

Report To: <b>Audit Committee</b>	Date <b>17 December 2013</b>	Classification <b>Unrestricted</b>	Report No.
REPORT OF: <b>Corporate Director, Resources</b>		<b>Treasury Management Activity for Period Ending 31 October 2013</b>	
ORIGINATING OFFICER(S): <b>Paul Thorogood, Service Head, Finance &amp; HR Development</b>		WARD(S) AFFECTED: N/A	

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

## **1. SUMMARY**

- 1.1 This report advises the Committee of treasury management activity for the current financial year up to 31 October 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 October 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 October 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 October 2013.

## **8 MARKET UPDATE**

- 8.1 Economic recovery in the UK has continued with GDP growth in Q2 confirmed at 0.7% with expectation of a further acceleration in Q3. Economic data indicate that growth of over 1% is likely in Q3. .
- 8.2 In its latest quarterly Inflation Report this month, the Bank of England shortened the expectation of a first increase in Bank Rate to as early as the end of 2014. Financial markets have also moved their expectations back to Q2 2015. However, the BOE has emphasised that reaching a 7% unemployment rate is not a trigger for the first increase in Bank Rate but is only an assurance that they will not increase Bank Rate before the 7% unemployment rate is reached. Given the disconnect between improving economic performance and reduction in jobless numbers, expectations of a Q2 2015 interest rate rise may be somewhat optimistic.
- 8.3 The Eurozone economy continues to show signs of modest recovery but remain heavily dependent on the performance of Germany. Exports from the Eurozone are being hampered by the slowing down in global demand and the strength of the Euro. However, there are still ongoing concerns with the economies of some of the countries in the Eurozone.
- 8.4 Ireland has made very good progress towards probably being able to exit from its bail out soon, but it looks increasingly likely that Greece is now going to need a third bailout package, though not one on the same scale as the first two. Concerns are also rising over Portugal requiring another bailout. Slovenia looks increasingly like it is heading towards a bailout. A growing lack of confidence in the EZ austerity programmes could cause bond yields to rise for EZ countries. This could help maintain UK gilts as a safe haven and so keep gilt yields depressed for longer at current levels.
- 8.4 In the US, the Federal government went into temporary shutdown after the Democrats and Republicans failed to reach a sustainable compromise on the dual fiscal problem of the budget setting and agreement on a new debt ceiling - the shutdown lasted for eighteen days. The US government agreed to delay a longer term decision on these issues until early 2014 with bi-party negotiations continuing in the interim. Initial forecast indicate that the shutdown had far less impact on the economy than had been predicted - Analysts expect that growth could slow down in Q4 2013 as a result of the shutdown, but expect this to be made up in Q1 of 2014.
- 8.5 There has been more positive data coming out of China which suggest that the authorities have managed to arrest the slowing down of the economy and achieved stability. However, growth will be dependent upon conditions in other countries and regions to maintain and improve this position

## **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.

## 10. INVESTMENT STRATEGY

10.1 Capita provides cash management services to the Council, but the Council retains control of the credit criteria and the investments, thus, Capita's role is purely advisory.

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

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
<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)</b>			
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

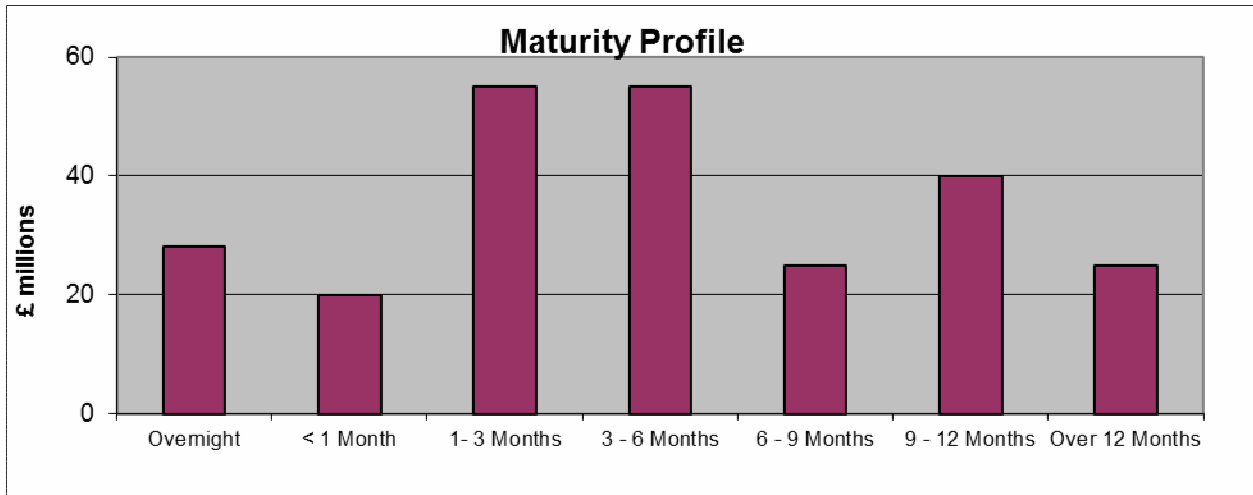
10.2 In addition to providing cash management services, Capita also provides treasury consultancy/advisory service to the Council.

