

Report To: Audit Committee	Date 16 September 2014	Classification Unrestricted	Report No.
REPORT OF: Chris Holme, Acting Corporate Director of Resources ORIGINATING OFFICER(S): Bola Tobun, Investment & Treasury Manager		Treasury Management Activity for Period Ending 31 July 2014 WARD(S) AFFECTED: N/A	

1. SUMMARY

- 1.1 This report advises the Committee of treasury management activity for the current financial year up to 31 July 2014 and the continued appropriateness of the Treasury Management Strategy and Treasury Prudential Indicators, which were approved by Council on 26 February 2014 as required under 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.
- 1.3 The current average return on investment stands at 0.69%, and is on target to achieve budgeted cash return on assets of £1.6m for 2014/15.
- 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. A Mid-Year review of the Treasury Management Strategy will be presented to Council at its meeting of the 26 November 2014.

2. DECISIONS REQUIRED

- 2.1 Members are recommended to:
- note the contents of the treasury management activity report for period ending 31 July 2014.

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 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 July 2014

- 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 July 2014.

8 MARKET UPDATE

- 8.1 Through the start of 2014, emerging markets and more recently, geopolitical concerns, have also had a major bearing on market sentiment. While the global recovery may continue, the outlook is by no means certain and markets are likely to be hit with further bouts of volatility through the year ahead.
- 8.2 Unlike the US and UK, consensus expectation on Eurozone central bank policy is still to the downside. Although the ECB sanctioned fresh policy support at its June meeting, there is a widely-held expectation that it will need to provide more policy support in coming months. At the latest August meeting there were no surprises, with Mario Draghi emphasising that rates will remain at the new record low at 0.15% for an 'extended period'. With no growth in Q2, and Q3 not exactly showing a strong bounce, market expectations will continue to focus on further support being provided before the year is out.
- 8.3 In Asia the focus is on two areas. First is how well the Bank of Japan's policy measures stand up to the sales tax increase in April. Second quarter growth fell sharply, but was much in line with market expectations. More recent data, covering the close of Q2 and the start of Q3 has suggested that the impact has already started fading. Such a recovery would back the government view that the impact will be temporary. Perhaps of greater importance could be whether China requires further policy support in addition to previous tax cuts for small firms and speeding up rail projects, to maintain growth above the government's 7.5% growth expectations. The government has stated that it stands ready to provide further support, to ensure that targets are met. This provision, if deemed necessary, will be made easier by recent inflation figures suggesting that price pressures remain some way below the authorities' tolerance levels. Nevertheless, previously provided support has seemingly had a positive impact on second quarter data. Furthermore, recent Chinese data has been more upbeat, suggesting that the 7.5% growth level could yet be achieved without the need for further stimulus.
- 8.4 It is likely, therefore, that policy announcements by the major central banks around the world will continue to dominate sentiment through much of 2014.
- 8.5 The economic outlook for the UK and US has improved in recent months, but for the Eurozone the future remains tepid at best, in spite of the recent ECB policy action. The Eurozone may have escaped recession, but progress will continue to be hampered by a number of fundamental issues, not least stubbornly high unemployment, in all but one or two countries in the bloc. While the overall economy is more robust than it was in 2011, a renewal of problems within the periphery and/or elsewhere may still weigh on market

sentiment in 2014. The fragility of sentiment towards the Eurozone was clearly shown by the recent issues surrounding Portuguese bank, Banco Espirito Santo.

- 8.6 Since early summer, most forecasters have been oscillating between late 2014 and the first half of 2015 as the date when the MPC will begin raising rates. The latest round of comments from Mark Carney has not helped stabilise a central view. This is a clear example of how the actions / words, or inactions, of central bankers are likely to continue to be the key themes dominating market sentiment in the coming months. They have undertaken enormous support programmes in recent years, in an effort to stabilise the world economy. However, can they be unwound without causing material market turbulence in the future – such as that seen in emerging markets earlier this year? The US has started to minimise the levels of increased support through its tapering programme, but the full unwinding of policy support may take many years to accomplish.
- 8.7 Counterparty quality remains the key factor when making investment decisions. Base rates will tighten at some stage, and this has called into question the benefits of some of the longer dated deals on offer. However, there are still some attractive rates on offer, especially if the future path of rate rises is measured, as the Bank continually suggests.

