

COMMITTEE: Audit Committee	DATE: 25 June 2013	CLASSIFICATION: Unrestricted	REPORT NO. AC 006/134
REPORT OF: Interim Corporate Director of Resources ORIGINATING OFFICER(S): Paul Thorogood – Interim Service Head Finance and HR Development Oladapo Shonola, Chief Financial Strategy Officer		TITLE: Treasury Management Activity for Period Ending 30 April 2013 Ward(s) affected: N/A	

1. SUMMARY

- 1.1 This report advises the Committee of treasury management activity for the current financial year to 30 April 2013 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 with the projected investment returns and the downgrading of the Co-operative Bank (the Council's relationship Bank).

2. DECISIONS REQUIRED

- 2.1 Members are recommended to:
 - Note the contents of the treasury management activity report for period ending 30 April 2013 and the recent downgrade of the Co-operative Bank.

3. REASONS FOR DECISIONS

- 3.1 The Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting) Regulations 2003 (as amended) 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 the 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 (as amended) 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 Corporate Director of Resources, 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 7 March 2013 by Full Council. The Strategy comprehensively outlines how the treasury function is to operate over the financial year 2013-14 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 April 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 30 April 2013.

8. MARKET UPDATE

- 8.1 The economic outlook remains gloomy despite the vast sums of money pumped into the system. The Eurozone remains in deep recession and unemployment continues to rise. The European Central Bank is coming under increasing pressure to offer the ailing economy support, and deflation looks to be a greater risk. There has been a relatively calm period following recent crises in a number of EU Countries, although there remains underlying worry about some peripheral members. For example, Slovenia appears to be the latest member that is likely to require some form of financial 'bailout'.
- 8.2 The US appears to be following the path of recent years, whereby the economy sees strong, uplifting data in Q1 but a subsequent failure to build on that start. The latest employment figures were disappointing suggesting that employers are uneasy about both the economic and political backdrop. China has also hit a slightly soft period which brings into question whether it can deliver its expected growth of 8% this year.
- 8.3 In the UK, GDP growth performed better than expected, thus preventing a slide into a triple dip recession. This has reduced expectations that the Bank of England (BoE) will undertake further quantitative easing in the near future. The economy however, remains vulnerable particularly with our two largest trading partners, the Eurozone and US showing weakness. Recession is not expected to be a threat to the economy but growth forecasts indicate that economic performance will be flat at best.
- 8.4 The low interest rate environment is set to continue into 2014 as the BoE continues to pump money into the economy by reinvesting funds from maturing assets purchased under Quantitative Easing and also by extending the life of the Funding for Lending Scheme (FLS). The UK Government's FLS may not have been taken up as freely as hoped but the low rate of interest at which this scheme lends, coupled with the Bank of England's QE programme has had a dampening effect on wider market rates. This and other issues in the economic update have implications on the Council's Treasury Management policy and Investment Strategy and consequently, returns on cash balances. Given the depressed economy and low interest rate environment, it is expected that achieving current/future income targets from investments will likely be challenging.

9. CREDIT CRITERIA

- 9.1 The following credit criteria for investment counterparties were established by the Council in March 2013 as part of the budget setting exercise and detailed below. The Council will continue to invest within the UK and its Government regardless of the country's sovereign rating. Definition of credit ratings is attached at Appendix 1 and the latest counterparty list is attached at Appendix 2.

Table 1 – Specified Investments

Institution	Minimum High Credit Criteria	Money Limit	Term Limit
Debt Management Office (DMO) Deposit Facility	Not applicable	No Limit	N/A
Local Authorities	Not applicable	£30m*	1 year
Bank/Building Society - (High Credit Quality)	Short-Term F1 Long-Term AA-	£30m	1 year
Bank/Building Societies - (Medium Credit Quality)	Short-Term F1 Long-Term A+	£15m	1 year
Bank/Building Societies - (Lower Credit Quality)	Short-Term F1 Long-Term A	£10m	6 months
Part Nationalised / Wholly Owned Banks	N/A	Lesser of £70m or 40% of portfolio**	1 year
Council's Own Banker***	N/A	£10m	7 days
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)			
Money Market Funds	AAA rated	£15m	Liquid

