

Report To: Audit Committee	Date 26 September 2013	Classification Unrestricted	Report No.
REPORT OF: Corporate Director, Resources		TITLE: Treasury Management Activity for Period Ending 31 August 2013	
ORIGINATING OFFICER(S): Paul Thorogood, Service Head, Finance & HR Development Oladapo Shonola, Chief Financial Strategy Officer		WARD(S) AFFECTED: N/A	

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 31 August 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 and the projected investment returns. The current average rate of return on investment stands at 0.83%,

2. DECISIONS REQUIRED

- 2.1 Members are recommended to:
 - note the contents of the treasury management activity report for period ending 31 August 2013.

3 REASONS FOR DECISIONS

- 3.1 Legislation requires 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.
- 4.3 Within reason, the Council can vary its treasury management strategy having regard to its own views about its appetite for risk in relation to the financial returns required.

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 Corporate Director of Resources, the investment strategy for the current financial year and the projected investment returns.

6. TREASURY MANAGEMENT STRATEGY 2013/14

- 6.1 The Council's Treasury Management Strategy was approved on 13 February 2013 by Full Council. The Strategy comprehensively outlines how the treasury function is to operate over the financial year 2013-14 and it covers the following:
- Treasury limits in force which will limit the treasury risk and activities of the Council;
 - Prudential and Treasury Indicators;
 - 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 31 August 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 31 August 2013.

8 MARKET UPDATE

- 8.1 Markets are generally volatile due to the uncertainty surrounding global outlook for economic growth.
- 8.2 Economic data in the UK show that there has been some sustained improvement, albeit at a modest level. The initial estimate for Q2 GDP growth showed that the economy has expanded at a far healthier rate than Q1 and early releases relating to Q3 suggest that the pattern has continued.
- 8.3 The availability of, and rate of borrowing on mortgages in the UK has brought buyers back to the market, which has been further boosted by Government intervention via the Funding for Lending and Help to Buy schemes. However, there are plenty of headwinds facing the economy that could stunt economic growth such as the problems in the Eurozone, which remain mired in recession. Export opportunities within the Eurozone remain weak, forcing UK exporters to look beyond Europe to sell goods.
- 8.3 The Eurozone remains an area of concern. Apart from Germany, the bloc's struggles have continued as the impact of austerity and global economic recession continue to affect members' economies, leaving the overall EU economy falling into deepening recession and record high unemployment. However, there are some promising signs from the region recently. Economic indicators in Germany, Italy and Spain have improved, offering some hope that the worst may be over. The European Central Bank has been able to maintain its low interest rate policy but, unlike the Bank of England, does not face an underlying inflation problem. Overall, there's more optimistic feel to EU despite other frailties in the Eurozone economy.
- 8.4 In the US, investors remain unclear as to when the Federal Reserve will start to taper its asset purchasing programme. Recent data has been more positive which has increased speculation that the tapering will commence sooner rather than later, although this uncertainty has generated market volatility.
- 8.5 China continues to raise concerns given the on-going struggle to maintain levels of growth that the Chinese authorities have targeted. Export markets remain weak with domestic demand failing to meet the shortfall of overseas demand. This uncertainty is set to continue for a while. Japan is starting to see some impact from the massive monetary actions that the Prime Minister has committed to in order to support and reflate the economy.

9 CREDIT CRITERIA

- 9.1 The following credit criteria for investment counterparties were established by the Council in February 2013 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.

INVESTMENT STRATEGY

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

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.

Definitions of credit ratings (which now incorporate Fitch's viability ratings) are attached at [Appendix 1](#).

