	In-house	£30m
Institutions that are owned/part owned by the UK Government	Sovereign rating	In-house	£45m
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)			
Money Market Funds	AAA rated	In-house	£10m

* Although limit has been set at £100m for the DMO, in reality there is no restriction on placement with the UK government.

** The group limit for local authorities has been set at £100m.

Non-Specified Investments:

- 5.5 All investments that do not qualify as specified investment are termed non-specified investments. The credit criteria for non-specified investments are detailed in table 2 over the page.

Table 2

Institution	Minimum High Credit Criteria	Use	Limit
Term deposits – Banks and Building Societies	Sovereign rating AAA Short-term F1+, Long-term AA-	In-house	£25m
Structured Deposits: Fixed term deposits with variable rate and variable maturities	Sovereign rating AAA Short-term rating F1+ Long-term rating AA-	In-house	£25m
UK Government Gilts	Long Term AAA	In-house	£25m

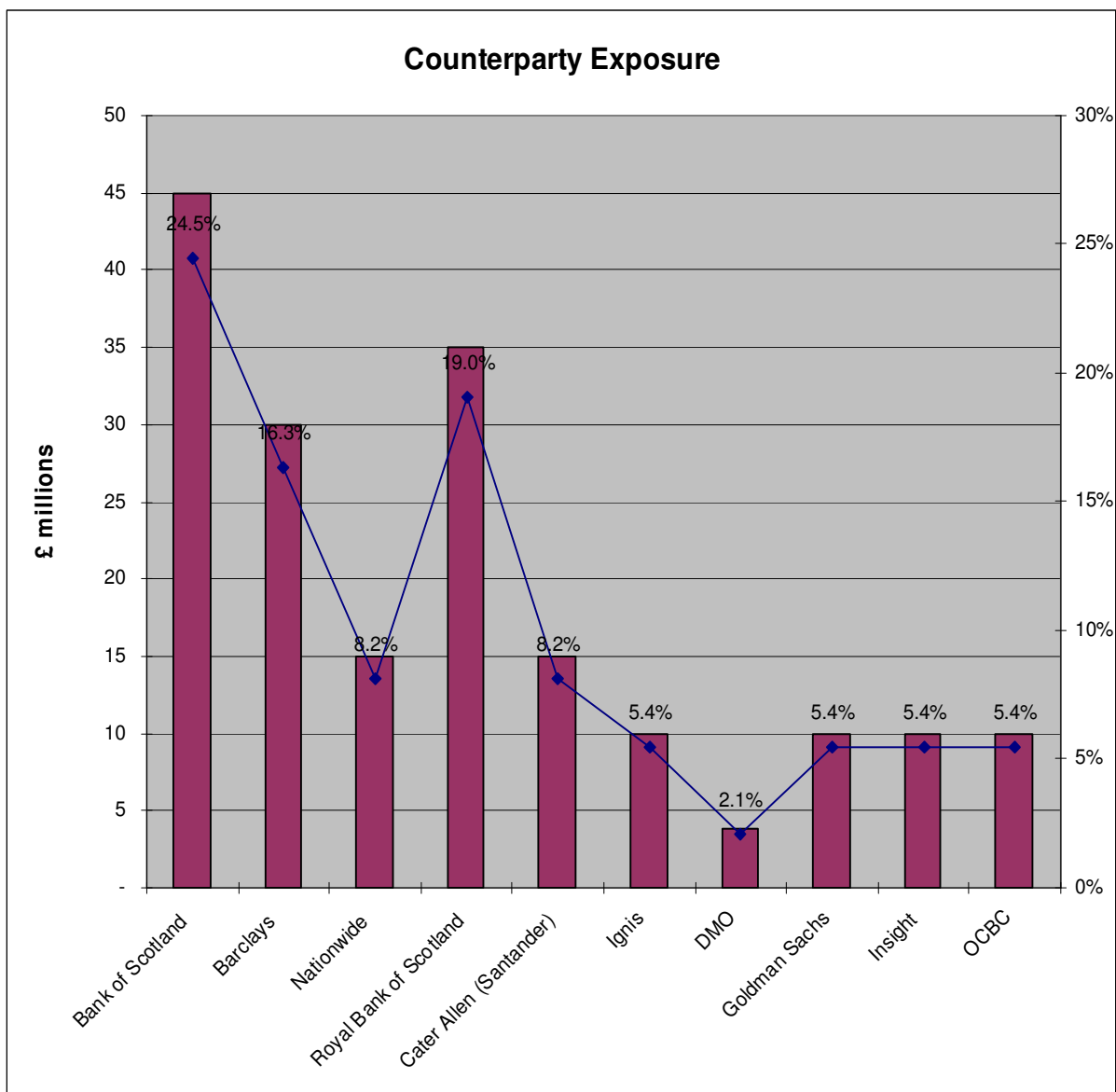
6. Current Investment Performance and Portfolio

- 6.1 The cash management services undertaken by the treasury team and supported by an external advisor, Sector, which has a lead role in ensuring that the counter party list of those financial institutions that meet the Council's investment criteria is updated daily and that total allocation to each counterparty does not exceed the proscribed limits.
- 6.2 In addition to providing cash management services, Sector also supports the on-going development of the wider treasury management policy, including interest rate projections which obviously represent a key factor in determining day-to-day investment decisions. Sector's current interest rate projections are that base rate will remain static at 0.50% for the medium term with no movement in rates likely until the third quarter of 2013.
- 6.3 The Council's bankers, the Co-operative Bank plc, are used as depositors of last resort for investment of any surplus cash received after the treasury transactions have been completed and the money markets have closed each day.
- 6.4 The investment strategy (as set out in Section 5 above) within the constraints of the Council's credit criteria and liquidity requirements is reflected in the current portfolio detailed in the table below.

