

COMMITTEE: Audit Committee	DATE: 14 January 2013	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO.
REPORT OF: Acting Chief Finance Officer		TITLE: Treasury Management Activity for Period Ending 30 November 2012		
ORIGINATING OFFICER(S): Alan Finch, Service Head, Finance, Risk & Accountability		Ward(s) affected: N/A		
Oladapo Shonola, Chief Financial Strategy Officer				

Lead Member	Cllr Alibor Choudhury – Resources
Community Plan Theme	All
Strategic Priority	One Tower Hamlets

1. SUMMARY

- 1.1 This report advises the Committee of treasury management activity for the current financial year up to 30 November 2012 as required by the Local Government Act 2003.
- 1.2 The report details the current credit criteria adopted by the Corporate Director - Resources, the investment strategy for the current financial year and the projected investment returns. The current average return on investment stands at 1.24%, and is on target to achieve budgeted cash return on assets of £2.395m.

2. DECISIONS REQUIRED

- 2.1 Members are recommended to note the contents of the treasury management activity report for period ending 30 November 2012.

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 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.
- 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 Service Head, Financial Services, Risk and Accountability, the investment strategy for the current financial year and the projected investment returns.

6. TREASURY MANAGEMENT STRATEGY 2012/13

- 6.1 The Council's Treasury Management Strategy was approved on 22 February 2012 by Full Council. The Strategy comprehensively outlines how the treasury function is to operate over the financial year 2012-13 and it covered 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

7. TREASURY ACTIVITY FOR PERIOD 1 April to 30 November 2012

- 7.1 This section of the report gives an update on the market and 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 30 November 2012.

8 MARKET UPDATE

- 8.1 The Eurozone debt crisis has continued to impact world economy and has depressed growth in most countries. This has however, been abated by the European Central Bank's pledge to buy unlimited amounts of bonds of countries which ask for a bailout. Market sentiment has improved considerably since this action by the ECB and the recent Eurozone commitment to support Greece and keep the Eurozone intact. Current reports on the US have shown a positive and improving economy but this is hampered by the government's discussions on ways to avert the 'fiscal cliff' of a possible recession if current tax concessions are allowed to lapse by the year end. The pace of economic growth in the US remains weak despite the Federal Reserve's liberal amounts of quantitative easing and ultra-low interest rates. Unemployment levels have been slowly reducing but against a fall in the number of those available for work. However, the housing market seems to have reached the bottom and house prices are picking up. Hopes for a broad recovery have now focused on the emerging markets.
- 8.2 The economic recovery in the UK since 2008 has been the worst and slowest recovery in recent history. Quarter 2 of 2012 was the third quarter of contraction in the economy although it returned to positive growth in the third quarter.
- 8.3 The implications of this challenging and uncertain outlook on treasury management is higher counterparty risk and relatively low investment returns, although borrowing interest rates continue to be attractive and may remain relatively low for some time. However, there is an existing threat by one of the major ratings agencies to downgrade the UK's credit rating and this may have a negative impact on the UK's borrowing costs.

9 CREDIT CRITERIA

- 9.1 The following credit criteria for investment counterparties were established by the Council in February 2012 as part of the budget setting exercise. The Council will continue to invest within the UK and its Government regardless of the country's sovereign rating. Explanation of credit ratings criteria is attached at Appendix 1.

Institution	Minimum Credit Criteria	High rating	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- Sovereign AAA	rating	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	Lesser of £70m or 40% of portfolio
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
Money Market Funds	AAA rated		In-house	£15m

*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.

