Report To:	Date	Classification	Report No.
Audit Committee	**17 March 2015**	**Unrestricted**	

REPORT OF: **Chris Holme, Acting Corporate Director of Resources** ORIGINATING OFFICER(S): **Bola Tobun, Investment & Treasury Manager**	**Treasury Management Activity for Period Ending 31 January 2015** 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 January 2015 and the continued appropriateness of the Treasury Management Strategy and Treasury Prudential Indicators, which were approved by Council on 26 February 2014 as required by the Local Government Act 2003.

1.2 The report details the current credit criteria adopted by the Acting Corporate Director of Resources, the investment strategy for the current financial year and the projected investment returns.

1.3 The current average return on investment stands at 0.72%, compared with budget set of 0.80%, whilst the budgeted cash return on assets was £1.6m for 2014/15; this has been revised to £2.7m due to large cash balances.

1.4 In accordance with regulatory requirements the Council has approved Prudential Indicators for Treasury Management. Treasury activities have not resulted in any breach of the approved limits. An annual Treasury Management Strategy Statement was presented and approved by Council at its meeting of the 25 February 2015.

2. DECISIONS REQUIRED

2.1 Members are recommended to:

- note the contents of the treasury management activity report for period ending 31 January 2015.

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 the 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.

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 2014/15

6.1 The Council's Treasury Management Strategy was approved on 26 February 2014 by Full Council. The Strategy comprehensively outlines how the treasury function is to operate over the financial year 2014-15 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 January 2015

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 January 2015.

8 MARKET UPDATE (January 2015)

8.1 The February Bank of England (BoE) Inflation Report highlighted that the strong performance the UK economy has shown is likely to continue into the foreseeable future. Inflation is forecast to remain below 1% for 2015, with the BoE suggesting that it could possibly enter negative territory in the first half of 2015 if energy prices remain low. For the first time, the BoE has said it would be prepared to further cut bank rate or resume QE if global activity weakened and threatened the UK economy.

8.2 The BoE opted to keep interest rates at their record low of 0.5% in February. The MPC minutes for the February meeting revealed that the vote was 9-0 for the second month running, given the weak short-term outlook for inflation.

8.3 The headline inflation figure fell to 0.3% in January, the lowest level since records began in 1989, leaving the Bank of England under no pressure to raise interest rates.

8.4 The pace of growth in UK economy slowed in Q4 2014. The first estimate showed that growth in gross domestic product slowed to 0.5%, down from 0.7% in Q3.

8.5 The UK unemployment rate fell to 5.7% in the three months to December with the number of people in employment rising by 103,000. Average weekly earnings, including bonuses, rose by 2.4% in annual terms in the month of December, outstripping inflation by the most in several years.

8.6 The Coalition Government is hampered in promoting growth by the need to tackle the budget deficit.

8.7 There is little sign of a coordinated strategy for the private sector to finance a major expansion of infrastructure investment to boost UK growth.

8.8 According to Nationwide, house prices rose by 0.3% in January and rose by 6.8% when compared with the same period last year.

US

8.9 US GDP expanded to 2.6% at an annualised rate in Q4, down from an expansion of 5% in Q3. This was due to weak business spending combined with a wider trade deficit offsetting consumer spending.

8.10 In October 2014, the Fed announced that it had ended its Quantitative Easing programme, showing confidence in the US economy. The Fed will, nonetheless, continue to reinvest the maturing securities each month to maintain a balance sheet of over $4 trillion.

8.11 The Fed has stated that it will remain “patient” in deciding when to raise interest rates despite drastic moves made by other central banks this month. The central bank acknowledged a decline in certain inflation measures, but seems confident about a strong labour market and growth.

EU

8.12 Growth in Eurozone GDP rose to 0.3% in Q4 2014, up from 0.2% in Q3. Growth however is still too weak to reduce the threat of deflation indicating a slowdown may be to come.

8.13 Austerity programmes in various countries have had a significant effect in reducing growth rates.

8.14 Following the European Central Bank's (ECB) meeting in January, its interest rate was held at 0.05%. The ECB also maintained a negative deposit rate, at -0.20%. The ECB announced their Quantitative Easing programme at this meeting and said they would inject at least €1.1 trillion into the ailing economy. The programme will begin in March 2015 and they will buy bonds worth €60bn per month until the end of September 2016.