9 CREDIT CRITERIA

- 9.1 The following credit criteria for investment counterparties were established by the Council in February 2014 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

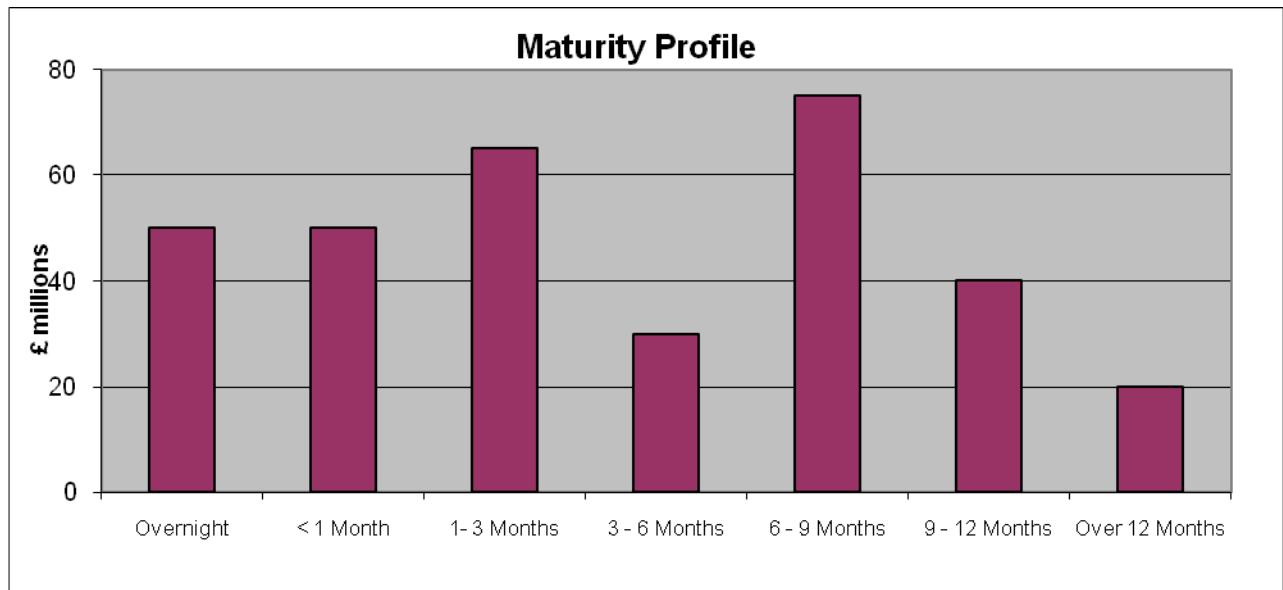
10 INVESTMENT STRATEGY

- 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 back, potentially into 2014. 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 £330.3m is £180.3m 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 At the end of July, we have £50.1m of outstanding investments of £330.1m as overnight money and £115m maturing within 1-3 months, £30m maturing within 3-6 months, £75m maturing within 6-9 months, £40m maturing within 9-12 months and £20m to mature after 12months.
- 10.6 The budgeted investment return in 2014/15 is £1.6m. It is expected that the new target will be achieved.