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

** Percentage of portfolio at the time of investing.

*** Limit applied where bank's rating is below minimum required for external investment

Table 2 - Non-Specified Investments:

Institution	Minimum High Credit Criteria	Money Limit	Term Limit
Bank /Building Society (High Credit Quality)	Sovereign rating AAA Short-term F1+, Long-term AA-	£25m	3 years
Part Nationalised/ Wholly Owned Banks	N/A	£25m	3 years
Structured Deposits: Fixed term deposits with variable rate and variable maturities	Sovereign rating AAA Short-term rating F1+ Long-term rating AA-	£25m	3 years
UK Government Gilts	Long Term AAA	£20m	5 years

10 INVESTMENT STRATEGY

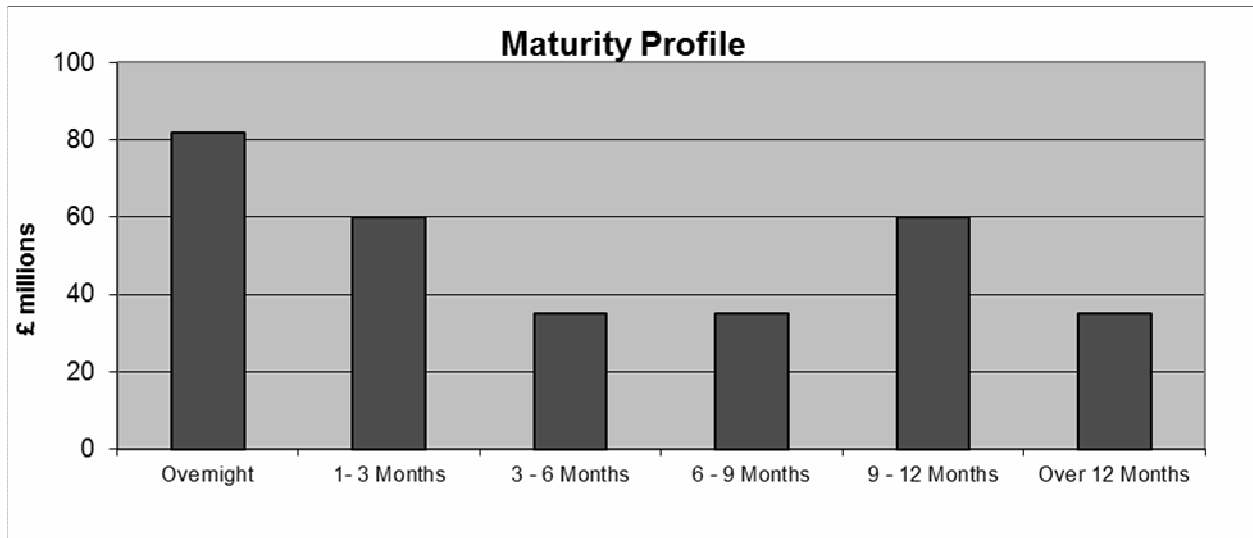
- 10.1 Sector provides cash management services to the Council, but the Council retains control of the credit criteria and the investments, so that Sector's role is purely advisory. Sector also provides treasury consultancy/advisory services to the Council.
- 10.2 Sector's current interest rate projections are that base rate will remain static at 0.5% for the current financial year with no movement in rates until 2015.
- 10.3 Given the recent downgrade of the Co-op Bank, an update is provided in section 13 of this report.
- 10.4 The current investment portfolio within the constraints of the Councils credit criteria and liquidity requirement is as set out below.