8.15 The decision to cut interest rates and embark on a QE programme was made in order to spur economic growth and stave off the threat of deflation.

China

8.16 The economy remains hugely unbalanced towards new investment expenditure. Major concerns have surfaced over rapid expansion of credit and the exposure of banks to a potential bursting of a bubble in the property market.

9 CREDIT CRITERIA

9.1 The credit criteria for investment counterparties were reviewed, amended and reported for approval to the Council in February 2015 as part of the annual Treasury Management Strategy Statement for 2015/16. The Council will continue to invest within the UK and its Government regardless of the country's sovereign rating.

9.2 The Council has been advised previously by the treasury adviser that the main rating agencies (Fitch, Moody's and Standard & Poor's) are going to remove the implied sovereign support. The actual timing of the changes is still subject to discussion, but the adviser have pre-empt the moves by making immediate changes to their methodology.

9.3 The current methodology was introduced at the start of the financial crisis, taking account of the full extent of rating categories applied to financial institutions and their domestic sovereigns. It has been a robust process which has provided clients with a wide range of suitable counterparties, based on rating agency methodologies that, themselves, evolved through the financial crisis. The changes in agency methodologies moving forward are such that they believed it is now right to make changes themselves.

9.4 The range of impacts across the three rating agencies is detailed below and how the Council's treasury adviser has proposed to address them.

9.5 Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be the same as their Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings. Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a possibility of external support, but it cannot be relied upon." With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

9.6 As a result of these rating agency changes, whilst the treasury adviser still display a full set of credit ratings for the immediate future, the credit element of their new methodology will **focus solely on the Short and Long Term ratings of an institution**. In addition, Rating Watch and Outlook information will continue to be assessed where it relates to these categories. And will also continue to utilise CDS prices as an overlay to ratings in their new methodology.

9.7 It is important to stress that this, and any future action directly related to this issue, is not indicative of deteriorating credit quality in the institution concerned. Instead it is reflective of underlying methodology changes by the agencies in light of regulatory changes.

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, so Capita's role is purely advisory.

10.2 In addition to providing cash management services, Capita 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. Forecasters are moving the date of the first projected interest rate increase in the UK forward, potentially into Q2 2015. If and when rates do start to rise, the authority will wish to be in a position to take advantage by not having too much money invested in longer term investments.

10.4 The current balance of £292.5m is £92.5m higher than the projected average cash balance of £200m. This is mainly attributable to slippage on the capital programme. It is envisaged that cash balances will reduce in the medium term as expenditure on the capital programme picks up through the remainder of the financial year.

10.5 At the end of January 2015, the Council had £72.5m of outstanding investments of £292.5m as overnight money and £125m maturing within 3 months, £55m maturing within 3-6 months, £10m maturing within 6-9 months, £5m maturing within 9-12 months and £25m to mature after 12months.

