

Report To: <b>Audit Committee</b>	Date <b>25 September 2012</b>	Classification <b>Unrestricted</b>	Report No.	Agenda Item No.
REPORT OF: <b>Corporate Director, Resources</b>		<b>Treasury Management Activity for Period Ending 31 August 2012</b>		
ORIGINATING OFFICER(S): <b>Alan Finch, Service Head, Finance, Risk &amp; Accountability</b> <b>Oladapo Shonola, Chief Financial Strategy Officer</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 August 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 1.40%, 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 August 2012; and
  - refer to Council amendments to the Investment Strategy attached at Appendix 3.

## 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 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 August 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 August 2012.

## **8 MARKET UPDATE**

- 8.1 The economic outlook remains gloomy with Europe the central influence on the markets. European peripheral economies remain central to problems in the Eurozone and the persistent nature of these problems is starting to impact on the core economies in the zone, including Germany. The European Central Bank has announced that it is to re-commence purchasing the sovereign debt of troubled economies in order to reduce the cost of borrowing for these countries - Markets have reacted positively to this news.
- 8.2 The Chinese economy has continued to slow which adds to global worries, but it is envisaged that the Chinese authorities will push through policies to stem the decline and significantly reverse the trend of declining growth.
- 8.3 The US economy continues to create new jobs, albeit it at a slower rate than is anticipated by the markets and that would significantly reduce unemployment, but the Federal Reserve Bank has so far resisted more stimulus funding. The presidential election and the closeness of the race is creating uncertainty for investors and consequently compounding underlying causes of slow growth.
- 8.4 In the UK, the economy recovery is slow and is failing to inspire any level of confidence in the markets. Following disappointing figures in Q1 which showed that the UK was technically in double dip recession, the country has not yet seen any boost from the Olympics that had been anticipated, although Q3 is expected to deliver some growth in GDP.
- 8.5 The impact of all of this speculation and uncertainty has been to put downward pressure on market rates with the expectation that interest rates will remain suppressed for an even longer period. This expectation is reflected in the rates that the Council is able to secure on its investments so that returns on the portfolio are expected to remain at these low levels in the short to medium term.

## **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.

<b>Institution</b>	<b>Minimum Credit Criteria</b>	<b>High</b>	<b>Use</b>	<b>Limit</b>
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
<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)</b>				
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 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 back, potentially into 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 £225.8m is £75.8m higher than the projected average cash balance of £150m. 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.

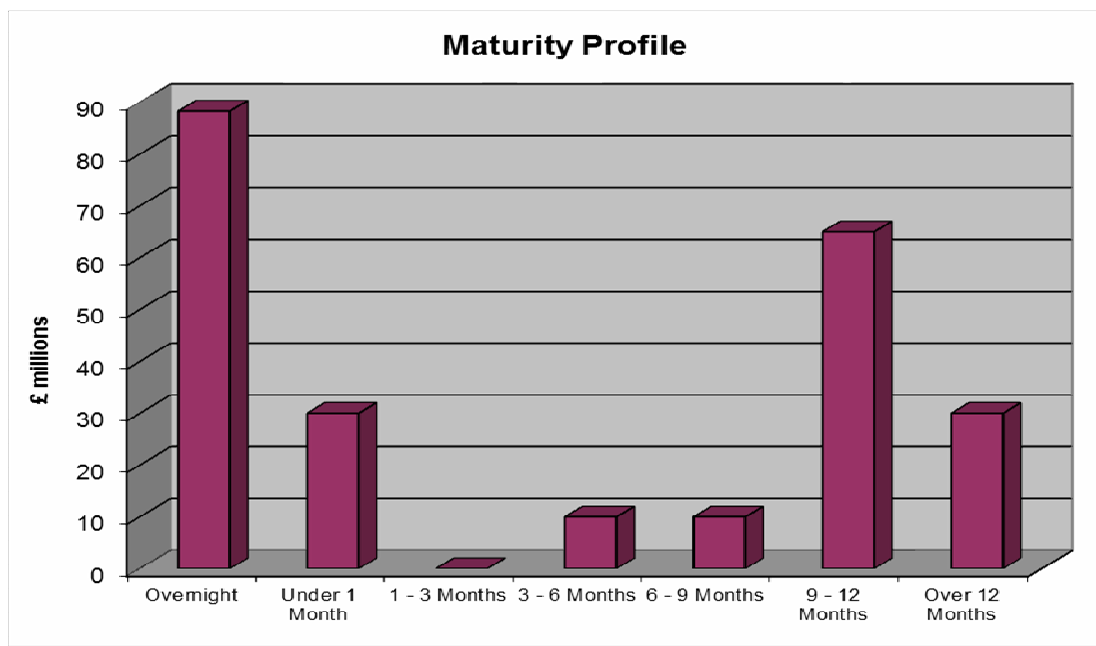
10.5 The current investment portfolio is as set out below.