Investment Portfolio at 30 April 2013

Term	Counterparty	From	Maturity	Amount £m	Rate
Overnight	Santander		Call	10.000	0.55%
Overnight	Deutsche MMF		MMF	15.000	0.32%
Overnight	SWIP		MMF	11.700	0.28%
Overnight	Goldman Sachs		MMF	15.000	0.36%
Overnight	Ignis		MMF	15.000	0.43%
Overnight	Insight		MMF	15.000	0.39%
	SUB TOTAL			81.700	
1 - 3 Months	National Australia Bank	18-Feb-13	20-May-13	20.000	0.40%
	Lancashire County Council	18-Mar-13	20-May-13	25.000	0.40%
	Barclays Bank Plc	11-Apr-13	13-May-13	10.000	0.41%
	Nationwide Building Society	11-Apr-13	13-Jul-13	5.000	0.44%
3 - 6 Months	Lloyds TSB	04-Dec-12	04-Jun-13	5.000	1.00%
	Royal Bank of Scotland	09-Jan-13	09-Jul-13	5.000	0.50%
	Bank of Scotland	11-Apr-13	11-Oct-13	5.000	0.80%
	Nationwide Building Society	16-Apr-13	16-Oct-13	5.000	0.52%
	OCBC	17-Apr-13	17-Oct-13	10.000	0.45%
	Deutsche Bank	29-Apr-13	29-Oct-13	5.000	0.48%
6 - 9 Months	Lloyds TSB	04-Dec-12	04-Sep-13	5.000	1.15%
	Lloyds TSB	07-Jan-13	07-Oct-13	5.000	0.95%
	Royal Bank of Scotland	09-Jan-13	09-Oct-13	10.000	0.67%
	Birmingham County Council	18-Feb-13	18-Nov-13	5.000	0.50%
	Bank of Scotland	11-Apr-13	11-Jan-14	5.000	0.95%
	Bank of Scotland	11-Apr-13	13-Jan-14	5.000	0.95%
9 - 12 Months	Royal Bank of Scotland	12-Jun-12	12-Jun-13	5.000	1.69%
	Bank of Scotland	27-Jul-12	07-Jul-13	10.000	3.00%
	Lloyds TSB	04-Dec-12	04-Dec-13	5.000	1.50%
	Bank of Scotland	29-Oct-12	29-Oct-13	5.000	2.25%
	Royal Bank of Scotland	09-Jan-13	09-Jan-14	10.000	0.85%
	Bank of Scotland	13-Feb-13	13-Feb-14	5.000	1.10%
	Lloyds TSB	04-Mar-13	04-Mar-14	5.000	1.10%
	Bank of Scotland	11-Apr-13	11-Apr-14	5.000	1.10%
	Bank of Scotland	15-Apr-13	15-Apr-14	5.000	1.10%
	Royal Bank of Scotland	16-Apr-13	16-Apr-14	5.000	0.73%
Over 12 Months	Royal Bank of Scotland	27-Jan-12	27-Jan-15	5.000	3.35%
	Royal Bank of Scotland	11-Apr-12	11-Oct-13	5.000	2.00%
	Royal Bank of Scotland	12-Jun-12	12-Dec-13	5.000	2.00%
	Royal Bank of Scotland	11-Jan-13	13-Jan-14	5.000	0.89% *
	Royal Bank of Scotland	27-Feb-13	26-Feb-16	10.000	1.90% *
	Royal Bank of Scotland	16-Apr-13	16-Apr-15	5.000	0.88% *
	SUB TOTAL			225.000	
	TOTAL			306.700	

