

COMMITTEE: Audit Committee	DATE: 26 June 2012	CLASSIFICATION: Unrestricted	REPORT NO.	AGENDA NO. 8.4
REPORT OF: Corporate Director of Resources		TITLE: Treasury Management Activity for Period Ending 31 May 2012		
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 31 May 2012 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 return on investment stands at 1.49%, which is on target to achieve budgeted cash return on asset of £2.395m.

2. DECISIONS REQUIRED

- 2.1 Members are recommended to note the contents of the treasury management activity report for period ending 31 May 2012.

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 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 22 February 2012 by Full Council. The Strategy comprehensively outlines how the treasury function was 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; and
 - The Minimum Revenue Provision (MRP) Strategy

7. TREASURY ACTIVITY FOR PERIOD 1 April to 31 May 2012

- 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 May 2012.

8 MARKET UPDATE

- 8.1 The economic outlook remains gloomy. Europe remains the central influence on the markets and global economy with fears that the problems in Spain are escalating and that Greece could be on the verge of withdrawal from the Eurozone, depending upon the result of the re-run parliamentary election.
- 8.2 Other worrying trends include record unemployment levels across the Eurozone, and latest data that to across the board weakening in member states economies apart from the German economy. Some are predicting that there will be a challenge to the approach to austerity measure employed to curtail budget deficits as economic growth in the Eurozone remains anaemic.
- 8.3 Although, the US economy continues to create new jobs, this is being achieved at a much slower rate than anticipated by the markets. Other data also point to weakening in the pace of the economic recovery with demand under threat in two key markets; Europe and China.
- 8.4 Turning to the UK, the economy recovery is slow and is failing to inspire any level of confidence in the markets. Q1 data release shows that the UK is now technically in (double dip) recession and the governor of the Bank of England has warned that the economy may not pull out of recession in Q2. Several economic indicators are downbeat and with Europe and US (major export destinations for UK goods) seemingly struggling, the prognosis for the UK economy is not particularly bright.

9 CREDIT CRITERIA

- 9.1 The following credit criteria for investment counterparties were established by the Council in February 2012 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.

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	£45m
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.

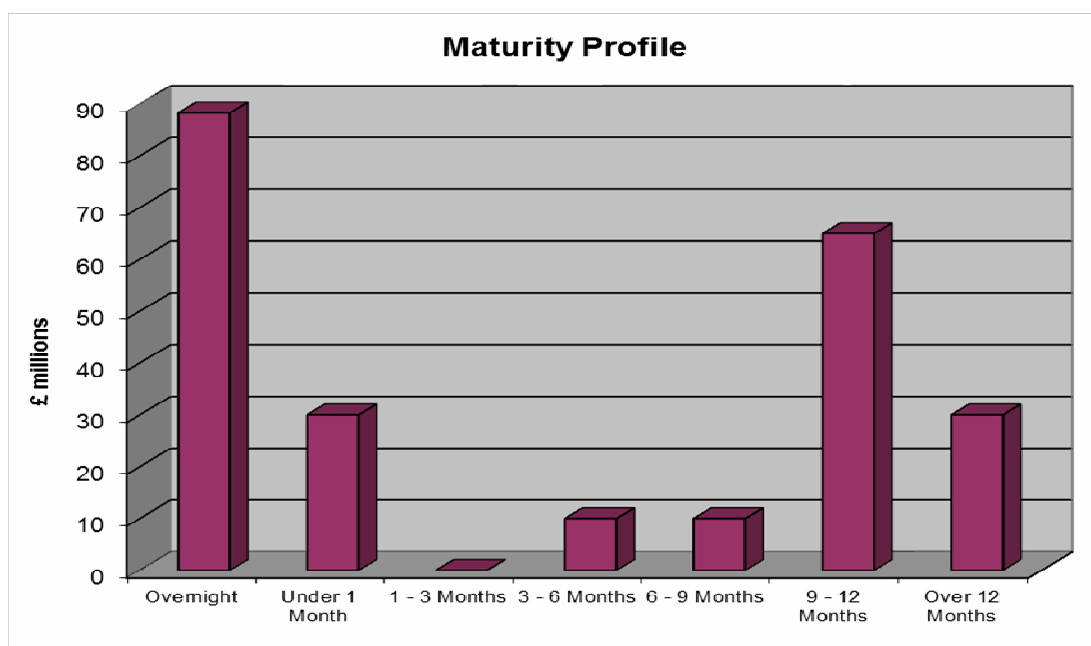
10 INVESTMENT STRATEGY

- 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% for the current financial year with no movement in rates until the fourth quarter of 2013. Although, the outlook for interest rate is below expectation, return on investment is expected to outperform budget this financial year.
- 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 is as set out below and also the maturity profile of the portfolio.

