PART A

Report to:	Audit Committee
Date of meeting:	25th September 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 uncertainties within the Eurozone continue to dominate the Council's investment strategy. At the time of preparing this report, the ECB has announced an 'unlimited' bond buying programme that would provide a 'fully effective' backstop to the stricken eurozone economies (called the 'Outright Money Transactions' initiative).

3.2 The most significant aspect of this announcement was that the ECB would renounce its seniority and be on a par with other creditors. This is a change of direction whereby in Greece for example, the ECB has written off none of its loans but has effectively imposed an 70% write down of all other private debt. The fear that the ECB would retain 'seniority' has led to a run on Spanish banks in particular with a massive 74 billion of euros being withdrawn in July alone and repatriated elsewhere. The ECB announcement will hopefully stop this flight of capital.

3.3 The ECB announcement has not been greeted with any enthusiasm in Germany/ Finland and the Netherlands. The Head of the German Bundesbank threatened to resign and it is highly likely that Germany will impose very severe terms upon any rescue of Spain and Italy.

3.4 This raises the one big stumbling block still to be negotiated namely that the ECB will support Spain and Italy only if they agree to ask for help and also agree to have their finances monitored. The ECB has also announced that any support would stop immediately if any country missed its targets on reducing budget deficits. Spain and Italy have considered this level of control to be unacceptable and an all too frequent game of brinkmanship is being played out.

3.5 Within the UK there are problems of LIBOR rate fixing and in addition Lloyd's and the Co-operative bank have had to make large compensation provisions for payment protection insurance. China has its own problems with a significant slow down in growth and a hard landing for its economy being predicted. Finally the United States has an election in the near future and will be imposing tax increases and spending cuts in the New Year.

3.6 In the immediate future it looks highly probable that Greece will be forced out of the eurozone (as a token sop for German public consumption).

4.0 The Council's Current Investment Strategy

4.1 The Council's strategy gives priority to the security of its assets before seeking a high interest rate return The uncertainties within Europe could affect UK financial institutions and this has caused the Council's portfolio to have a generally short maturity profile in order to be able to react to 'events'. Further, the lack of growth within the UK economy and the high levels of personal and private company debt has resulted in there being no expectation of an early increase in interest rates.

4.2 The effect can best be illustrated in quotations received on 29th August for the deposit of Council funds:

Rate of Interest	1 month	3 months	6 months	12 months
Yorkshire Building Society	N/A	0.40%	0.65%	1.10%
Leeds Building Society	N/A	0.52%	0.90%	1.36%
Barclay's Bank	0.35%	0.50%	0.77%	1.25%

4.3 The two building societies are not interested in 1 month money and the rates generally are pretty pathetic. The average rate of return anticipated for 2012/2013 was 1.3% so current rates (unless placed for 12 months) are well below this target.

4.4 **Money Market Funds (MMF)**

4.4.1 At the June meeting of the Audit Committee discussion was held regarding the use of MMFs, at which time I was unconvinced of the potential risk/ reward relationship. Since that time, the number of reliable counterparties for the Council's funds has continued to reduce. The opportunity was taken at the CIPFA national conference in July (where there is a large exhibition centre) to discuss MMFs with all the leading suppliers. Discussion was also held with a number of local authorities that invest in Money Market Funds.

4.4.2 As a consequence, £3m of the Council's portfolio has been invested with Deutsche Asset Management (DAM) whose credentials are as follows:

* The Money Market Fund is triple AAA rated by Moody's and Standard and Poors—the two leading credit rating agencies.
* DAM has over 180 public sector mandates
* DAM has £6.3billion under management all within the same fund
* DAM has 9 dedicated money market analysts constantly monitoring credit risk
* The Council's portfolio can be called back at a day's notice

4.4.3 Deutsche Asset Management was awarded 'Best Money Market Fund-Europe' at the Treasury Management International ceremony in 2011.
It also was deemed to be 'Best Provider of Money Market Funds-Western Europe at the Global Finance ceremony in both 2011 and 2012.

4.4.4 Its current portfolio includes 107 counterparties and are mainly international banks who would never consider dealing with individual local authorities. The portfolio includes amongst others the bank of China; bank of Tokyo/ Mitsubishi; and a number of North European banks. It has no exposure to Spain; Italy; Portugal; Ireland; or Greece. Due to the wide scope of the counterparties used, the overall fund is considered triple AAA rated. It meets the Council's main priority for security of the investment. It is also highly 'liquid' and can be called back at a day's notice. In these circumstances the 'yield' is not great (0.49%) but, as shown at paragraph 4.2, is comparable with most alternatives. The Government backed Debt Management Office offers a 0.25% rate of interest and will take, on average, 1 month to repay funds.

5.0 The Council's Investment Portfolio

5.1 The Council's current investment portfolio is attached at **Appendix 1** and is as at 14th September. It is currently over loaded with deposits with Nat West and this is because a £3m investment with Santander UK ltd matured on 7th September. Although it has previously been reported that it is a separate entity from its Spanish parent, however, in the light of the fluctuating situation with Spain (and as reported in Section 3 of this report) it has been felt prudent to await developments. Should the Spanish Government formally request support from the ECB then the pressure on financial institutions in Spain should ease considerably. If this were to occur, then £3m of the Council's Portfolio would probably be placed again with Santander UK ltd. Should however the Spanish Government prevaricate then it is probable that there will be a further run on their banking sector and this £3m investment will need to be placed elsewhere. The problem relates to the fact that the number of counterparties available to the Council is extremely small.

5.2 Currently, the portfolio comprises leading banks in the UK (where a £3m maximum ceiling is in place), and £2m with each of the top 5 Building Societies. As explained earlier the maturity profile is being kept short for the present time.

6.0 IMPLICATIONS

6.1 **Financial Issues**

The Head of Strategic Finance comments that the revenue estimates for 2012/2013 has assumed £325k of investment interest will be achieved (based upon a 1.3% rate of return). It is anticipated that this will still be achieved due to an increased rate of return from the early part of the financial year and the fact that the investment portfolio is larger than originally anticipated.

6.2 **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.

6.3 **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.			

6.4 **Staffing & Equalities**

None Directly

6.5 **Accommodation**

None Directly