EAST HERTS COUNCIL

COUNCIL – 14 DECEMBER 2011

REPORT BY THE EXECUTIVE MEMBER FOR FINANCE

SHORT TERM INVESTMENT STRATEGY

WARDS AFFECTED: All

Purpose/Summary of Report

- To advise the Council of actions taken in respect of the Council's investments since the Council met on 28 September and to seek Council's endorsement of the proposed strategy over the next three months.

RECOMMENDATIONS: that	
(A)	**the investment strategy of maintaining significant investments in UK government securities accepting that there will be lesser return on such compared with bank deposits and Money Market Funds, be endorsed; and**
(B)	**the maximum sum with Nat West at any time not to exceed £15m.**

1 Background

1.1 At its meeting on 28th September Council resolved:

"That the Executive Member for Finance be authorised to vary the Council's investment strategy if he determines this necessary as a matter of urgency prior to the Council meeting in December to protect the Council's funds at any time of heightened uncertainty in the financial markets or to take advantage of opportunities afforded by market volatility. The Executive Member, with the agreement of the Chairman of Audit, the Committee charged with oversight of the Council's Treasury Management, and the Leader or Deputy Leader, and having consulted with the Council's treasury advisers before varying the strategy, to report back to Council in December on any action taken or to recommend any proposed change to the strategy."

1.2 The context for the resolution was concerns about market volatility in the lead up to the 23 October meeting of Eurozone ministers to address the debt problems faced by Greece and the potential impact on the international financial system of a failure to agree triggering an unmanaged default by Greece.

2 Report

2.1 The three members referred to in the resolution met on the 11 October and were in agreement that the investment strategy should be varied for a period to minimise exposure to European banks not withstanding that that exposure was primarily via a AAA rated Money Market Fund (MMF). Members agreed to switch the £35.5m investment to short dated UK government securities with flexibility given to Scottish Widows to select instruments which would permit prompt reinvestment in that or other MMF at minimum cost or loss from interest rate exposure. The Council's advisors recommendation was not to use the deposit facility offered by the government's debt management office but to buy gilts or other UK government debt. The switch of investments was substantially completed on the 18 October with a final purchase of £500k on 21 October.

2.2 Members will be aware that following the Eurozone meeting on 23 October markets responded positively to the agreements announced but then reversed in the light of uncertainty that the Greek government would implement the measures expected of it. Markets have subsequently questioned the sustainability of Italy's ability to manage its sovereign debt with the yield on 10 year bonds reaching 7% the rate at which markets assess the debt burden to be no longer sustainable on 9 November. The resignations of both the Greek and Italian prime ministers and appointment of unelected cabinets in both countries added political uncertainty to the mix. In Spain, 10 bond yield rose close 7% in the week prior to the national elections leading to the change of government in Spain. Immediate market response was an increase in borrowing rate and fall in stock prices.

2.3 As at the 5 December the prospects for confidence and stability returning to financial markets appear to be strengthening with much now dependent on Eurozone governments agreeing more integration in the setting of fiscal policies. France and Germany are proposing changes to EU treaties to include deficit reduction measures in the constitutions of member states and automatic sanctions for excessive deficits. The write down of Greek sovereign debt is not to be a precedent

2.4 The strategy agreed on 11 October continues to be sound until it is clear that the Eurozone countries are implementing arrangements to avoid a sovereign default for which banks are unprepared and unable to absorb without impact on institutional depositors. The actions taken were within the boundaries set by the existing Treasury Management Strategy approved by Council in February 2011 which provides for unlimited investment in UK government securities.

2.5 **Essential Paper B** sets out the investment held as at 1st November.

2.6 The switch of funding is not without cost in terms of reduced returns. The investments in government securities are expected to yield 0.43% per annum compared to up to 1.1% potentially achievable on a Money Market Fund. The monthly cost of maintaining this strategy is therefore some 0.6% or £18,000 on the investment of £35.5m.

2.7 SWIP had been the depository for short term cash flow income in excess of that immediately needed to fund spending. As a consequence of the disinvestment from the SWIP fund alternatives to place deposits are needed. It was agreed to allow these funds to be retained with Nat West the Council’s banker involving an increase in the maximum holding from £10m to £15m. This report seeks endorsement of the revision to the Treasury Management Strategy.

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ESSENTIAL REFERENCE PAPER 'A'

Contribution to the Council's Corporate Priorities/ Objectives	Investment income as an unringfenced source of revenue funding contributes to all the Council's priorities but with a particular relevance to **Prosperity**.
Consultation:	As set out in the report consultation was undertaken as required by the Council resolution.
Legal:	None
Financial:	Risk mitigation involves acceptance of a lower return on the investments.
Human Resource:	None
Risk Management:	The report alerts the Council to the continuing risks in financial markets.