* 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

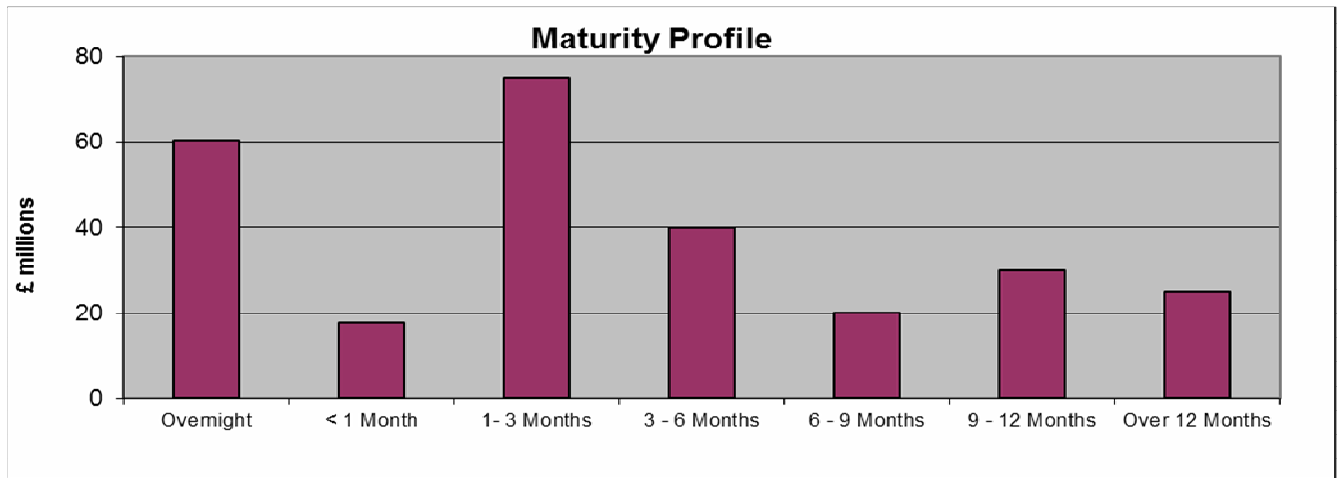
10.2 In addition to providing cash management services, Sector also provides treasury consultancy/advisory service to the Council.

10.3 The outlook for interest rates indicates a growing belief that central banks are keen to keep rates low for a prolonged period, to encourage global growth. Sector's view on interest rate is that bank rate is unlikely to rise before the 4th quarter of 2016. If and when rates do start to rise, the Council's cash management portfolio will be in a position to take advantage of rising interest rates.

10.4 The current balance of £268m is £93m higher than the projected average cash balance of £175m. This is mainly attributable to slippage on the capital programme and an increase in earmarked reserves. It is envisaged that cash balances will reduce in the medium term as expenditure on the capital programme and earmarked revenue expenditure catch up.

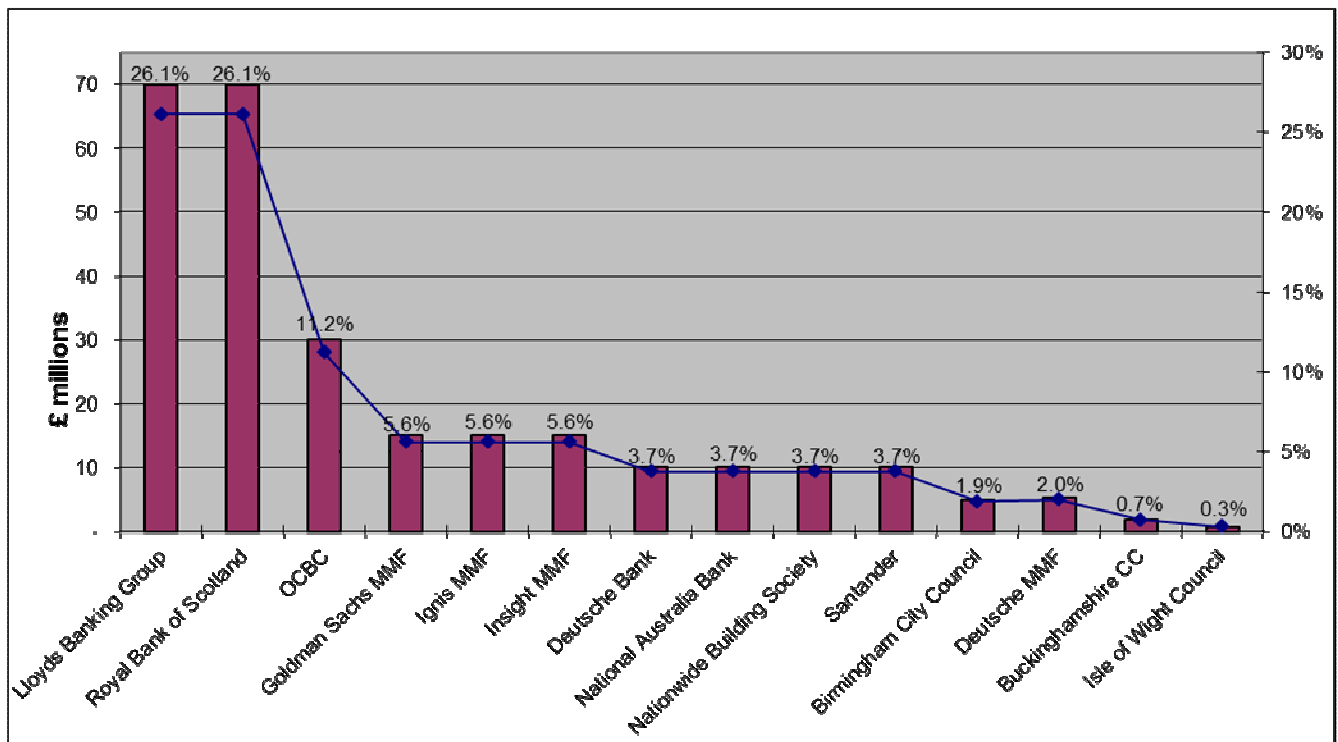
10.5 Current investment portfolio is as set out below.