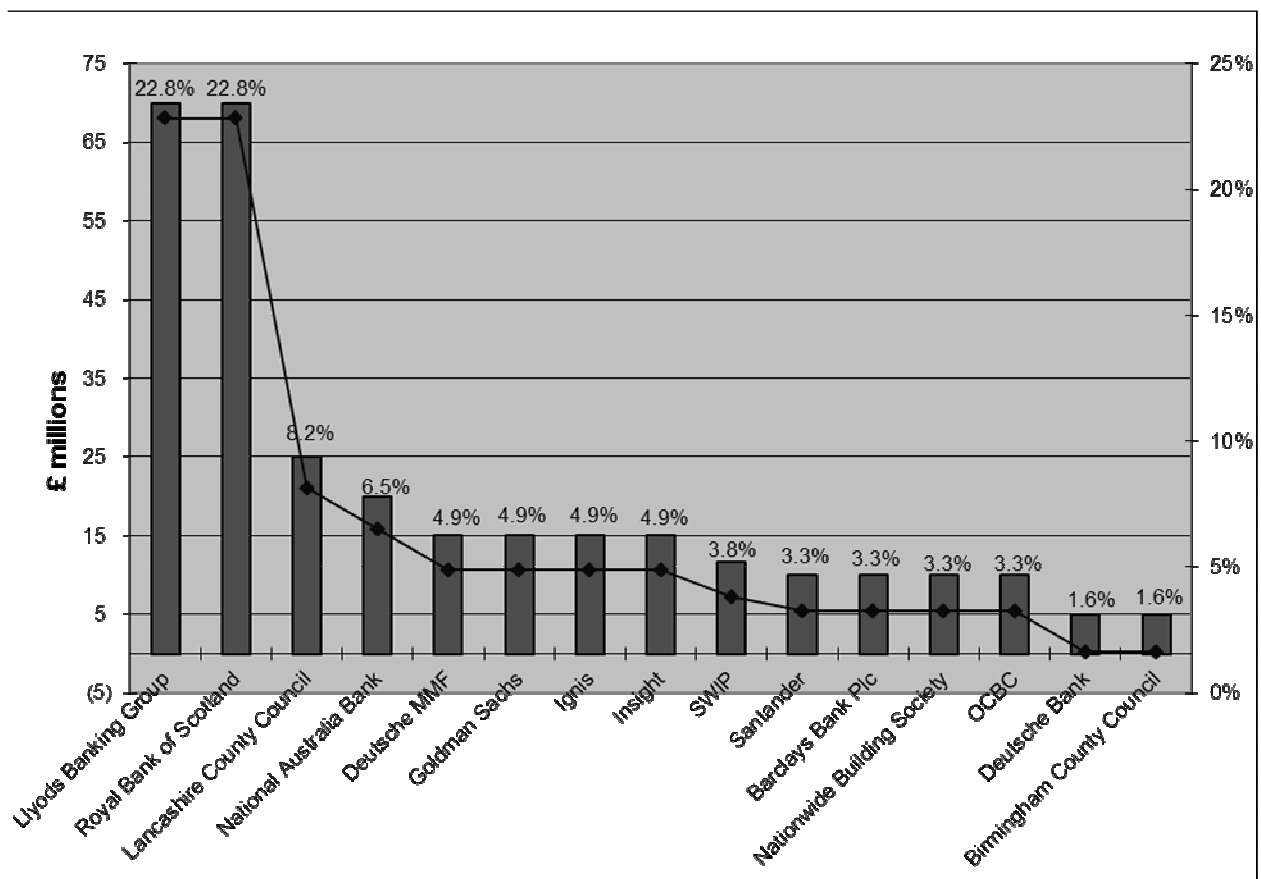
* This is a structured deal, the terms of which could change during the duration of the deal.

Maturity Structure of Investment Portfolio



10.5 The amount in overnight instruments appears high because of money market fund deposits which though technically classed as overnight investments, are in reality used as longer term investment vehicles. Of the £81.7m in overnight instruments, £71.7m is held with money market funds.

10.6 The Council's exposure to any one counterparty/Group is represented by the chart below including the Council's exposure as a percentage of total assets invested as at 30 April 2013.



