PART A

Report to:	Audit Committee
Date of meeting:	14 March 2012
Report of:	Head of Strategic Finance
Title:	Treasury Management Update Report

1.0 SUMMARY

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

2.0 RECOMMENDATIONS

2.1 That the Committee notes the report.

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3.0 Background

3.1 The global situation remains volatile with continuing problems within the eurozone. To some extent the announcement by the European Central Bank (ECB) in December 2011 that it would make an unlimited three year lending facility available to all eurozone banks @ 1% rates of interest has relieved a considerable amount of pressure from the financial system. To date, the ECB has loaned 1 trillion euros to European banks (489 billion euros in December; 530 billion end February 2012). UK Banks have taken a very small part of this loan facility (Lloyds 11.4bn; Barclay's 8.2 billion; RBS 10 billion; and HSBC 350million). In all these instances the loans have been taken out to cover some exposure in Europe. Italian and Spanish institutions are believed to have taken half of the money on offer.

3.2 The size of the funding already taken up reveals the extent of the problems within the euro zone where there is a strong suspicion that a lot of losses within the banks have yet to be reported / covered by alternative funding. The ECB bail out whilst apparently attractive (1% rate of interest for up to three years) does mean that the ECB becomes the 'preferred creditor' and all other depositors/ shareholders are effectively down graded to junior status.

3.3 Problems continue in Greece where social and political unrest are likely to reach breaking point in the near future. The latest 'bail out' package to Greece of circa 130 billion euros will only exacerbate the situation as the conditions for such a loan imposed principally by Germany/ Holland/ Finland/ and Austria will increase resentment. The Greek general election in April is likely to return a socialist government and a reversal of current austerity measures may well be the result. Private holders of Greek sovereign debt will probably be required to write off 70% of their holdings (and includes French and German banks; UK banks having very limited exposure). The funding source from the ECB has effectively cushioned the effects of this 'haircut' but a write down of debt is still not good news for the affected banks.

3.4 The probability of Greece being forced out of the eurozone remains high as the northern European countries now believe that any consequent 'contagion' can be contained. Portugal, Spain, Ireland and Italy are all experiencing, to some degree, an increase in unemployment and economies that are contracting. This situation is likely to continue for the foreseeable future and will continue to place strains upon the eurozone as a whole.

3.5 The rating agency Standard and Poors has recently downgraded a number of European countries with another agency Moody's putting the UK on negative watch. The 'markets' have taken this in their stride and the cost of lending to most sovereign countries has generally stabilised/ fallen.

3.6 As a consequence of all the activity over the past 3 months (and particularly the lending facility made available by the ECB) it is less likely that a wider banking crash will now occur and it is opportune for the Council to reconsider its current investment strategy for 2012/2013.

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, the current practise has been 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 a higher ceiling to apply). Council has also approved the placing of overnight money with Nat West (maximum ceiling £10m) and the Co-op (maximum ceiling £5m).

4.3 Due to the prevailing uncertainty within Europe the Council's portfolio has been kept of relative short maturity and this has affected the investment return achievable. It is probably the case that the situation has stabilised and a slightly longer maturity profile can be considered for 2012/2013. The portfolio will therefore be structured whereby circa 33% of funds will be invested up to 12 months duration; 33% of medium term duration—up to six months; and 33% will be kept with a maturity of less than two months. Counterparty limits may also revert to up to £5m with any one financial institution and £3m with any of the top 5 building societies. The use of Nat West and the Co-operative Bank for overnight facilities of £10m and £5m respectively will continue to be utilised.

4.4 The current portfolio attached at **Appendix 1** does not reflect the revised maturity strategy referred to in paragraph 4.3 (but it is likely that an updated portfolio to be handed at the meeting will do so). It will be evident by comparing the two portfolios that the return on investments is greater with a longer maturity profile.

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 1.17% but due to a slightly larger investment portfolio it is anticipated that the £346k will be achieved.

5.2 For 2012/2013, an average rate of interest of 1.3% has again been assumed and with a slightly longer maturity profile, should be achieved. In cash terms the estimates for 2012/2013 has assumed £325k of income will accrue and will be dependent upon the degree to which the investment portfolio will be drawn down to finance the Council's Capital Programme.

5.3 **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.

5.4 **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.			

5.5 **Staffing**

None Directly

5.6 **Accommodation**

None Directly