Investment Portfolio at 31 August 2013



10.6 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 31 August 2013.

Maturity of Investment Portfolio as at 31 August 2013



10.7 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 £60.3m in overnight instruments, £50.3m is held with money market funds. This allows the Council to maintain liquidity whilst still able to secure reasonable return on its assets.

10.8 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 August 2013.

Counterparty Exposure as at 31 August 2013

Time to Maturity	Counterparty	From	Maturity	Amount £m	Rate
Overnight	Santander		Call	10.00	0.55%
Overnight	Deutsche MMF		MMF	5.30	0.32%
Overnight	Goldman Sachs		MMF	15.00	0.37%
Overnight	Ignis		MMF	15.00	0.43%
Overnight	Insight		MMF	15.00	0.39%
	SUB TOTAL			60.30	
< 1 Month	Isle of Wight Council	30/08/2013	02/09/2013	0.75	0.50%
	Buckinghamshire CC	30/08/2013	02/09/2013	1.90	0.55%
	Lloyds Banking Group	04/12/2012	04/09/2013	5.00	1.15%
	OCBC	11/06/2013	11/09/2013	10.00	0.40%
1 - 3 Months	Lloyds Banking Group	07/01/2013	07/10/2013	5.00	0.95%
	Royal Bank of Scotland	09/01/2013	09/10/2013	10.00	0.67%
	Royal Bank of Scotland	11/04/2012	11/10/2013	5.00	2.00%
	Lloyds Banking Group	11/04/2013	11/10/2013	5.00	0.80%
	Nationwide Building Society	11/07/2013	11/10/2013	5.00	0.44%
	Society	16/04/2013	16/10/2013	5.00	0.52%
	OCBC	17/04/2013	17/10/2013	10.00	0.45%
	Lloyds Banking Group	29/10/2012	29/10/2013	5.00	2.25%
	Deutsche Bank	29/04/2013	29/10/2013	5.00	0.48%
	Deutsche Bank	02/08/2013	04/11/2013	5.00	0.40%
	OCBC	02/08/2013	04/11/2013	5.00	0.40%
	Lloyds Banking Group	13/02/2013	13/11/2013	5.00	0.95%
	Birmingham City Council	18-Feb-13	18-Nov-13	5.00	0.50%
3 - 6 Months	Lloyds Banking Group	04/12/2012	04/12/2013	5.00	1.50%
	Royal Bank of Scotland	12/06/2012	12/12/2013	5.00	2.00%
	Royal Bank of Scotland	09/01/2013	09/01/2014	10.00	0.85%
	Royal Bank of Scotland	11/01/2013	13/01/2014	5.00	0.89%
	Lloyds Banking Group	11/04/2013	13/01/2014	5.00	0.95%
	OCBC	12/08/2013	12/02/2014	5.00	0.40%
	Lloyds Banking Group	13/02/2013	13/02/2014	5.00	1.10%
6 - 9 Months	Lloyds Banking Group	04/03/2013	04/03/2014	5.00	1.10%
	Lloyds Banking Group	11/04/2013	11/04/2014	5.00	1.10%
	Lloyds Banking Group	15/04/2013	15/04/2014	5.00	1.10%
	Royal Bank of Scotland	16/04/2013	16/04/2014	5.00	0.73%
9 - 12 Months	Lloyds Banking Group	04/06/2013	04/06/2014	5.00	1.05%
	Royal Bank of Scotland	12/06/2013	12/06/2014	5.00	0.65%
	National Australia Bank	03/07/2013	03/07/2014	10.00	0.62%
	Lloyds Banking Group	04/04/2013	04/07/2014	10.00	1.01%
Over 12 Months	Royal Bank of Scotland	09/07/2013	09/01/2015	5.00	0.95%
	Royal Bank of Scotland	27/01/2012	27/01/2015	5.00	3.35%
	Royal Bank of Scotland	16/04/2013	16/04/2015	5.00	0.88%
	Royal Bank of Scotland	28/02/2013	26/02/2016	10.00	1.90% *
	SUB TOTAL			207.65	
	TOTAL			267.95	

