

COMMITTEE: Audit Committee	DATE: 26 March 2013	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO.
REPORT OF: Acting Chief Finance Officer		TITLE: Treasury Management Activity for Period Ending 28 February 2013		
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 28 February 2013 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.
- 1.3 The current average return on investment stands at 1.25%, 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 28 February 2013.

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 revised Treasury Management Strategy was approved on 28 November 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;
 - The Minimum Revenue Provision (MRP) Strategy

7. TREASURY ACTIVITY FOR PERIOD 1 April 2012 to 28 February 2013

- 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 28 February 2013.

8 MARKET UPDATE

- 8.1 The UK economy is barely growing and remains vulnerable to a prolonged period of high inflation. There is mounting pressure on the Bank of England to take further action to improve the economic outlook, so it is expected that further quantitative easing will be implemented along with 'Funding for Lending Scheme'. Both of these measures should inject credit into the economy.
- 8.2 The general consensus is that the economy is teetering on another dip into recession, and the latest public finance figures suggest that the Chancellor will not meet his deficit reduction target for the financial year 2012/13. Furthermore, the UK's AAA rating that the Chancellor had set out to protect has now been cut by Moody's. Going forward, these issues create challenges for the Investment Strategy around balancing risk and return.
- 8.3 Reignited by the inconclusive outcome of the Italian election, fears and uncertainty about the Eurozone have returned despite assurances given by the ECB president to do whatever it takes to protect the Eurozone economies and the Euro. The economic region as a whole shows no signs of pulling out of recession, with the greater likelihood that the position will worsen before it improves. This is a problem for the UK as Europe is the UK's largest trading partner, and a weak Europe will inevitably impact on the UK economy.
- 8.4 There are also concerns about China, where there has been a slow-down in economic performance. In the USA, there are signs of an improving economy, but on-going difficulties around budget deficit reduction will likely adversely impact on the economy if not resolved.
- 8.5 The implications of this challenging and uncertain global economic outlook on investment returns, is higher counterparty risk and relatively low investment returns.

9 CREDIT CRITERIA

- 9.1 The following credit criteria for investment counterparties were agreed by the Council in November 2012. The Council will continue to invest within the UK and its Government regardless of the country's sovereign rating.

Institution	Minimum Credit Criteria	High	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 rating AAA		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.

9.2 The Council approved the 2013/14 Treasury Management Strategy Statement, Minimum Revenue Provision and Investment Strategy at its meeting on 7 March 2013. Therefore, the new Investment Strategy will take effect from 1 April 2013.

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.

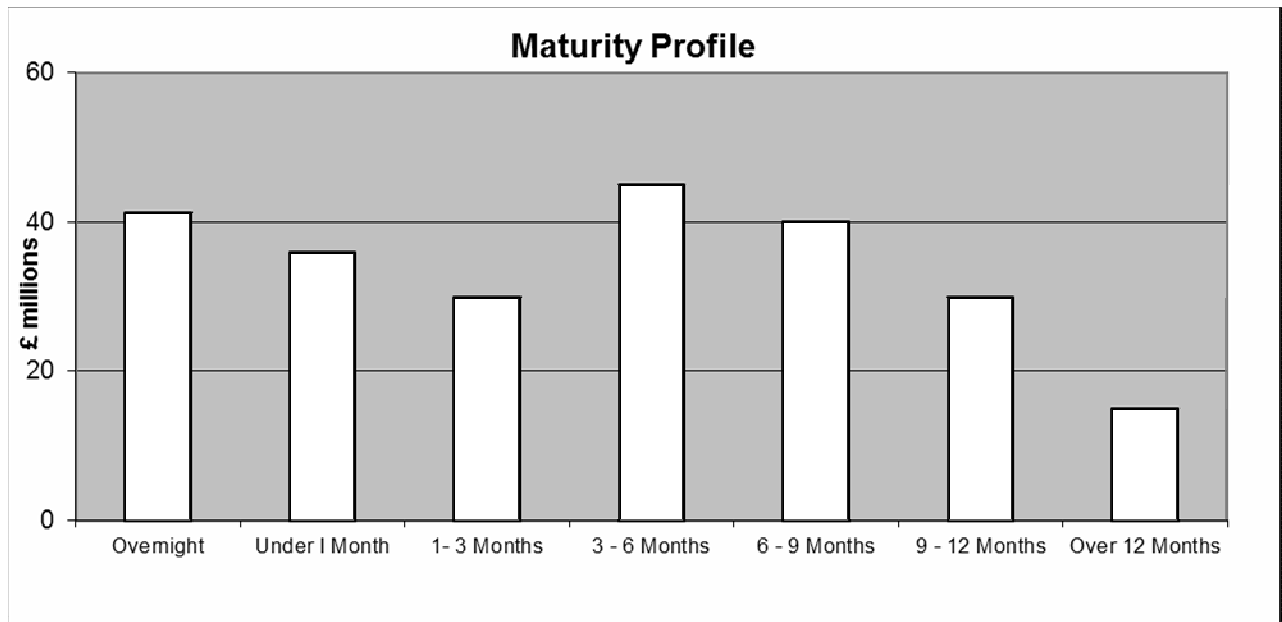
10.3 Sector's current interest rate projections are that base rate will remain static at 0.50% with limited changes in Bank Base Rate before 2015. Although the outlook for interest rate is below expectation, budgeted return on investment is expected to be achieved this financial year due to higher than expected levels of cash balances.