Investment Portfolio at 31 May 2012

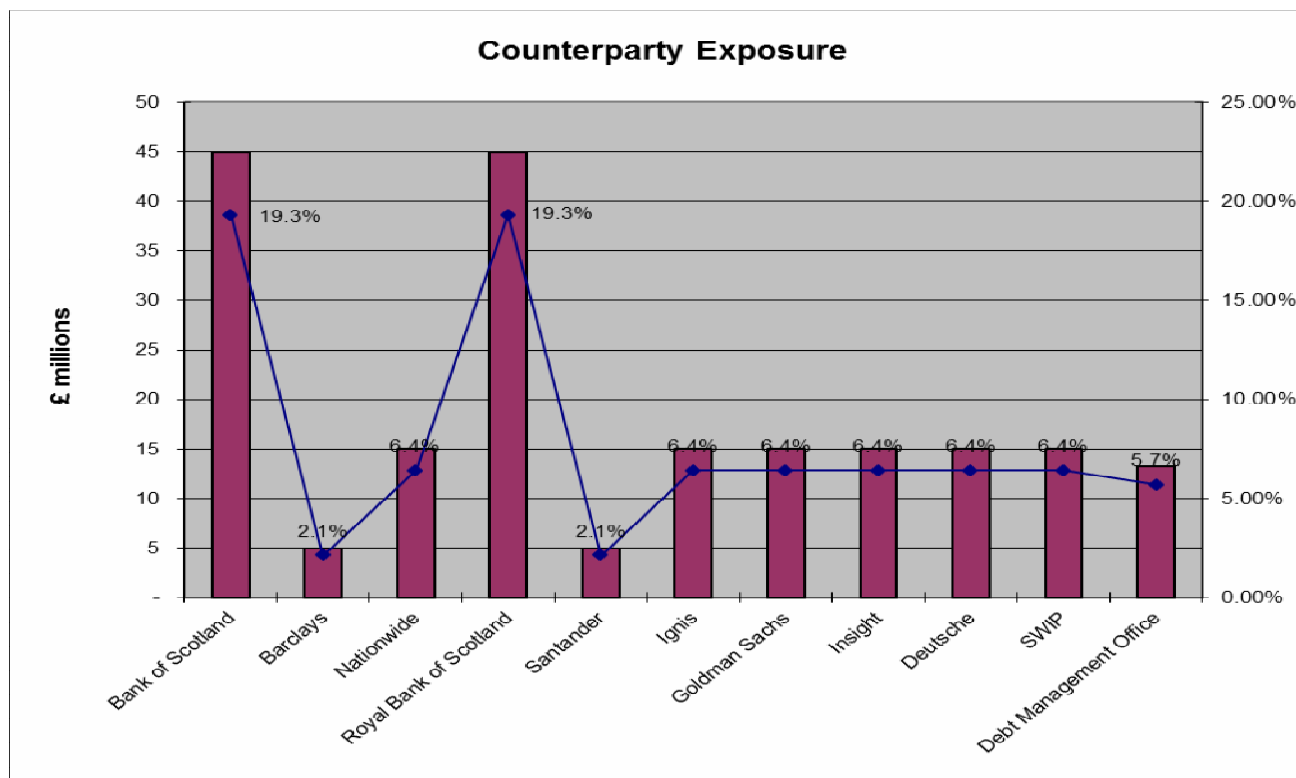
Duration	Breakdown of Investment Portfolio			
Term	Counterparty	Maturity	Amount £M	Rate
Overnight	Ignis	MMF	15.000	0.69%
Overnight	Goldman Sachs	MMF	15.000	0.60%
Overnight	Insight	MMF	15.000	0.65%
Overnight	Deutsche	MMF	15.000	0.58%
Overnight	SWIP	MMF	15.000	0.51%
Overnight	Debt Management Office		13.300	0.25%
	SUB TOTAL		88.300	
1 Month	Overseas Chinese Banking Corporation (OCBC)	18-Jun-12	30.000	0.42%
6 Months	Royal Bank of Scotland	12-Jun-12	10.000	1.31%
9 Months	Bank of Scotland	27-Oct-12	5.000	2.00%
	Royal Bank of Scotland	11-Jan-13	5.000	1.50%
12 Months	Cater Allen (Santander)	19-Jul-12	5.000	2.50%
	Barclays	10-Aug-12	5.000	1.50%
	Nationwide	10-Aug-12	10.000	1.44%
	Nationwide	07-Sep-12	5.000	1.55%
	Bank of Scotland	13-Feb-13	5.000	3.10%
	Bank of Scotland	13-Feb-13	5.000	3.10%
	Royal Bank of Scotland	11-Apr-13	10.000	2.10%
	Bank of Scotland	11-Apr-13	10.000	3.00%
	Bank of Scotland	11-Apr-13	10.000	3.00%
Over 12 Months	Bank of Scotland	27-Jul-12	5.000	2.65%
	Bank of Scotland	27-Jul-12	5.000	2.65%
	Royal Bank of Scotland	11-Oct-13	5.000	2.00%
	Royal Bank of Scotland	03-Jan-14	10.000	4.00%
	Royal Bank of Scotland	27-Jan-15	5.000	3.35%
	SUB TOTAL		145.000	
	TOTAL		233.300	1.494%