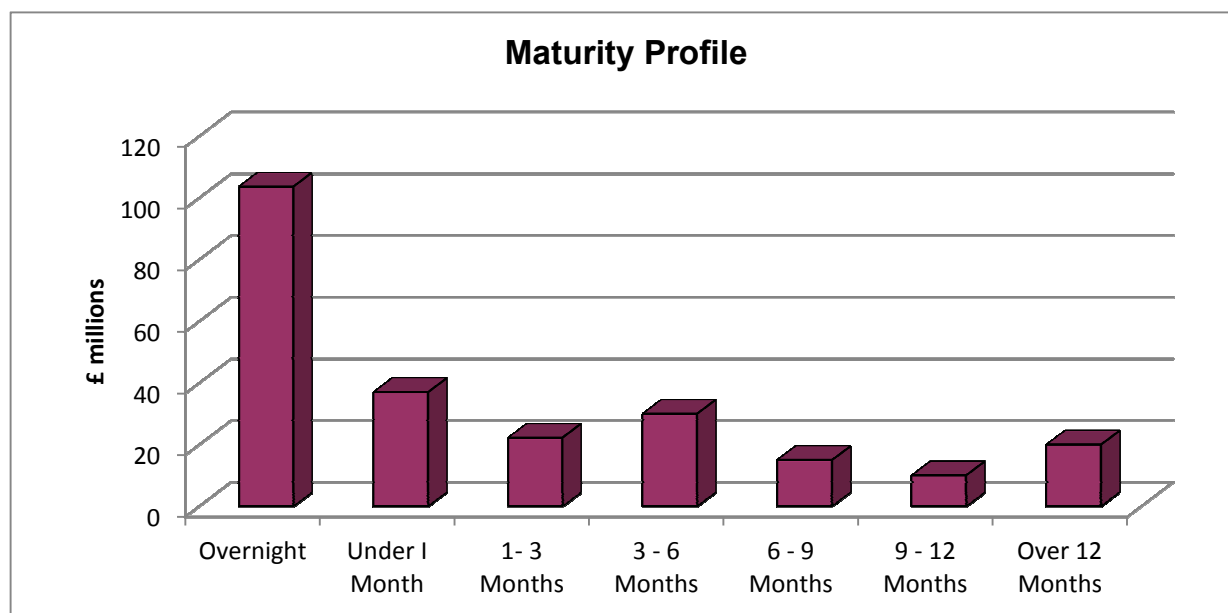
10 INVESTMENT STRATEGY

- 10.1 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.
- 10.2 In addition to providing cash management services, Sector also provides treasury consultancy/advisory service to the Council.
- 10.3 Sector's current interest rate projections are that base rate will remain static at 0.50% with limited changes in Bank Base Rate before 2015. Although, the outlook for interest rate is below expectation, budgeted return on investment is expected to be achieved this financial year.
- 10.4 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.
- 10.5 The current investment portfolio within the constraints of the Councils credit criteria and liquidity requirement together with the maturity profile of the portfolio is as set out below.

Investment Portfolio at 30 November 2012

Projection	Actual Deal			
Term	Counterparty	Maturity	Amount £M	Rate
Overnight	Deutsche Managed Sterling	MMF	15.000	0.37%
Overnight	SWIP Global Liquidity Sterling	MMF	15.000	0.34%
Overnight	Goldman Sachs	MMF	15.000	0.43%
Overnight	Ignis Liquidity Funds	MMF	15.000	0.48%
Overnight	Insight	MMF	15.000	0.42%
Overnight	DMO	Overnight	28.600	0.25%
	SUB TOTAL		103.600	
< 1 Month	Leeds City Council	10-Dec-12	3.000	0.30%
	Glasgow City Council	17-Dec-12	4.000	0.30%
	OCBC	18-Dec-12	30.000	0.35%
1 - 3 Months	Glasgow City Council	09-Jan-13	5.000	0.30%
	Salford City Council	09-Jan-13	1.200	0.30%
	Royal Bank of Scotland	11-Jan-13	5.000	0.15%
	Glasgow City Council	16-Jan-13	1.000	0.30%
	Bank of Scotland	13-Feb-13	5.000	3.10%
	Bank of Scotland	13-Feb-13	5.000	3.10%
3 - 6 Months	Bank of Scotland	11-Apr-13	10.000	3.00%
	Bank of Scotland	11-Apr-13	10.000	3.00%
	Royal Bank of Scotland	11-Apr-13	10.000	0.54%
6 - 9 Months	Royal Bank of Scotland	12-Jun-13	5.000	1.69%
	Bank of Scotland	04-Jul-13	10.000	3.00%
9 - 12 Months	Royal Bank of Scotland	11-Oct-13	5.000	2.25%
	Bank of Scotland	29-Oct-13	5.000	2.00%
Over 12 Months	Royal Bank of Scotland	12-Dec-13	5.000	2.00%
	Royal Bank of Scotland	03-Jan-14	10.000	4.00%
	Royal Bank of Scotland	27-Jan-15	5.000	3.35%
	SUB TOTAL		134.200	
	TOTAL		237.800	