11 INVESTMENT RETURNS

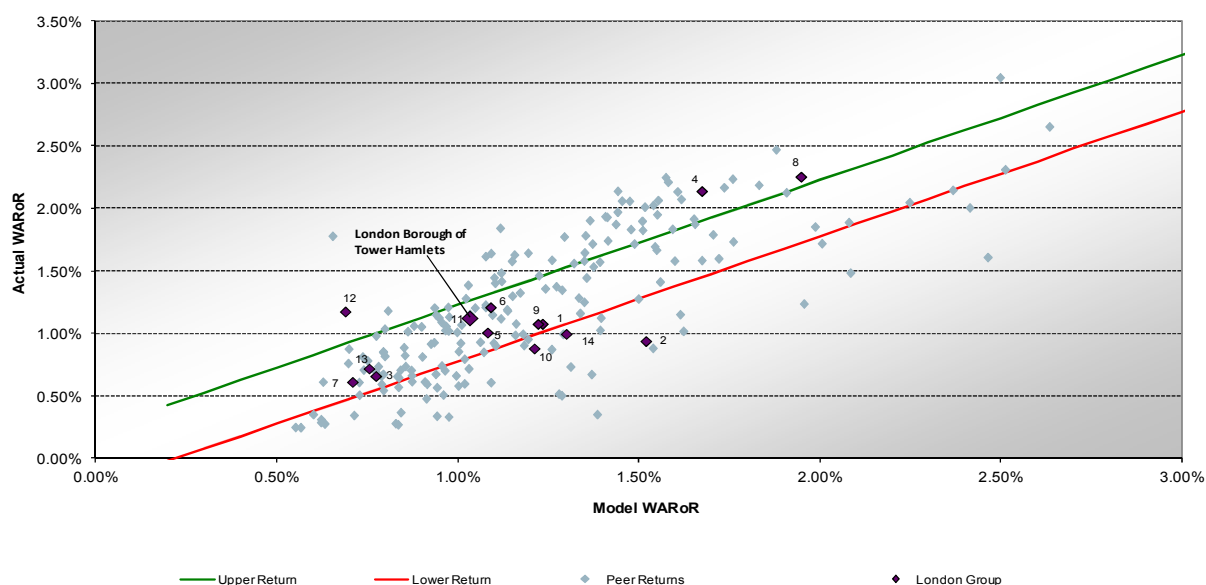
- 11.1 The Strategy approved at the 7 March 2013 Council meeting allowed for more flexibility and the benefits of this Strategy has increased the list of counterparties that the Council can invest with, therefore, providing more flexibility to officers making investment decisions. However, there remain challenges in the wider money markets and the economy which means that the low interest rate environment is set to continue for some time yet.
- 11.2 Return on investment in April 2013 was 0.92%. The portfolio outperformed benchmark (7 day London Interbank Bid Rate (LIBID) plus 0.25%) by 0.28%.

Period	LBTH Performance	Benchmark (7 Day LIBID+0.25%)	(Under)/Over Performance
Full Year 2012-13	1.24%	0.64%	0.60%
April 2013-14	0.92%	0.64%	0.28%

- 11.3 As the table shows, rates have fallen significantly. Given the investment environment and current money market rates, it is likely that the income target of £2.545m will not be achieved. Officers continue to explore options to maximise return whilst maintaining first principles of security and liquidity in any investment decision.

