PART A

Report to:	Audit Committee
Date of meeting:	12 January 2012
Report of:	Head of Strategic Finance
Title:	Treasury Management Quarterly Report

1.0 SUMMARY

1.1 This report provides the third quarter's review of the Council's Treasury Management Strategy and investment performance.

2.0 RECOMMENDATIONS

2.1 That the Committee notes the report.

Contact Officer:
For further information on this report please contact: Bernard Clarke, Head of Strategic Finance, telephone extension: 8189 email: bernard.clarke@watford.gov.uk

3.0 Background

3.1 The UK and global economies have experienced a slowing of overall growth projections. Combined with that there has continued to be turmoil within the EU community. The recent Heads of State meeting in Brussels resulted in a Treaty signed by 26 members of the EU (the UK rejected the Treaty). It is now apparent that there are serious divisions across Europe regarding the detail within the Treaty and it is likely that President Sarkozy will get increasingly isolated.

3.2 The 27 European Finance Ministers are due to discuss (19th December) the lending of 200 billion of euros to the IMF which, in turn, would make that available to euro countries requiring funding. There is a great deal of doubt that this will be delivered as it is dependent upon the 10 non euro zone countries within the EU having to contribute 50 billion euros of the total. The UK has been pencilled in to contribute 30 billion even though it rejected the latest Treaty. It is possible that the IMF itself will make additional credit facilities available to euro zone countries but there continues to be understandable reluctance from the USA/ Canada that the IMF should be required to solve Europe's problems for them.

3.3 Just before the festive break, the European Central Bank announced unlimited credit facilities for private banking institutions across Europe. This had an immediate (if worrying response) in that this facility was drawn down by over 17.3 billion euros before the Xmas recess (with a further drawdown of 14.8 billion euros on 3rd January). This indicates the scale of private banking difficulties. President Sarkozy has a master strategy whereby these banks borrow extensively from the ECB (at 1% rates of interest) and lend on to their own national governments at the going rate (circa 3-4%). This has had limited success but the ECB exposure to euro zone debt is now very significant and the northern Europe countries are extremely concerned.

3.4 The credit rating agencies have taken a dim view of the current situation and it is only a matter of time before countries such as France and Austria lose their much cherished triple AAA credit rating. This has caused a political back lash in France where national elections will be held in the Spring 2012.

3.5 The consequence of this accumulation of 'fear' has resulted in a situation where UK banks have reduced their exposure to club med countries and also to French Banks and have increased their lending to US, German and Dutch financial institutions.

3.6 The global slowdown in the economy has resulted in an increase in the UK base rate being delayed until probably 2013. This continues to be bad news for the Council's investment portfolio as the base rate (currently 0.5%) determines the rates of interest that can be achieved on the money markets.

3.7 For Watford, the estimate of interest to be earned in 2011/2012 was geared to achieving an average rate of return of 1.3% for the year (for the first three quarters of the year an average 1.23% has been achieved). The volatility in the financial markets referred to earlier has meant that Watford's strategy continues to be to keep our investments with a relatively short maturity profile and this has affected investment returns.

4.0 Current Investment Strategy

4.1 The over-riding criteria for the Council's investments is governed by:

S ecurity of the investment (how safe is the counterparty)

L iquidity (how quickly can you move your investment somewhere else)

Y ield (what rate of interest can you achieve)

In that priority order.

4.2 Another tenet of investment strategy is to spread investments and, when last reported to Audit Committee in September, it was intended to restrict all investments in banks to £3m or less per institution and to £2m for the top 5 building societies (the Treasury Policy Statement approved by Council permits £5m and £3m upper limits). Council has also approved the placing of overnight money with Nat West (maximum ceiling £10m) and the Co-op (maximum ceiling £5m).

4.3 Since the last report to the Audit Committee, the Council has received a number of refunds from the Government relating, for example, to overpayments to the Business Rates Pool (circa £3m). As a consequence the balance of the Council's investment portfolio has increased from £33m to £39m and a temporary home was required for the Council's cash. This does cause a problem as the counter party list available to the Council is not large (unless we were to increase our lending list which is not advisable at the present time). There is always recourse to the Government Debt Management Office (DMO) where the rate of interest on offer is only 0.25%. The Government also own circa 90% of RBS and 43% of Lloyds and the Council's Treasury adviser, Sector, continue to recommend these institutions as safe havens.

4.4 Faced with this dilemma, the Head of Strategic Finance instructed the treasury officers within Shared Services Finance to place an additional £2m with Barclays for three months at 0.88% rate of interest. This will bring the Council's exposure to Barclays up to the upper limit of £5m permitted within the Treasury Policy Statement. He also instructed a further £3m be placed with Lloyds for a four month period at 1.70% rate of interest. The Council already has £3m with Lloyd's which is due to mature on 6th March 2012 and until that date the Council's exposure will be £6m which is £1m in excess of Treasury Policy guidelines.

4.5 The reason for this particular course of action includes Lloyds are 43% Government owned; Sector Treasury advisers recently recommended (within the last month to all its clients) to invest in Lloyds for 12 months duration—our current investments have a maximum exposure of 4 months; Lloyds have recently announced the Co-operative bank as having preferred bidder status for circa 634 of its banking outlets which fulfils an EU requirement, will bring in capital and will give the market confidence; finally the Chief Executive of Lloyds (Antonio Horta Osorio) has announced he will return to work on 9th January which has again provided some comfort to the markets.

4.6 The Audit Committee is asked to note this divergence to the current Treasury Policy Statement and which will be notified to Council when the Treasury Policy Statement is reviewed on 21st March 2012. The current portfolio is attached at **Appendix 1** and continues to have a predominantly short maturity profile with

£31m of investments due to mature by 14th March 2012.

5.0 IMPLICATIONS

5.1 **Financial Issues**

The Head of Strategic Finance comments that the revenue estimates for 2011/2012 has assumed £346k of investment interest will be achieved (based upon a 1.3% rate of return). The current rate of return is 1.23% so it is hoped that anticipated income will be achieved.

5.2 **Legal Issues** (Monitoring Officer)

The Head of Legal and Property Services comments that there are statutory limitations governing cash fund investments and all proposals within this report ensure continued compliance.

5.3 **Potential Risks**

Potential Risk	**Likelihood**	**Impact**	**Overall score**
Investment with non approved body	1	3	3
Investment with an approved counterparty that subsequently defaults	1	4	4
Failure to achieve investment interest budget targets	2	2	4
Those risks scoring 9 or above are considered significant and will need specific attention in project management. They will also be added to the service's Risk Register.			

5.4 **Staffing**

None Directly

5.5 **Accommodation**

None Directly