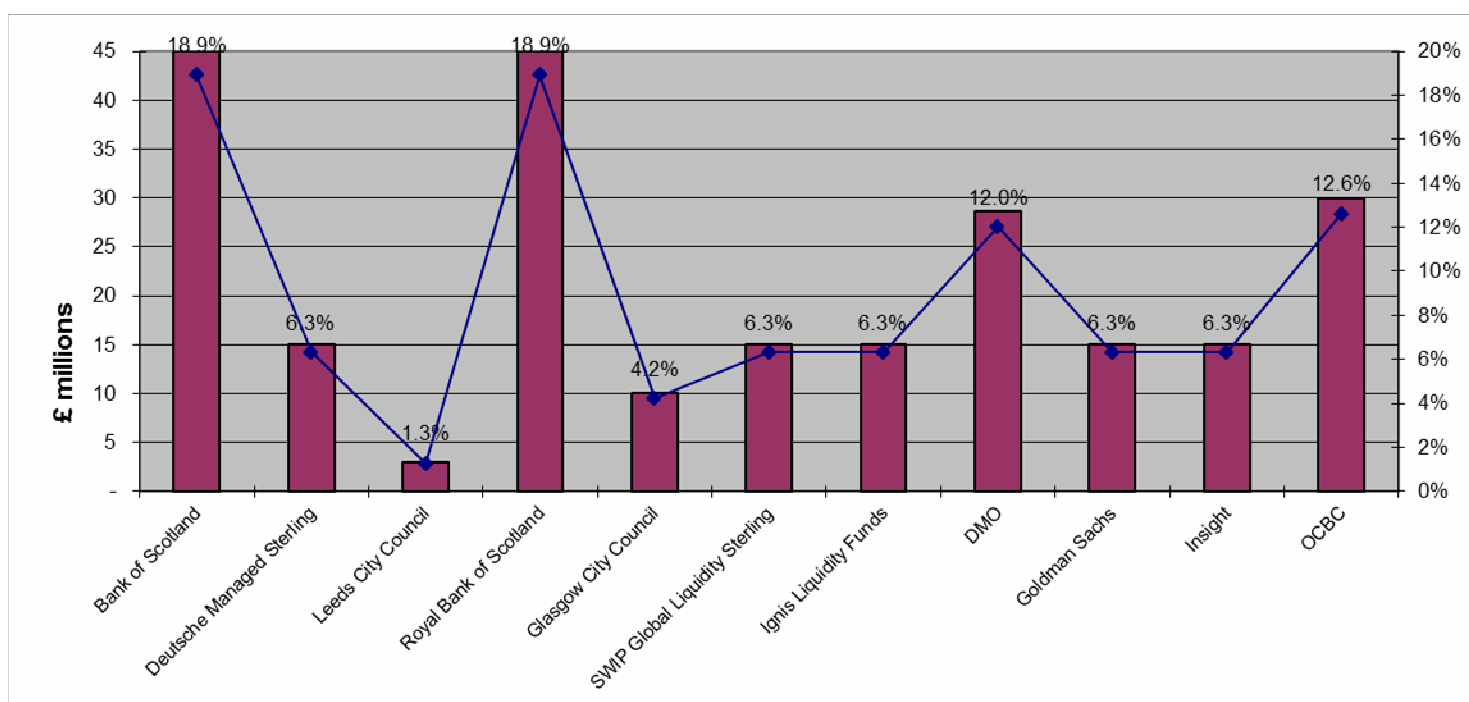
Maturity of Investment Portfolio



10.6 The amount in overnight instruments appears high because of money market fund deposits which although are technically classed as overnight investments. In reality, these are used as longer term investment vehicles. Of the £103.6m in overnight instruments, £75m is held with money market funds. This allows the Council to maintain liquidity whilst still able to secure reasonable return on its assets.