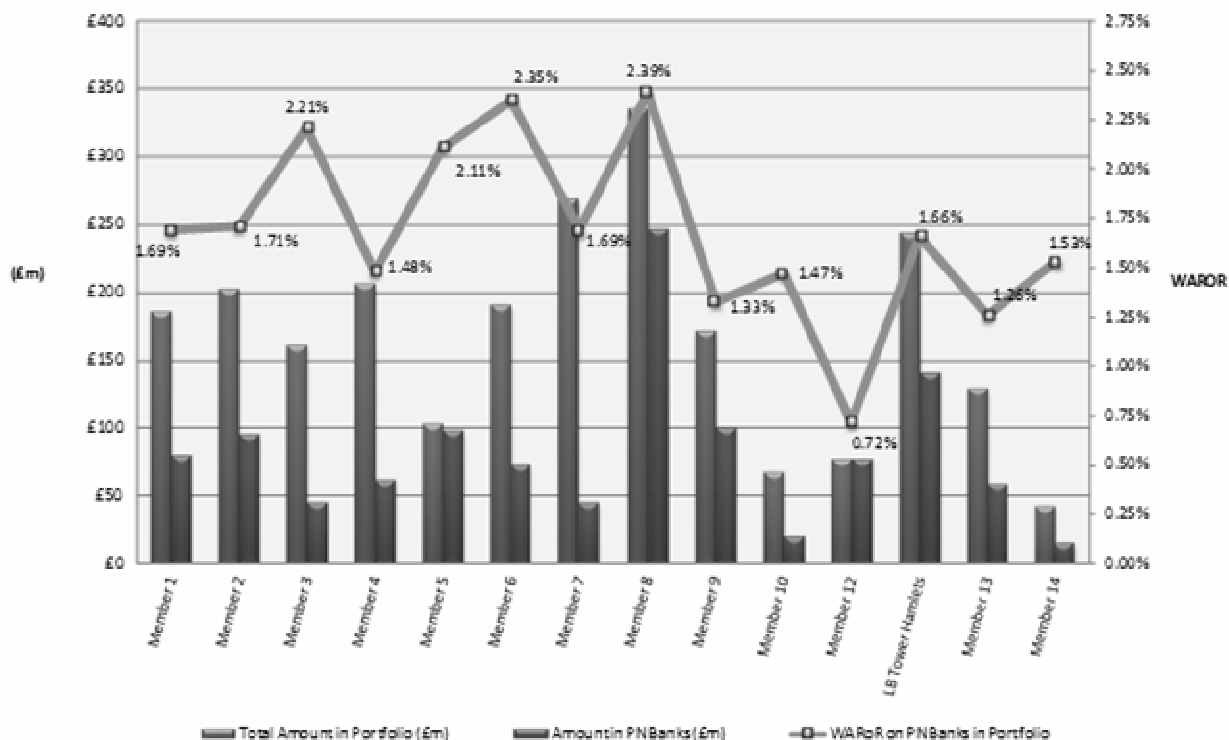
12. INVESTMENT BENCHMARKING CLUB

- 12.1 LBTH participates in a benchmarking club to enable officers compare the Council's treasury management /investment returns against those of similar authorities. The model below shows the performance of benchmark club members given the various levels of risks taken as at 31 March 2013. The model takes into account a combination of credit, duration and returns achieved over the duration, and it includes data from 201 local authorities. Tower Hamlets lies close to the expected return given the council's portfolio risk profile.



12.2 The weighted average rate of return (WARoR) for Tower Hamlets is 1.12% compared to 1.13% for the group. The return on LBTH investment is commensurate with the Council's risk appetite as set out in the Investment Strategy.

12.3 A further chart is provided that compares exposure to Part-Nationalised Banks (PNB) between club members as the Council currently has a significant amount of investment with PNBs. The chart shows that the Council's allocation to and returns from investment with PNBs is in line with other London boroughs.



12.4 The Council's current level of investments with Part –Nationalised banks is due to the support rating they enjoy from being part-owned by the Government. There is a risk to this strategy in the medium/long-term if the banks were to be privatised, thus the Council would need to either disinvest at the earliest opportunity or bring levels down to reflect the privatised banks' revised credit rating. In any case, the amount that the Council would be able to invest will be £30m depending on the privatised bank's residual credit rating.

13. CO-OPERATIVE BANK DOWNGRADE

13.1 The Co-operative Bank was recently downgraded to 'below investment grade' status by Fitch and Moody's rating agencies as a result of its capital inadequacy. The rating agencies explained that although the non-performing loan ratio of the bank's core portfolio remains stable, the quality of its non-core book has significantly weakened due to the deterioration of its commercial real estate exposures. They therefore felt that its vulnerability to losses is heightened by the low level of provisions held against its overall lending portfolio.

- 13.3 Along with majority of local authorities, the Council banks with the Co-operative Bank, and the account 'emptied' on a daily basis so that all surplus funds are invested overnight with alternative counterparties that meet the Council's minimum credit criteria. LBTH's dealing with the Co-operative Bank is thus limited to transactional, rather than investment purposes.
- 13.4 Officers will continue to work with the Council's treasury management consultants and other councils to actively monitor the situation and will report back on further developments.

14. COMMENTS OF THE CHIEF FINANCIAL OFFICER

- 14.1. The comments of the Chief Financial Officer have been incorporated into the report.

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

- 15.1 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.
- 15.2 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended by 2013 regulations to deal with equal pay compensation and the pooling of housing receipts) 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.
- 15.3 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.

16. ONE TOWER HAMLETS CONSIDERATIONS

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

17. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

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

18. RISK MANAGEMENT IMPLICATIONS

- 18.1 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.

19. CRIME AND DISORDER REDUCTION IMPLICATIONS

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

20. EFFICIENCY STATEMENT

- 20.1 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"

April 2013 Investment Portfolio Analysis Report

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

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