10.7 Current investment portfolio is as set out below.

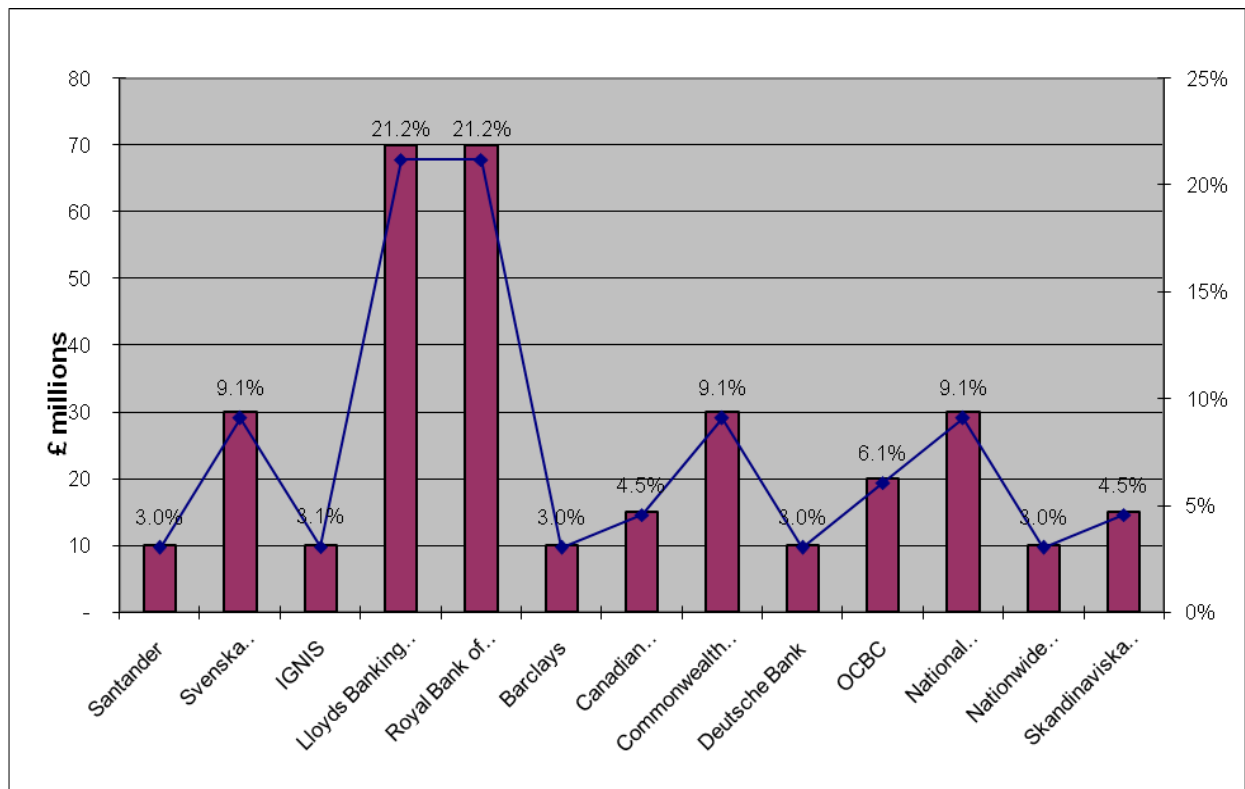
Investment Portfolio at 31 July 2014



10.8 The Weighted Average Time to Maturity for outstanding investment portfolio is 166 days. This is the average time, in days, from reporting date until the portfolio matures, weighted by principal amount. And the Weighted Average Total Time is 284 days. This is the average time, in days, that deposits are lent out for, weighted by principal amount.

10.9 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 July 2014.