10.7 The Council's exposure to any one counterparty/Group is represented by the chart below including exposure as a percentage of total assets invested as at 30 November 2012.

Counterparty Exposure



11 INVESTMENT RETURNS

- 11.1 Investment returns since inception of the cash management arrangement with Sector has been consistently above the portfolio benchmark and the 7 day London Interbank Bid Rate (LIBID). Performance against LIBID has been strong so far but in recent months (since September 2012), the portfolio has marginally been underperforming against the portfolio benchmark, with year to date return on investment at 1.24%.
- 11.2 Though the Strategy approved at the 22 February 2012 Council allowed for more flexibility, the challenge of a counterparty list that continues to contract in the face of credit worthiness downgrades by the ratings agencies, combined with falling rates of return on the Money Market Funds (MMFs) and higher rate longer term investments which have now matured and being replaced with lower rate investments have resulted in a decline in the rate of return of the fund. The latest approved counterparty list is attached at Appendix 2.
- 11.3 Notwithstanding these constraints, the portfolio has outperformed the 7 day LIBID, which currently stands at an average of 0.40% year to date.
- 11.4 The budgeted investment return for 2012/13 is £2.395m. It is expected that this target will be achieved.
- 11.5 The table below details performance of investments. The table shows that performance has consistently outperformed LIBID.

Period	LBTH Performance	7 Day LIBID	(Under)/Over Performance
Full Year 2011/12	1.52%	0.48%	1.04%
June 2012	1.39%	0.44%	0.95%
July 2012	1.35%	0.42%	0.93%
August 2012	1.26%	0.40%	0.86%
September 2012	1.21%	0.39%	0.82%
October 2012	1.12%	0.37%	0.75%
November 2012	1.11%	0.36%	0.75%
Average YTD - 2012/13	1.24%	0.40%	0.84%

- 11.6 Following a review of the current strategy and the current market environment, a revised Treasury Management Policy Statement report was received by Full Council on 28 November 2012 requesting approval of an increase in the limits of deposits with wholly or partly owned government banks whilst maintaining a risk profile similar to the existing portfolio. These changes do not affect the period covered by this report.

12. DEBT PORTFOLIO

- 12.1 There has been no new borrowing this financial year to date. Current debt portfolio stands at £91m.

13. COMMENTS OF THE CHIEF FINANCIAL OFFICER

- 13.1. The comments of the Acting chief Finance Officer have been incorporated into the report.

14. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL)

- 14.1 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.
- 14.2 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.
- 14.3 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.

15. ONE TOWER HAMLETS CONSIDERATIONS

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

16. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

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

17. RISK MANAGEMENT IMPLICATIONS

- 17.1 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.

18. CRIME AND DISORDER REDUCTION IMPLICATIONS

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

19. EFFICIENCY STATEMENT

19.1 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"

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

November 2012 Investment Portfolio Analysis Report

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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
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