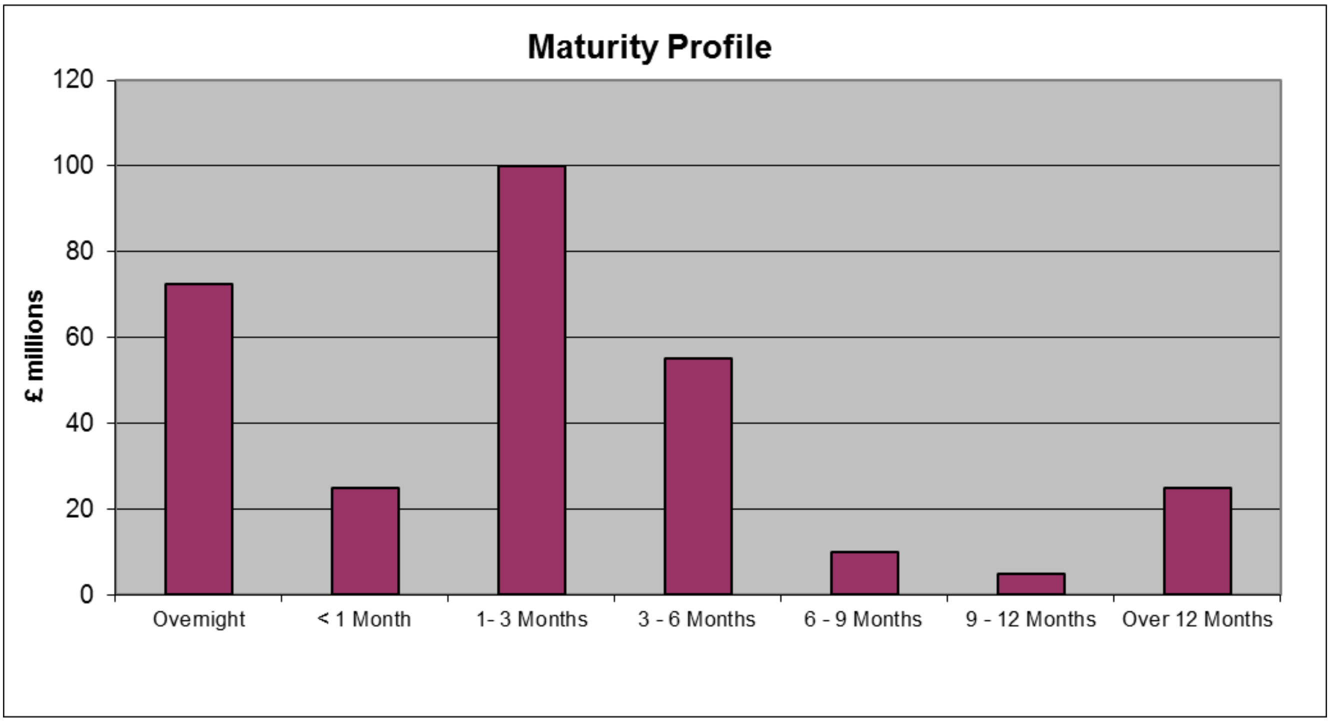
10.6 The budgeted investment return for 2014/15 was £1.6m. This target has been achieved due to large cash balances. The Council's outstanding investment balance has been well above the estimated budget balance of £200m. The investment return has now been revised to £2.7m with average cash balance of £325m for 2014/2015.

10.7 The table below shows the amount of investments outstanding at the end of January 2015, split according to the financial sector.

FINANCIAL SECTOR	£m
Banks in the UK	140.00
Building Societies in the UK	10.00
Banks in the Rest of the World	70.00
Money Market Funds	72.5