Maturity of Investment Portfolio as at 31 July 2014



Counterparty Exposure as at 31 July 2014

Time to Maturity	Counterparty	From	Maturity	Amount £m	Rate
Overnight	Santander		Call	10.00	0.45%
	Svenska Handelsbanken		Call	30.00	0.30%
	IGNIS		MMF	10.10	0.44%
	SUB TOTAL			50.10	
< 1 Month	Commonwealth Bank of Australia	01/05/2014	01/08/2014	5.00	0.43%
	OCBC	13/05/2014	13/08/2014	10.00	0.45%
	Commonwealth Bank of Australia	14/05/2014	14/08/2014	5.00	0.43%
	Canadian Imperial Bank of Commerce	16/05/2014	18/08/2014	15.00	0.41%
	OCBC	20/05/2014	20/08/2014	10.00	0.45%
	Skandinaviska Enskilda Banken	29/04/2014	29/08/2014	5.00	0.46%
1 - 3 Months	Lloyds Banking Group	04/06/2014	04/09/2014	5.00	0.57%
	Barclays	05/03/2014	05/09/2014	10.00	0.53%
	Commonwealth Bank of Australia	09/06/2014	09/09/2014	5.00	0.45%
	Commonwealth Bank of Australia	14/05/2014	15/09/2014	5.00	0.44%
	Deutsche Bank	24/03/2014	24/09/2014	5.00	0.55%
	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%
	Nationwide Building Society	11/04/2014	13/10/2014	5.00	0.56%
	Nationwide Building Society	16/04/2014	16/10/2014	5.00	0.56%
	Lloyds Banking Group	29/10/2013	29/10/2014	5.00	0.98%
	Deutsche Bank	29/04/2014	29/10/2014	5.00	0.60%
3 - 6 Months	Lloyds Banking Group	13/11/2013	13/11/2014	5.00	0.98%
	Skandinaviska Enskilda Banken	29/04/2014	14/11/2014	5.00	0.56%
	Lloyds Banking Group	04/12/2013	04/12/2014	5.00	0.98%
	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%
	Lloyds Banking Group	04/02/2014	04/02/2015	5.00	0.95%
6 - 9 Months	Lloyds Banking Group	13/02/2014	13/02/2015	5.00	0.95%
	Lloyds Banking Group	05/03/2014	05/03/2015	10.00	0.95%
	National Australia Bank	18/03/2014	18/03/2015	10.00	0.57%
	National Australia Bank	03/04/2014	02/04/2015	10.00	0.60%
	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%
	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%
	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%
9 - 12 Months	National Australia Bank	14/05/2014	14/05/2015	10.00	0.63%
	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%
> 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% *
	SUB TOTAL			280.00	
	TOTAL			330.10	

* 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 0.69%, same as target set.
- 11.2 The Strategy approved at the 26 February 2014 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 delivered a return which equalsthe target set,LIBID + 0.25% for the first four months of the year. Althoughreturns are significantly above the LIBID, which currently stands at 0.35%.
- 11.4 With interest rates set to remain low and provided there's no undue increase in the Council's risk, we would continuallyreview the counter party list prudently and cautiously in order to broadenthe 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.
- 11.5 Chart 1 below shows the deposits outstanding with authorised counterparties as at 31 July 2014, of which 42.4% were with part-nationalised banks (Lloyds and RBS Groups).
- 11.6 Below is a table that details performance of investments. The table shows that performance has consistently outperformed LIBID.

Performance against Benchmark

Period	LBTH Performance	Benchmark(7 Day LIBID+0.25%)	(Under)/Out Performance
Full Year 2013/14	0.82%	0.60%	0.22%
April 2014/15	0.70%	0.59%	0.11%
May 2014/15	0.69%	0.59%	0.10%
June 2014/15	0.68%	0.60%	0.08%
July 2014/15	0.70%	0.60%	0.10%

12 DEBT PORTFOLIO

- 12.1 The table below sets out the Council's debt as at the beginning of the year and 31 July 2014.

	31 March 2014 Principal	31 July 2014 Principal
	£'000	£'000
Fixed Rate Funding:		
-PWLB	12,064	12,064
-Market	13,000	13,000
Total Fixed Rate Funding	25,064	25,064
Variable Rate Funding:		
-PWLB	-	-
-Market	64,500	64,500
Total Variable Rate Funding	64,500	64,500
Total debt	89,564	89,564
CFR	220,720	245,513
Over/ (under) borrowing	(131,156)	(155,949)

- 12.2 No borrowing has been undertaken to date in this financial year. Total debt outstanding, stands at £89.564m, against estimated CFR of £245.513m for 2014/15, resulting in an under-borrowing of £155.949m

13. INVESTMENT STRATEGY UPDATE

- 13.1 Full Council approved the Investment Strategy on 26 February 2014. 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.
- 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, 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.

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. LEGAL COMMENTS

- 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. 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.
- 15.4. 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.
- 15.5. 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.

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***

July 2014 Investment Portfolio Analysis Report

*Bola Tobun Ext. 4733
Mulberry Place, 3rd Floor.*