**Investment Portfolio at 31 August 2012**

<b>Projection</b>	<b>Actual Deal</b>			
<b>Term</b>	<b>Counterparty</b>	<b>Maturity</b>	<b>Amount £M</b>	<b>Rate</b>
Overnight	Goldman Sachs	MMF	15.000	0.64%
Overnight	Ignis Liquidity Funds	MMF	15.000	0.82%
Overnight	Insight	MMF	15.000	0.77%
Overnight	Deutsche Managed Sterling	MMF	15.000	0.70%
Overnight	SWIP Global Liquidity Sterling	MMF	15.000	0.70%
Overnight	DMO	Overnight	15.800	0.25%
	<b>SUB TOTAL</b>		<b>90.800</b>	
3 Months	OCBC	18-Sep-12	5.000	0.50%
	OCBC	18-Sep-12	25.000	0.50%
6 Months	National Bank of Australia	14-Dec-12	10.000	0.77%
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	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%
	Bank of Scotland	11-Apr-13	10.000	3.00%
	Bank of Scotland	11-Apr-13	10.000	3.00%
	Royal Bank of Scotland	11-Apr-13	10.000	0.85%
	Royal Bank of Scotland	12-Jun-13	5.000	1.69%
	Bank of Scotland	07-Jul-13	10.000	3.00%
	Royal Bank of Scotland	11-Oct-13	5.000	2.00%
	Royal Bank of Scotland	12-Dec-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%
	<b>SUB TOTAL</b>		<b>135.000</b>	
	<b>TOTAL</b>		<b>225.800</b>	

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 2012.

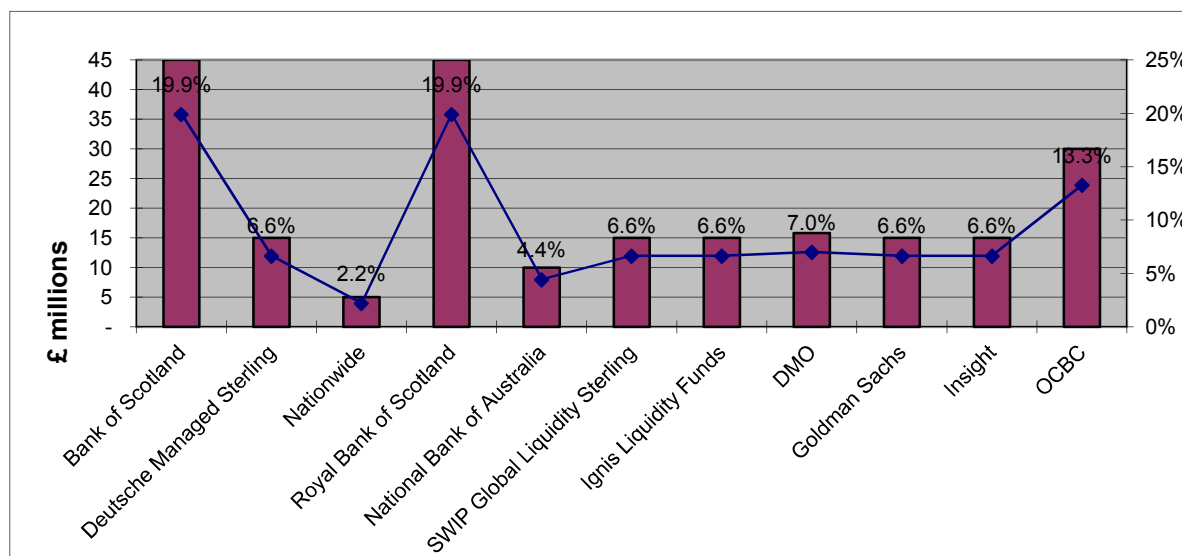
**Maturity of Investment Portfolio as at 31 August 2012**