10.8 Current investment portfolio is as set out below.

Investment Portfolio at 31 January 2015

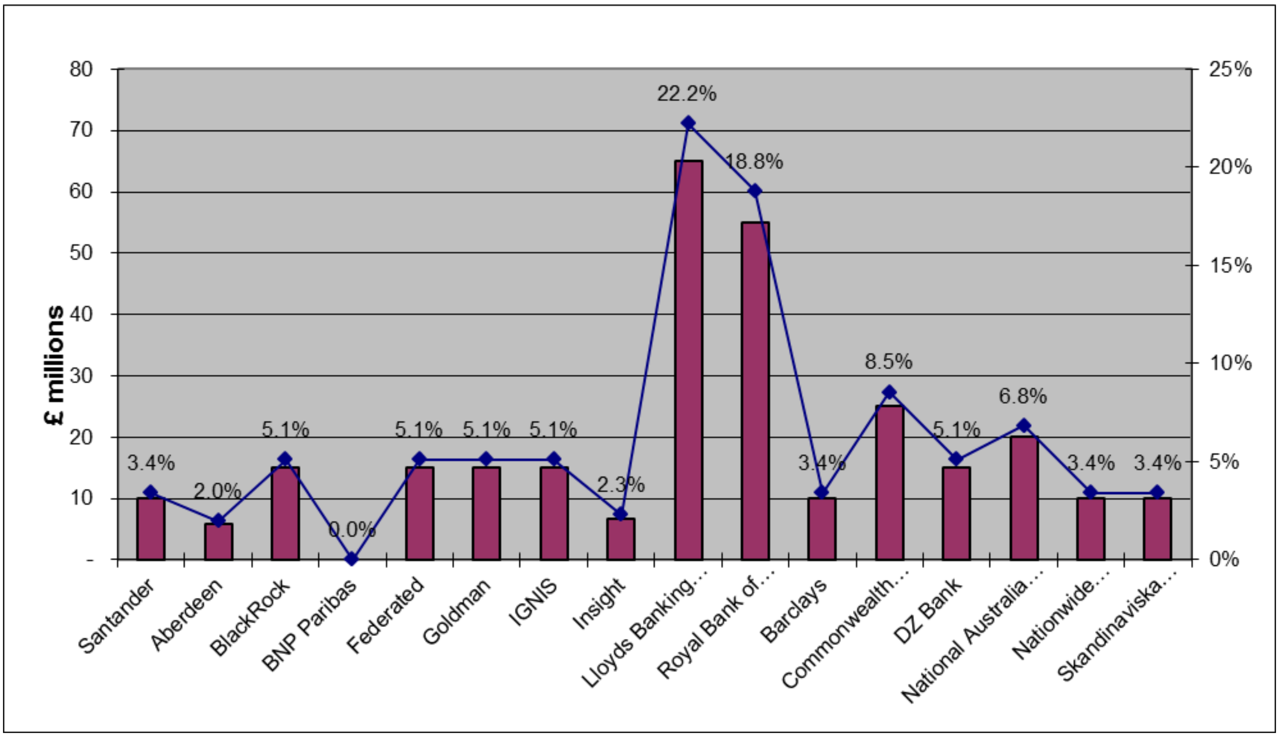


10.9 The Weighted Average Maturity for outstanding investment portfolio is 118 days. This is the average number of outstanding days to maturity of each deal from 31st January 2015

10.10 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 January 2015.

10.11 The chart below shows the deposits outstanding with authorised counterparties as at 31 January 2015, of which 41% were with part-nationalised banks (Lloyds and RBS Groups).

Maturity of Investment Portfolio as at 31 January 2015



11 INVESTMENT BENCHMARKING CLUB

11.1 LBTH participates in a benchmarking club to enable officers to 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 December 2014. The model takes into account a combination of credit, duration and returns achieved over the duration, and it includes data from 20 local authorities. Tower Hamlets lies close to the expected return given the council's portfolio risk profile, which is placing deposits with institutions with the sovereign rate of AAA.

	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
London Borough Of Tower Hamlets	0.80%	0.77%	0.03%	0.70%	0.83%	In line

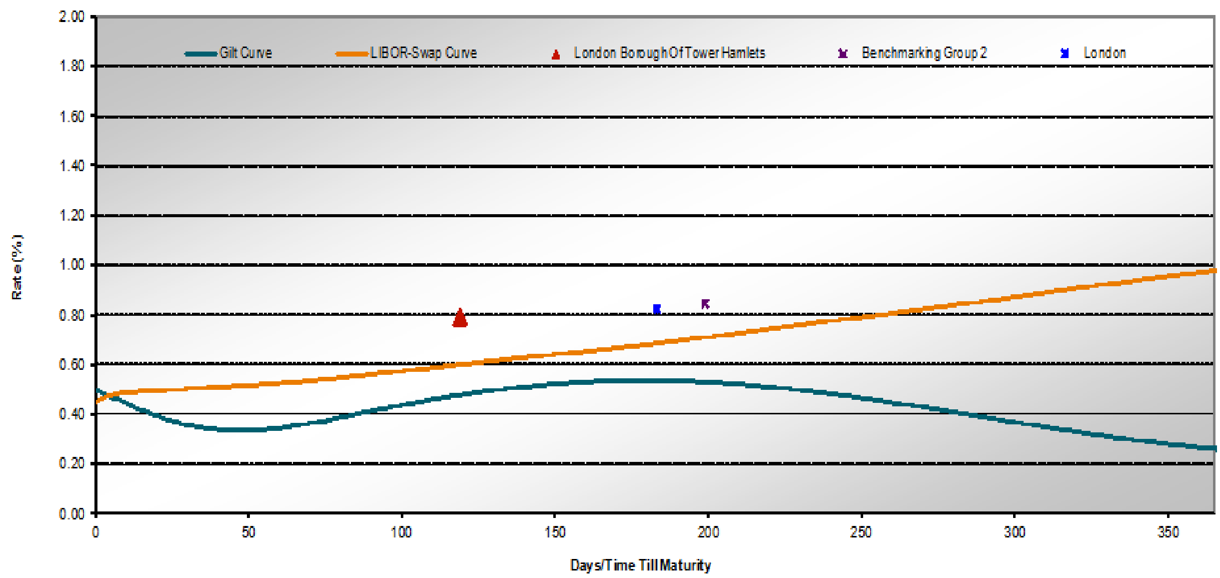
11.2 The weighted average rate of return (WARoR) - this is the average annualised rate of return weighted by the principal amount in each rate. And for Tower Hamlets is 0.80% at the end of December 2014, compared to 0.77% for the model portfolio. The return on LBTH investment is in line with the Council's risk appetite as set out in the Investment Strategy.