Maturity of Investment Portfolio



10.6 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 £88.3m in overnight instruments, £75m is held with money market funds. This allows the Council to maintain liquidity whilst still able to secure reasonable return on its assets.

10.7 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 May 2012.



11 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 1.49%.
- 11.2 The Strategy approved at the 22 February 2012 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 three main credit agencies have downgraded the credit criteria of most banks across the world. The sovereign ratings of some nations have also taking a hit, most notably the US, which was downgraded by Standard and Poor's last year – some major European countries such as France, Spain and Italy have also seen their credit worthiness slashed by the ratings agencies and there may be more on the way. The Council is not currently invested in any European countries or financial institutions.
- 11.4 Notwithstanding these constraints, the portfolio has outperformed benchmark of 1.25% in the first two months of the year and returns are significantly above the 7 day London Interbank Bid Rate (LIBID), which currently stands at 0.45%. The Council has also seen a spike in the level of balances, which has had the effect of diluting earnings rate, but balances are expected to gradually trend downwards as funds are committed to projects at a faster pace through the rest of the financial year.
- 11.5 The budgeted investment return in 2011/12 is £2.395m. This includes a savings proposal that was approved by Full Council that increased the target investment return by £445k. It is expected that the new target will be achieved.
- 11.6 Below is a table that details performance of investments. The table shows that performance has consistently outperformed LIBID.

Period	LBTH Performance	7 Day LIBID	(Under)/Over Performance
Full Year 2011/12	1.33%	0.48%	0.85%
Return for May 2012	1.46%	0.45%	1.01%
Average to date – 2012/13	1.49%	0.45%	0.93%

12. COMMENTS OF THE CHIEF FINANCIAL OFFICER

- 12.1. The comments of the Corporate Director Resources have been incorporated into the report.

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

- 13.1. 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.
- 13.2. 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.
- 13.3. 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.

14. ONE TOWER HAMLETS CONSIDERATIONS

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

15. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

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

16. RISK MANAGEMENT IMPLICATIONS

- 16.1 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.

17 CRIME AND DISORDER REDUCTION IMPLICATIONS

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

18 EFFICIENCY STATEMENT

- 18.1 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"

May 2012 Investment Portfolio Analysis Report

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

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

Appendix 1: Definition of Credit Ratings

Support Ratings

Rating	
1	A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-term rating floor of 'A-'.
2	A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-term rating floor of 'BBB-'.
3	A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'BB-'.
4	A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-term rating floor of 'B'.
5	A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-term rating floor no higher than 'B-' and in many cases no floor at all.

Short-term Ratings

Rating	
F1	Highest short-term credit quality. Indicates the strongest capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.
F2	Good short-term credit quality. A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.
F3	Fair short-term credit quality. The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

Long-term Rating Scales

Rating	Current Definition (August 2003)
AAA	Highest credit quality. 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality. 'AA' ratings denote a very low expectation of credit risk. They indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A	High credit quality. 'A' ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.
BBB	Good credit quality. 'BBB' ratings indicate that there is currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. This is the lowest investment-grade category

Individual Ratings

Rating	
A	A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment or prospects.
B	A strong bank. There are no major concerns regarding the bank. Characteristics may include strong profitability and balance sheet integrity, franchise, management, operating environment or prospects
C	An adequate bank, which, however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects.
D	A bank, which has weaknesses of internal and/or external origin. There are concerns regarding its profitability, substance and resilience, balance sheet integrity, franchise, management, operating environment or prospects. Banks in emerging markets are necessarily faced with a greater number of potential deficiencies of external origin.
E	A bank with very serious problems, which either requires or is likely to require external support.