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

INVESTMENT RETURNS

- 11.1 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 against LIBID and benchmark has been strong so far, with year to date return on investment at 0.83% compared to 1.24% average in 2012/13.
- 11.2 The Strategy approved at the 13 February 2013 Council allowed for more flexibility and the benefits of this Strategy is proving extremely valuable given the challenge of a counterparty list that continues to contract in the face of credit worthiness downgrades by the ratings agencies. The latest counterparty list is attached at Appendix 2.
- 11.3 The portfolio has outperformed the benchmark of LIBID + 0.25% in the first five months of the year and returns are significantly above the 7 day London Interbank Bid Rate (LIBID), which currently stands at 0.36%. Cash balances have fallen, with the average year to date falling to £293m and range of balances remained fairly wide at £267m to a high of £319m. Nevertheless, the average rate of return over the month of August (0.81%) was helped by reduced balances on the low paying Money Market Funds. Counterparty pressures have also eased in recent months.
- 11.4 Below is a table that details performance of investments. The table shows that performance has consistently exceeded benchmark (LIBID + 0.25%).

Performance Against Benchmark

Period	LBTH Performance	7 Day LIBID + 0.25%	(Under)/Out Performance
Full Year 2012/13	1.24%	0.64%	0.60%
April 2013	0.92%	0.62%	0.30%
May 2013	0.83%	0.61%	0.22%
June 2013	0.82%	0.61%	0.21%
July 2013	0.79%	0.61%	0.18%
August 2013	0.81%	0.61%	0.20%
Average for 2013/14	0.83%	0.61%	0.22%

12 DEBT PORTFOLIO

12.1 The table below sets out the Council's debt as at the beginning of the year and 31 August 2013.

	31 March 2013 Principal	31 August 2013 Principal
£'000		
Fixed Rate Funding:		
-PWLB	12,908	12,406
-Market	13,000	13,000
Total Fixed Rate Funding	25,908	25,406
Variable Rate Funding:		
-PWLB	-	-
-Market	64,500	64,500
Total Variable Rate Funding	64,500	64,500
Total debt	90,408	89,906
CFR	225,849	225,849
Over/ (under) borrowing	(135,441)	(135,943)

12.2 No borrowing has been undertaken to date in this financial year but the Council repaid £0.502m of PWLB loans. Total debt outstanding now stands at £89.906m, resulting in an under-borrowing of £135.94m against a CFR of £225.85m.

14. COMMENTS OF THE CHIEF FINANCIAL OFFICER

14.1. The comments of the Acting Corporate Director Resources have been incorporated into the report of which he is the author.

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 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"

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

*August 2013 Investment Portfolio Analysis
Report*

*Oladapo Shonola Ext. 4733
Mulberry Place, 3rd Floor.*