11.3 The Weighted Average Time to Maturity (WAM) - This is the average time, in days, till the portfolio matures, weighted by principal amount. At the end of December for LBTH was 119 days, compared to 199 days for the benchmarking group.

11.4 The Weighted Average Total Time (WATT) - this is the average time, in days, that deposits are lent out for, weighted by principal amount. At the end of December for LBTH was 272 days, compared to 356 days for the benchmarking group.

11.5 With the market rates moving lower again, the investment strategy for the rest of this financial year 2014/15, is to place at least £50m of current cash balances as deposit for 6 months and over if and when the opportunity arose, as rates could be dramatically reduced further.

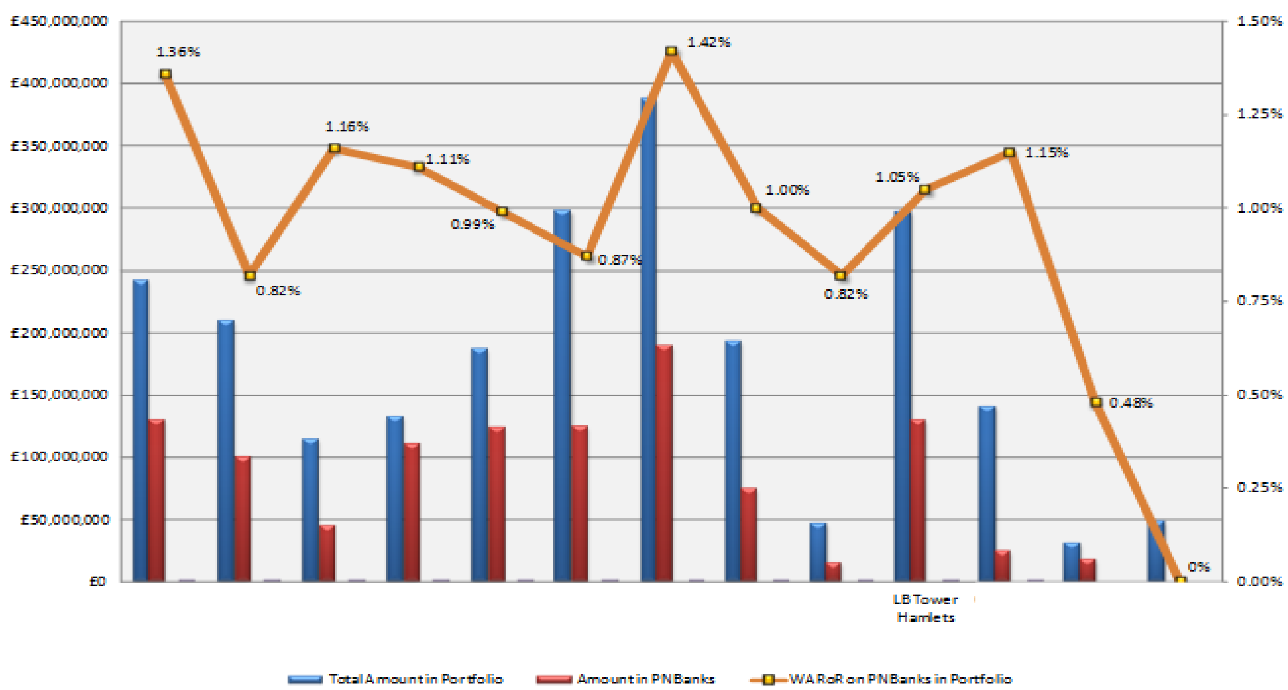
Returns Comparable Against the Risk-Free Rate and LIBOR Curve