10.3 Capita's latest view of the first increase in Bank of England base rate has now marginally moved forward from Q3 2015 to Q2 2016, forecasting Bank Rate to reach 1.25% in Q1 2017. Capita believe that this is a slow rate of increase because as there are still major reservations about the strength and sustainability of the UK's recent economic growth which was down largely to increases in consumer spending and an uplift in borrowing to buy property.

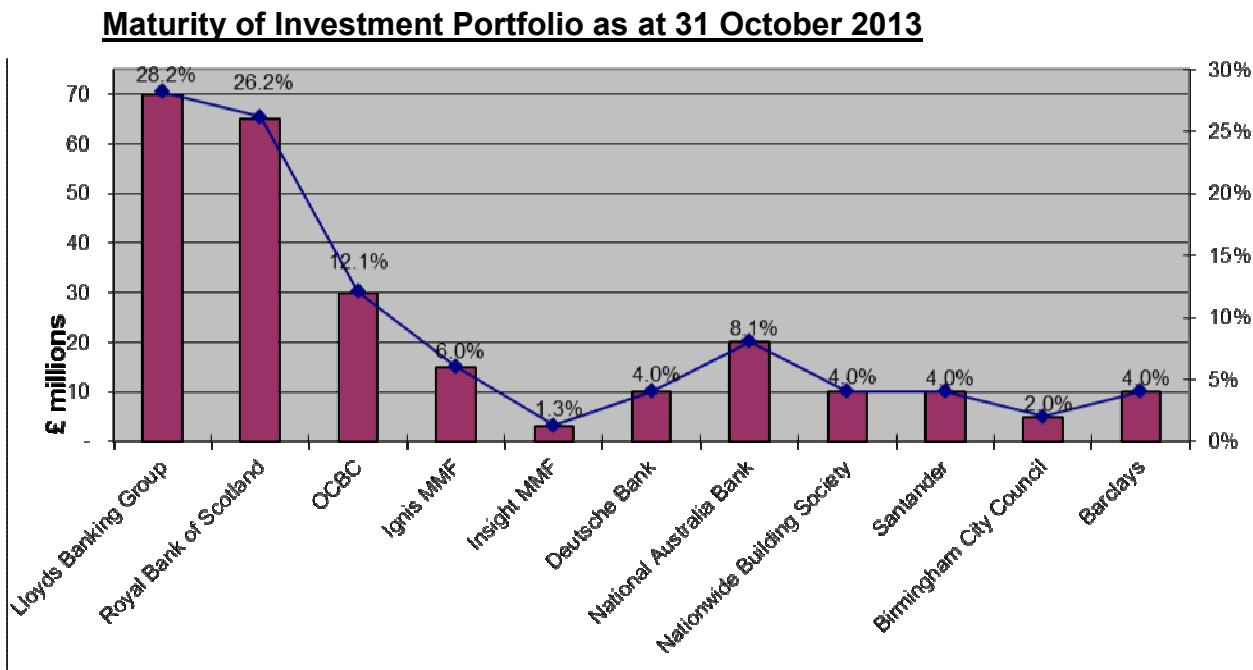
10.4 The current cash balance of £248.2m is £68.2m higher than the projected average cash balance of £180m. This is mainly attributable to slippage on the capital programme and an increase in earmarked reserves. It is envisaged that cash balances will reduce in the medium term as expenditure on the capital programme and earmarked revenue expenditure catch up.

10.5 Current investment portfolio is as set out below.

**Investment Portfolio at 31 October 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 October 2013.



10.7 Money Market Fund deposits which, though technically classed as overnight investments, are in reality, used as longer term investment vehicles. Of the £28.2m in overnight instruments, £18.2m is held with money market funds and the balance of £10m in a call account. This allows the Council to maintain liquidity whilst still being able to secure reasonable return on its assets.

10.8 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 October 2013.