Investment Portfolio as at 31 January 2012

Projection			Actual Deal			
Term	Amount £M	Rate %	Counterparty	Maturity	Amount £M	Rate %
Overnight	40.000	0.80%	Bank of Scotland	Call	5.000	0.75%
		0.50%	Goldman Sachs	MMF	10.000	0.64%
		0.50%	Ignis	MMF	10.000	0.82%
		0.50%	Insight	MMF	10.000	0.77%
			DMO	Call	3.800	0.25%
			SUB TOTAL		38.800	
3 Months	25.000	0.75%	Barclays	02-Mar-12	5.000	0.90%
			Barclays	05-Mar-12	10.000	1.29%
			OCBC	04-Apr-12	10.000	0.75%
			Bank of Scotland	05-Apr-12	10.000	2.10%
			Royal Bank of Scotland	11-Apr-12	10.000	1.23%
			Cater Allen (Santander)	12-Apr-12	5.000	2.50%
			Bank of Scotland	27-Apr-12	5.000	2.10%
6 Months	20.000	1.20%	Barclays	04-May-12	5.000	1.55%
			Barclays	10-May-12	5.000	1.23%
			Cater Allen (Santander)	14-May-12	5.000	2.50%
			Royal Bank of Scotland	12-Jun-12	10.000	1.31%
			Cater Allen (Santander)	19-Jul-12	5.000	2.50%
			Bank of Scotland	27-Jul-12	5.000	2.65%
			Bank of Scotland	27-Jul-12	5.000	2.65%
9 Months	20.000	1.40%	Barclays	10-Aug-12	5.000	1.50%
			Nationwide	10-Aug-12	10.000	1.44%
			Nationwide	07-Sep-12	5.000	1.55%
			Bank of Scotland	27-Oct-12	5.000	2.00%
12 Months and over	20.000	1.75%	Bank of Scotland	13-Feb-13	5.000	3.10%
			Bank of Scotland	13-Feb-13	5.000	3.10%
			Royal Bank of Scotland	03-Jan-14	10.000	4.00%
			Royal Bank of Scotland	27-Jan-15	5.000	3.35%
			SUB TOTAL		145.000	
	150.000		TOTAL		183.800	

6.5 The Council's exposure to any one counterparty/group is represented by the below chart including exposure as a percentage of total assets invested as at 31 January 2012.



6.6 The Council uses Fitch ratings (or equivalent from other agencies if Fitch does not provide a rating) to derive its counterparty criteria, but will take into consideration ratings from all three main credit ratings providers when compiling its counterparty list. The Council will take an overall view on its counterparties so that an organisation could be removed from the list if the predominant view of the organisation is pessimistic. Where the overall view of the three main ratings agency is pessimistic, the Council is likely to adopt the most pessimistic of the available ratings.

6.7 However, on-going uncertainty in the financial markets allied to further downgrades in the Fitch ratings for erstwhile established financial institutions (following changes in the ratings methodology used by Fitch) have further squeezed an already limited counterparty list and underlined the need for the Council to keep its investment strategy under constant review.

6.8 The credit rating downgrades and associated sovereign and counterparty restrictions has led to more short term deposits within the portfolio than would otherwise have been anticipated. This position has been further exacerbated by some major financial institutions, which meet all of our investment criteria, either not being active in the

treasury market or requiring a level of deposit and duration which is beyond the liquidity position of the Council.

- 6.9 If this position continues for a protracted period then this will have a detrimental affect on the level of investment returns.

7 Investment Returns

7.1 Investment returns since inception of the cash management arrangement with Sector has been consistently above the portfolio benchmark and the London Interbank Bid Rate (LIBID). Performance has been improved during the financial year and currently stands at 1.55%.

7.2 The projected investment return in 2011/12 is £2.9m with average cash balances of some £190m which is broadly in line with the cash flow forecast for the year. The Council has outperformed benchmark of 1.25% for most of the year and returns have been significantly above the 7 day London Interbank Bid Rate (LIBID), which currently stands at 0.50%. Although, the level of balances held in call accounts and overnight is still high at 21% in January 2012.

7.3 The table details performance of investments compared to the 7 day LIBD rate.

Period	LBTH Performance	7Day LIBID	(Under)/Over Performance
Full Year 2010/11	0.99%	0.43%	0.56%
Quarter 1 2011/12	1.15%	0.46%	0.69%
Quarter 2 2011/12	1.28%	0.48%	0.80%
Quarter 3 2011/12	1.38%	0.50%	0.88%
January 2012	1.43%	0.50%	0.93%
Average for 2011/12	1.25%	0.47%	0.77%

8. Comments of the Chief Financial Officer

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

9. Concurrent Report of the Assistant Chief Executive (Legal)

9.1. Treasury management activities cover the management of the Council's investments and cash flows, its banking, money market and capital market transactions, the effective control of risks associated with those activities and the pursuit of optimum performance consistent with those risks. 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.

- 9.2. 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. If after having regard to the Treasury Management Code the Council wished not to follow it, there would need to be some good reason for such deviation.
- 9.3. The Treasury Management Code requires as a minimum that there be a practice of regular reporting on treasury management activities and risks to the responsible committee and that these should be scrutinised by that committee. Under the Council's Constitution, the audit committee has the functions of monitoring the Council's risk management arrangements and making arrangements for the proper administration of the Council's affairs.

10. One Tower Hamlets Considerations

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

11. Sustainable Action for Greener Environment

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

12. Risk Management Implications

- 12.1 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.

13 Crime and Disorder Reduction Implications

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

14 Efficiency Statement

- 14.1 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.

LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D

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

Brief description of "background papers"

January 2012 Investment Portfolio Analysis Report

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

*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 short-term 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 short-term 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 short-term 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 Rating Scales

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.