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 £90.8m 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.

10.8 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 2012.

**Counterparty Exposure as at 31 August 2012**



## **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 1.40%.
- 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 Notwithstanding the challenge of an ever decreasing list of counterparties that the Council can invest with, 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 0.40%. 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.
- 11.4 The budgeted investment return in 2012/13 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.
- 11.5 Below is a table that details performance of investments. The table shows that performance has consistently outperformed LIBID.

### **Performance Against Benchmark**

<b>Period</b>	<b>LBTH Performance</b>	<b>7 Day LIBID</b>	<b>(Under)/Over Performance</b>
Full Year 2011/12	1.52%	0.48%	1.04%
Return for June 2012	1.39%	0.44%	0.95%
Return for July 2012	1.35%	0.42%	0.93%
Return for August 2012	1.26%	0.40%	0.86%
Average to date – 2012/13	1.40%	0.43%	0.97%

## 12 DEBT PORTFOLIO

12.1 The table below sets out the Council's debt as at the beginning of the year and 31 August 2012.

	31 March 2012 Principal	31 August 2012 Principal
<b>£'000</b>		
Fixed Rate Funding:		
-PWLB	13,852	13,683
-Market	13,000	13,000
<b>Total Fixed Rate Funding</b>	<b>26,852</b>	<b>26,683</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>91,352</b>	<b>91,183</b>
<b>CFR</b>	<b>231,735</b>	<b>231,735</b>
<b>Over/ (under) borrowing</b>	<b>(140,383)</b>	<b>(140,552)</b>

12.2 No borrowing has been undertaken to date in this financial year but the Council repaid £0.169m of PWLB loans. Total debt outstanding now stands at £91.183m, resulting in an under-borrowing of £140.55m against a CFR of £231.74m.

## 13. INVESTMENT STRATEGY UPDATE

13.1 Full Council approved the Investment Strategy on 22 February 2012. Following further review of the Strategy, there is a need to clarify the credit criteria for the UK.

13.2 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. However, the on-going sovereign debt crisis has kept interest rates suppressed for longer and led to more downgrades of sovereign and individual counterparties' credit ratings. This has further restricted an already limited counterparty list.

13.3 The effect of these issues is that the only available counterparty that the Council is able to invest with is the Government, namely the Debt Management Office (DMO). Officers do not see prolonged periods of investment with the DMO as efficient investment strategy. Therefore a proposal will be put before Full Council to approve a revised strategy that will allow the Council to continue to invest in a way that maximises returns whilst maintaining a risk profile similar to the existing portfolio.

13.4 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, but it is proposed that the strategy is revised to increase the individual limit for this group of banks to 40% of cash balance or £70m, whichever is the greater. 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.



#### **14. COMMENTS OF THE CHIEF FINANCIAL OFFICER**

- 14.1. The comments of the 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.

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### **LOCAL GOVERNMENT ACT 1972 (AS AMENDED) SECTION 100D**

#### **LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT**

<i><b>Brief description of "background papers"</b></i>	<i><b>Name and telephone number of holder And address where open to inspection</b></i>
<i>August 2012 Investment Portfolio Analysis Report</i>	<i>Oladapo Shonola Ext. 4733 Mulberry Place, 4<sup>th</sup> Floor.</i>