**Counterparty Exposure as at 31 October 2013**

<b>Time to Maturity</b>	<b>Counterparty</b>	<b>From</b>	<b>Maturity</b>	<b>Amount £m</b>	<b>Rate</b>
<b>Overnight</b>	Santander		<b>Call</b>	10.00	0.55%
<b>Overnight</b>	Ignis MMF		MMF	15.00	0.44%
<b>Overnight</b>	Insight MMF		MMF	3.20	0.40%
	<b>SUB TOTAL</b>			<b>28.20</b>	
<b>&lt; 1 Month</b>	OCBC	02/08/2013	04/11/2013	5.00	0.40%
	Deutsche Bank	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	18/02/2013	18/11/2013	5.00	0.50%
<b>1 - 3 Months</b>	Lloyds Banking Group	04/12/2012	04/12/2013	5.00	1.50%
	Lloyds Banking Group	04/09/2013	04/12/2013	5.00	0.70%
	Royal Bank of Scotland	12/06/2012	12/12/2013	5.00	2.00%
	OCBC	12/09/2013	12/12/2013	10.00	0.42%
	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%
<b>3 - 6 Months</b>	Lloyds Banking Group	04/03/2013	04/03/2014	5.00	1.10%
	Barclays	05/09/2013	05/03/2014	10.00	0.53%
	Lloyds Banking Group	11/04/2013	11/04/2014	5.00	1.10%
	Nationwide Building Society	11/10/2013	11/04/2014	5.00	0.53%
	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%
	Nationwide Building Society	16/10/2013	16/04/2014	5.00	0.53%
	OCBC	17/10/2013	17/04/2014	10.00	0.45%
	Deutsche Bank	29/10/2013	29/04/2014	5.00	0.50%
<b>6 - 9 Months</b>	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%
	Lloyds Banking Group	04/04/2013	04/07/2014	10.00	1.01%
	Lloyds Banking Group	11/10/2013	11/07/2014	5.00	0.83%
<b>9 - 12 Months</b>	National Australia Bank	18/09/2013	18/09/2014	10.00	0.58%
	National Australia Bank	03/10/2013	03/10/2014	10.00	0.58%
	Lloyds Banking Group	07/10/2013	07/10/2014	5.00	0.98%
	Royal Bank of Scotland	09/10/2013	09/10/2014	10.00	0.59%
	Lloyds Banking Group	29/10/2013	29/10/2014	5.00	0.98%
<b>Over 12 Months</b>	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% *
	<b>SUB TOTAL</b>			<b>220.00</b>	
	<b>TOTAL</b>			<b>248.20</b>	

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

## 11. INVESTMENT RETURNS

- 11.1 Investment returns since inception of the cash management arrangement with Capita have been consistently above the portfolio benchmark and the London Interbank Bid Rate (LIBID). Year to date return on investment is 0.83% compared to the full year average of 1.24% in 2012/13.
- 11.2 The 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 outperformed the benchmark of LIBID + 0.25% in the first seven 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 £283m and range of balances remained fairly wide at £248m to a high of £318m. Nevertheless, the average rate of return over the month of October (0.81%) was helped by reduced balances on the low paying Money Market Funds.
- 11.4 The table below details performance of investments. It shows that performance has consistently exceeded benchmark (LIBID + 0.25%).

#### **Performance Against Benchmark**

<b>Period</b>	<b>LBTH Performance</b>	<b>7 Day LIBID + 0.25%</b>	<b>(Under)/Out Performance</b>
<b>Full Year 2012/13</b>	<b>1.24%</b>	<b>0.64%</b>	<b>0.60%</b>
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%
September 2013	0.82%	0.61%	0.21%
October 2013	0.81%	0.60%	0.21%
<b>Average for 2013/14</b>	<b>0.83%</b>	<b>0.61%</b>	<b>0.22%</b>

## 12 DEBT PORTFOLIO

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

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

12.2 No borrowing has been undertaken in this financial year to date and the Council repaid £0.502m of PWLB loans in June 2013, with a further £0.343m to be repaid in March 2013. Total debt outstanding now stands at £89.906m against a CFR of £225.85m, resulting in an under-borrowing position of £135.94m.

## 13. COMMENTS OF THE CHIEF FINANCIAL OFFICER

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

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

14.1 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 It is a key principle of the Treasury Management Code that an authority should put in place "comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities". 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. It is consistent with the key principles expressed in the Treasury Management Code for the Council to review performance against the strategies and policies it has adopted.

- 14.4 When discharging its treasury management functions, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don't. Information is contained in section 15 of the report relevant to these considerations.

## **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.

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### **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***

*October 2013 Investment Portfolio Analysis Report*

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