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 28 February 2013

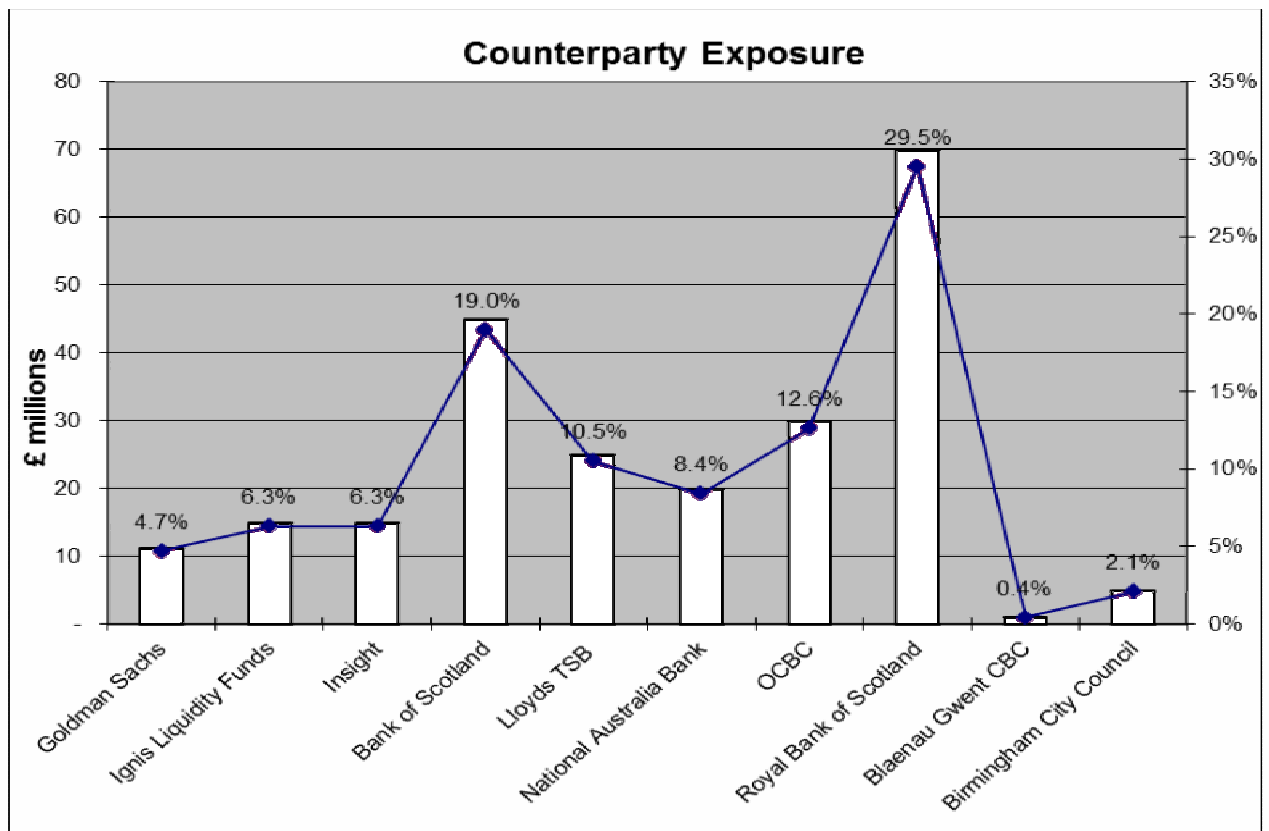
Projection	Actual Deal			
Term	Counterparty	Maturity	Amount £m	Rate
Overnight	Goldman Sachs	MMF	11.200	0.36%
Overnight	Ignis Liquidity Funds	MMF	15.000	0.45%
Overnight	Insight	MMF	15.000	0.41%
	SUB TOTAL		41.200	
< 1 Month	Lloyds TSB	04-Mar-13	5.000	0.80%
	Blaenau Gwent CBC	06-Mar-13	1.000	0.30%
	OCBC	18-Mar-13	30.000	0.35%
1 - 3 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	2.10%
3 - 6 Months	National Australia Bank	20-May-13	20.000	0.40%
	Lloyds TSB	04-Jun-13	5.000	1.00%
	Royal Bank of Scotland	12-Jun-13	5.000	1.69%
	Bank of Scotland	07-Jul-13	10.000	3.00%
	Royal Bank of Scotland	09-Jul-13	5.000	0.50%
6 - 9 Months	Lloyds TSB	04-Sep-13	5.000	1.15%
	Lloyds TSB	07-Oct-13	5.000	0.95%
	Royal Bank of Scotland	09-Oct-13	10.000	0.67%
	Royal Bank of Scotland	11-Oct-13	5.000	2.00%
	Bank of Scotland	29-Oct-13	5.000	2.25%
	Bank of Scotland	13-Nov-13	5.000	0.95%
	Birmingham City Council	18-Nov-13	5.000	0.50%
9 - 12 Months	Lloyds TSB	04-Dec-13	5.000	1.50%
	Royal Bank of Scotland	12-Dec-13	5.000	2.00%
	Royal Bank of Scotland	09-Jan-14	10.000	0.85%
	Royal Bank of Scotland	13-Jan-14	5.000	0.89%
	Bank of Scotland	13-Feb-14	5.000	1.10%
Over 12 Months	Royal Bank of Scotland	27-Jan-15	5.000	3.35%
	Royal Bank of Scotland	26-Feb-16	10.000	1.90%
	SUB TOTAL		196.000	
	TOTAL		237.200	



10.6 The amount in overnight instruments is money market fund deposits which, though technically classed as overnight investments, are in reality used as longer term investment vehicles. This allows the Council to maintain liquidity whilst still able to secure reasonable returns 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 28 February 2013.

Counterparty Exposure



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). Although performance has been trending downwards recently, year to date performance matches benchmark at 1.25%.
- 11.2 The revised Strategy approved at the 28 November 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 remains. When 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. Our latest 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, by 0.85%.
- 11.4 It is expected that the 2012/13 budgeted investment target of £2.395m will be achieved. The table below details performance of investments.

Period	LBTH Performance	7 Day LIBID	(Under)/Over Performance
Full Year 2011/12	1.52%	0.48%	1.04%
Quarter 1 2012/13	1.46%	0.45%	1.01%
Quarter 2 2012/13	1.27%	0.40%	0.87%
Quarter 3 2012/13	1.14%	0.36%	0.78%
January 2013	1.08%	0.36%	0.72%
February 2013	1.07%	0.36%	0.71%
Average for 2012/13	1.25%	0.40%	0.85%

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 Financial 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"

February 2013 Investment Portfolio Analysis Report

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

*Oladapo Shonola Ext. 4733
Mulberry Place, 4th Floor.*