	WARoR	WAM	WATT	WARisk	Gilt	LIBOR-Swap	Difference Gilt	Difference LIBOR-Swap	Model Bands	Model Performance
London Borough Of Tower Hamlets	0.80%	119	272	3.0	0.48%	0.60%	0.32%	0.19%	0.70% - 0.83%	Inline
Benchmarking Group 2	0.85%	199	356	3.0	0.53%	0.71%	0.32%	0.14%	0.73% - 0.86%	Inline
London	0.83%	183	343	2.8	0.54%	0.69%	0.29%	0.14%	0.73% - 0.86%	Inline

11.6 A further chart is set below 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 as at 31 December 2014.

LB Tower Hamlets Exposure to Part-Nationalised Banks- end of Dec 2014



Counterparty Exposure as at 31 January 2015

Time to Maturity	Counterparty	From	Maturity	Amount £m	Rate
Overnight	IGNIS		**MMF**	15.00	0.48%
	Aberdeen		**MMF**	5.80	0.41%
	Blackrock		**MMF**	15.00	0.42%
	Federated		**MMF**	15.00	0.46%
	Goldman		**MMF**	15.00	0.42%
	Insight		**MMF**	6.70	0.43%
	SUB TOTAL			**72.50**	
< 1 Month					
	Lloyds Banking Group	04/02/2014	04/02/2015	5.00	0.95%
	Lloyds Banking Group	13/02/2014	13/02/2015	5.00	0.95%
	Commonwealth Bank of Australia	15/08/2014	13/02/2015	5.00	0.48%
	DZ Bank	26/08/2014	26/02/2015	5.00	0.71%
	Skandinaviska Enskilda Banken	29/08/2014	27/02/2015	5.00	0.64%
1 - 3 Months					
	Santander		Call - 95N	10.00	0.45%
	Lloyds Banking Group	04/09/2014	04/03/2015	5.00	0.70%
	Lloyds Banking Group	05/03/2014	05/03/2015	10.00	0.95%
	Barclays	05/09/2014	05/03/2015	10.00	0.61%
	Commonwealth Bank of Australia	15/09/2014	16/03/2015	5.00	0.53%
	Lloyds Banking Group	07/10/2014	07/04/2015	5.00	0.70%
	Lloyds Banking Group	11/04/2014	10/04/2015	5.00	0.95%
	Lloyds Banking Group	11/07/2014	13/04/2015	10.00	0.80%
	Nationwide Building Society	13/10/2014	13/04/2015	5.00	0.66%
	Lloyds Banking Group	15/04/2014	15/04/2015	5.00	0.95%
	Royal Bank of Scotland	16/04/2013	16/04/2015	5.00	0.88%
	Royal Bank of Scotland	16/04/2014	16/04/2015	5.00	0.67%
	Nationwide Building Society	16/10/2014	16/04/2015	5.00	0.66%
	Lloyds Banking Group	17/07//2014	17/04/2015	5.00	0.80%
	Skandinaviska Enskilda Banken	29/04/2014	29/04/2015	5.00	0.71%
	Lloyds Banking Group	29/10/2014	29/04/2015	5.00	0.70%
3 - 6 Months					
	National Australia Bank	06/11/2014	06/05/2015	5.00	0.55%
	National Australia Bank	14/05/2014	14/05/2015	10.00	0.63%
	DZ Bank	26/08/2014	26/05/2015	5.00	0.86%
	National Australia Bank	07/07/2014	07/07/2015	5.00	0.64%
	Royal Bank of Scotland	15/07/2014	15/07/2015	20.00	0.97%
	Commonwealth Bank of Australia	15/07/2014	15/07/2015	5.00	0.83%
	Commonwealth Bank of Australia	17/07/2014	17/07/2015	5.00	0.82%
6 - 9 Months					
	Commonwealth Bank of Australia	12/08/2014	12/08/2015	5.00	0.81%
	DZ Bank	26/08/2014	26/08/2015	5.00	0.98%
9 - 12 Months					
	Lloyds Banking Group	04/12/2014	04/12/2015	5.00	1.00%
> 12 Months					
	Royal Bank of Scotland	27/02/2013	26/02/2016	10.00	1.15%
	Royal Bank of Scotland	20/03/2014	20/03/2016	5.00	1.25%
	Royal Bank of Scotland	10/01/2014	09/01/2017	5.00	1.74% *
	Royal Bank of Scotland	30/01/2015	30/012018	5.00	1.20% *
	SUB TOTAL			**220.00**	
	TOTAL			**292.50**	

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

INVESTMENT RETURNS

11.1 Investment returns since inception of the cash management arrangement with Capita has been consistently above the portfolio benchmark, which is 7 Day LIBID (the London Interbank Bid Rate). Performance against target which is benchmark (7 Day LIBID) plus 0.25% has been good so far, with year to date return on investment at 0.73%, which is 11 basis points above target set.