Country / Financial Institution	Credit Ratings											
	Fitch Rating					Moody's Ratings				S&P Ratings		
	Long Term Status	Long Term	Short Term	Viability	Support	Long Term Status	Long Term	Short Term	FSR	Long Term Status	Long Term	Short Term
Australia	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Canada	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Bank of Montreal	SB	AA-	F1+	aa-	1	SB	Aa2	P-1	B-	SB	A+	A-1
Bank of Nova Scotia	SB	AA-	F1+	aa-	1	SB	Aa1	P-1	B	SB	AA-	A-1+
Canadian Imperial Bank of Commerce	SB	AA-	F1+	aa-	1	SB	Aa2	P-1	B-	SB	A+	A-1
Toronto Dominion Bank	SB	AA-	F1+	aa-	1	NO	Aaa	P-1	B+	SB	AA-	A-1+
Denmark	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Finland	SB	AAA	-	-	-	SB	Aaa	-	-	NO	AAA	-
Nordea Bank Finland plc ~	SB	AA-	F1+	-	1	SB	Aa3	P-1	C	SB	AA-	A-1+
France	NO	AAA	-	-	-	NO	Aaa	-	-	NO	AA+	-
Germany	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Landwirtschaftliche Rentenbank	SB	AAA	F1+	-	1	SB	Aaa	P-1	-	SB	AAA	A-1+
Hong Kong and Shanghai Banking Corporation Ltd	NO	AA	F1+	aa-	1	RD	Aa1	P-1	B+	SB	AA-	A-1+
Luxembourg	SB	AAA	-	-	-	SB	Aaa	-	-	NO	AAA	-
Netherlands	SB	AAA	-	-	-	SB	Aaa	-	-	NO	AAA	-
Bank Nederlandse Gemeenten	SB	AAA	F1+	-	1	SB	Aaa	P-1	A	NO	AAA	A-1+
Norway	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Singapore	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
DBS Bank Ltd	SB	AA-	F1+	aa-	1	RD	Aa1	P-1	B	SB	AA-	A-1+
Oversea Chinese Banking Corporation Ltd	SB	AA-	F1+	aa-	1	SB	Aa1	P-1	B	SB	AA-	A-1+
United Overseas Bank Ltd	SB	AA-	F1+	aa-	1	SB	Aa1	P-1	B	SB	AA-	A-1+
Sweden	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
Nordea Bank AB	SB	AA-	F1+	aa-	1	SB	Aa3	P-1	C	SB	AA-	A-1+
Svenska Handelsbanken AB	SB	AA-	F1+	aa-	1	SB	Aa3	P-1	C	SB	AA-	A-1+
Switzerland	SB	AAA	-	-	-	SB	Aaa	-	-	SB	AAA	-
U.K	NO	AAA	-	-	-	NO	Aaa	-	-	SB	AAA	-
Bank of New York Mellon (International) Ltd	SB	AA-	F1+	-	1	-	-	-	-	-	-	-
Standard Chartered Bank	NO	AA-	F1+	aa-	1	SB	A1	P-1	B-	SB	AA-	A-1+
U.S.A	NO	AAA	-	-	-	NO	Aaa	-	-	NO	AA+	-
Bank of New York Mellon, The	SB	AA-	F1+	aa-	1	NO	Aa1	P-1	B	NO	AA-	A-1+
Wells Fargo Bank NA	SB	AA-	F1+	aa-	1	NO	Aa3	P-1	C+	NO	AA-	A-1+
AAA Rated	-	-	-	-	-	-	-	-	-	-	-	-
Collateralised LA Deposit*	-	AAA	-	-	-	-	Aaa	-	-	-	AAA	-
Debt Management Office	-	AAA	-	-	-	-	Aaa	-	-	-	AAA	-
Supranationals	-	AAA	-	-	-	-	Aaa	-	-	-	AAA	-
UK Gilts	-	AAA	-	-	-	-	Aaa	-	-	-	AAA	-
Lloyds Banking Group plc	SB	A	F1	bbb	1	RD	A2	-	-	SB	A-	A-2
Bank of Scotland Plc	SB	A	F1	-	1	RD	A1	P-1	D+	SB	A	A-1
Royal Bank of Scotland Group plc	SB	A	F1	bbb	1	RD	A3	P-2	-	SB	A-	A-2
National Westminster Bank Plc	SB	A	F1	-	1	RD	A2	P-1	C-	SB	A	A-1
The Royal Bank of Scotland Plc	SB	A	F1	bbb	1	RD	A2	P-1	C-	SB	A	A-1