Country/Financial Institution	Credit Ratings											
	Fitch Ratings					Moody's Ratings				S&P Ratings		
	Long Term Status	Long Term	Short Term	Viability	Support	Long Term Status	Long Term	Short Term	FSR	Long Term Status	Long Term	Short Term
Australia	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Bank Nederlandse Gemeenten	SB	AAA	F1+	-	1	NO	Aaa	P-1	A	NW	AAA	A-1+
Bank of Montreal	SB	AA-	F1+	aa-	1	RD	Aa2	P-1	B-	SB	A+	A-1
Bank of New York Mellon (International) Ltd	SB	AA-	F1+	-	1	-	-	-	-	-	-	-
Bank of New York Mellon, The	SB	AA-	F1+	aa-	1	SB	Aa1	P-1	B	NO	AA-	A-1+
Bank of Nova Scotia	SB	AA-	F1+	aa-	1	RD	Aa1	P-1	B	NO	AA-	A-1+
Bank of Scotland Plc	SB	A	F1	-	1	NO	A2	P-1	D+	NO	A	A-1
Canada	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Canadian Imperial Bank of Commerce	SB	AA-	F1+	aa-	1	RD	Aa2	P-1	B-	SB	A+	A-1
Collateralised LA Deposit*	-	AAA	-	-	-	-	Aaa	-	-	-	AAA	-
DBS Bank Ltd	SB	AA-	F1+	aa-	1	NO	Aa1	P-1	B	SB	AA-	A-1+
Debt Management Office	-	AAA	-	-	-	-	Aaa	-	-	-	AAA	-
Denmark	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Finland	SB	AAA	-	-	-	SB	Aaa	-	-	NO	AAA	-
France	NO	AAA	-	-	-	NO	Aa1	-	-	NO	AA+	-
Germany	SB	AAA	-	-	-	NO	Aaa	-	-	SB	AAA	-
Landwirtschaftliche Rentenbank	SB	AAA	F1+	-	1	NO	Aaa	P-1	-	SB	AAA	A-1+
Lloyds Banking Group plc	SB	A	F1	bbb	1	NO	A3	-	-	NO	A-	A-2
Luxembourg	SB	AAA	-	-	-	NO	Aaa	-	-	NO	AAA	-
National Westminster Bank Plc	SB	A	F1	-	1	NO	A3	P-2	D+	SB	A	A-1
Netherlands	SB	AAA	-	-	-	NO	Aaa	-	-	NO	AAA	-
Nordea Bank AB	SB	AA-	F1+	aa-	1	SB	Aa3	P-1	C	NO	AA-	A-1+
Nordea Bank Finland plc ~	SB	AA-	F1+	-	1	SB	Aa3	P-1	C	NO	AA-	A-1+
Norway	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Oversea Chinese Banking Corporation Ltd	SB	AA-	F1+	aa-	1	SB	Aa1	P-1	B	SB	AA-	A-1+
Royal Bank of Scotland Group plc	SB	A	F1	bbb	1	NO	Baa1	P-2	-	SB	A-	A-2
Singapore	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Standard Chartered Bank	NO	AA-	F1+	aa-	1	SB	A1	P-1	B-	SB	AA-	A-1+
Supranationals	-	AAA	-	-	-	-	Aaa	-	-	-	AAA	-
Svenska Handelsbanken AB	SB	AA-	F1+	aa-	1	SB	Aa3	P-1	C	NO	AA-	A-1+
Sweden	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Switzerland	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
The Hong Kong and Shanghai Banking Corp	NO	AA	F1+	aa-	1	SB	Aa2	P-1	B	SB	AA-	A-1+
The Royal Bank of Scotland Plc	SB	A	F1	bbb	1	NO	A3	P-2	D+	SB	A	A-1
Toronto Dominion Bank	SB	AA-	F1+	aa-	1	RD	Aaa	P-1	B+	NO	AA-	A-1+
U.K	NO	AAA	-	-	-	NO	Aaa	-	-	SB	AAA	-
U.S.A	NO	AAA	-	-	-	NO	Aaa	-	-	NO	AA+	-
UK Gilts	-	AAA	-	-	-	-	Aaa	-	-	-	AAA	-
United Overseas Bank Ltd	SB	AA-	F1+	aa-	1	SB	Aa1	P-1	B	SB	AA-	A-1+
Wells Fargo Bank NA	SB	AA-	F1+	aa-	1	SB	Aa3	P-1	C+	NO	AA-	A-1+