11.2 The portfolio delivered a return which outperforms the target set, LIBID + 0.25% for the first ten months of the year. Although returns are significantly above the LIBID, which currently stands at 0.35%.

11.3 With interest rates set to remain low and provided there's no undue increase in the Council's risk, we would continually review the counter party list prudently and cautiously in order to broaden the range of counterparties and/or products in order to enhance returns of our cash holdings, giving priority to the security and liquidity of investments before yield.

11.4 Below is a table that details performance of investments. The table shows that performance has consistently outperformed LIBID.

Performance against Benchmark

Period	LBTH Performance	Target (7 Day LIBID+0.25%)	(Under)/Out Performance
Full Year 2013/14	**0.82%**	**0.60%**	**0.22%**
April 2014	0.70%	0.59%	0.11%
May 2014	0.69%	0.59%	0.10%
June 2014	0.68%	0.60%	0.08%
July 2014	0.70%	0.60%	0.10%
August 2014	0.73%	0.60%	0.13%
September 2014	0.76%	0.61%	0.16%
October 2014	0.77%	0.61%	0.16%
November 2014	0.78%	0.60%	0.18%
December 2014	0.77%	0.60%	0.17%
January 2015	0.75%	0.60%	0.15%
Average 2014/15	**0.73%**	**0.62%**	**0.11%**

12 DEBT PORTFOLIO

12.1 The table below sets out the Council's debt as at the beginning of the year and 31 January 2015.

	31 March 2014 Principal £'000	Average rate %	31 January 2015 Principal £'000	Average rate %
Fixed Rate Funding:				
-PWLB	12,064	7.37	11,727	7.37
-Market	13,000	4.37	13,000	4.37
Total Fixed Rate Funding	25,064	5.81	24,727	5.81
Variable Rate Funding:				
-PWLB	-		-	
-Market	64,500	4.32	64,500	4.32
Total Variable Rate Funding	64,500	4.32	64,500	4.32
Total debt	***89,564***	***4.73***	***89,227***	***4.73***
CFR	***220,720***		***266,884***	
Over/ (under) borrowing	***(131,156)***		***(177,657)***	

12.2 No borrowing has been undertaken to date in this financial year. Officers are monitoring long term interest rates with a view to borrow externally when the rates are considered to be near their lowest point. Total debt outstanding, stands at £89.227m, against estimated CFR of £266.884m for 2014/15, resulting in an under-borrowing of £177.657m

14. INVESTMENT STRATEGY UPDATE

14.1 Full Council approved the 2015/16 Investment Strategy on 25 February 2015. Officers continue to look for ways to maximise returns on cash balances within the constraints of the Investment Strategy. The Investment Strategy was developed based on an improving outlook in the money markets and the evolving regulatory regime.

14.2 Wholly or partly owned government banks offer significantly higher rates than the DMO, but have similar levels of security based on government guarantee of their credit quality. The Council already relies on this guarantee and invests with these banks, and the current strategy is to have £70m money limit for each group with an aggregate of 40% of the overall investment portfolio. This should ensure that the Council continues to receive good returns on its cash balances and that the investment strategy is optimised to support the Council's efficiency programme.

15. COMMENTS OF THE CHIEF FINANCIAL OFFICER

15.1. The comments of the Acting Corporate Director Resources are incorporated in the report.

16. LEGAL COMMENTS

16.1 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.

16.2 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.

16.3 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.

17. ONE TOWER HAMLETS CONSIDERATIONS

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

18. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

18.1 There are no Sustainable Actions for A Greener Environment implications.

19. RISK MANAGEMENT IMPLICATIONS

19.1 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.

20. CRIME AND DISORDER REDUCTION IMPLICATIONS

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

21. EFFICIENCY STATEMENT

21.1 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***
December 2014 Benchmarking Report & January 2015 Investment Portfolio Analysis Report	*Bola Tobun Ext. 4733 Mulberry Place, 3rd Floor.*