

NORTH LINCOLNSHIRE COUNCIL

AUDIT COMMITTEE

QUARTERLY TREASURY MANAGEMENT AND STRATEGY REPORT

1. OBJECT AND KEY POINTS IN THIS REPORT

- 1.1 To provide a regular review of the treasury strategy approved each year by council.
- 1.2 This is a report on treasury management performance between April and December 2009. It explains how the strategy has been implemented during the first nine months of the year, the state of the financial markets, and what action has been taken to address the challenges and the results of that action.
- 1.3 The report also provides an update on the latest position with regard to our Icelandic investments and on new best practice guidance for local authority treasury management.

2. BACKGROUND INFORMATION

- 2.1 The **investment strategy for 2009/2010** aims to reduce risk by
 - Investing for shorter periods (up to 3 months)
 - In institutions with high credit ratings or with greater or equivalent security (Debt Management Office, local authorities and building societies)
 - Applying a maximum limit of £5m (except our own bankers Royal Bank of Scotland and the DMO)
 - The limit on the banking group not the individual institution (this tightens the previous policy)
 - With the option of using Money Market Funds and high rated foreign banks when market conditions make it prudent to do so
 - At the same time keeping an even maturity profile of investments from one to three months to minimize exposure to liquidity risk and interest rate risk.
- 2.2 The **borrowing strategy for 2009/2010** is
 - To aim to borrow only to support the capital programme
 - But retaining the option to borrow for cash flow purposes should

this be necessary

- To borrow for capital investment purposes at a time which is most advantageous on cost
- To maximize long-term borrowing through the PWLB while this remains the best option (typically 25 years), while retaining the option to borrow for shorter periods and at variable rates
- To delay borrowing in the plan period and temporarily use cash balances and to consider debt rescheduling if prudent.

2.3 The council's budget projected a base rate of 1% for 2009/10 and 2010/11 and 2.5% for 2011/12 as a benchmark for the council's own return on investment. It also projected an average PWLB 25 year maturity rate of 5% for each year of the plan period 2009/12. It also set a range of prudential indicators which the Service Director Finance is required to monitor. The performance against each measure is reported here.

3. **OPTIONS FOR CONSIDERATION**

3.1 The report considers the implementation of an agreed strategy. There are therefore no options to consider.

4. **ANALYSIS OF OPTIONS**

Investment strategy

4.1 We have applied a range of criteria to reduce risk by narrowing further the investment options allowed by the strategy until the banking sector recovers greater stability:

- For the first part of the year to September a maximum term of one month was applied, reverting to three months thereafter
- No new investments in foreign banks
- No use of Money Market Funds
- Investment only in building societies which achieve the same minimum credit ratings as applied to banks
- To reduce risk further where an institution is given a negative rating watch or is under review for a possible downgrade no new investments are made
- Unless a possible downgrade would keep the institution above the minimum floor as agreed by Council
- Except that, for institutions backed by the UK government liquidity and capitalization scheme, overnight and seven day deposits can be made as in effect cash is on call. This includes the council's own bankers NatWest/RBS
- Wider data has been used to determine the financial health of institutions including the CIPFA treasury forum, financial press, stock market data and other market intelligence as ratings cannot be relied upon in isolation.

- 4.2 As a result investments have been made in only a narrow range of UK institutions with the largest proportion placed with the Debt Management Office (**appendix 1**). The price of increased security has been that interest earned has been below target: actual achieved April to December 2009 was 0.60 % against an average base rate in the same period of 0.5% and a budget target of 1%. In cash terms the return to date is £0.211m against a full year target of £0.450m. The target compares with a full year return of £2.695m in 2008/09, when base rates were 5% or above for the first 6 months of the year.
- 4.3 In the light of the experience of greater stability in money markets this financial year we reverted to a three month limit on investments in September as allowed by the approved policy. This has provided the double benefit of a wider spread of investments and some better rates of return with no appreciable increase in investment risk.

Borrowing strategy

- 4.4 In line with the strategy, borrowing for the capital programme has been delayed. Borrowing of £6.3m to fund the 2008/09 capital programme will be required at some future date. Similarly planned borrowing of £16.925m for the 2009/10 programme will be deferred for the time being.
- 4.5 The logic is that by applying cash in hand to fund spending in the short term reduces cash balances and provides a short term financial benefit (cost of PWLB borrowing average 4.44%, average investment return 0.6%). Exposure to risks in the financial markets is also reduced. However this needs to be kept under review to make sure that we change our policy at the appropriate time depending on risks diminishing in the banking sector, and the gap closing between borrowing and lending rates.
- 4.6 Key performance indicators set for the year are shown at **Appendix 2**. These will be reviewed for the budget report to council in February 2010.

Icelandic Investments

- 4.7 The council has taken steps to recover investments with Icelandic banks in concert with other local authorities through the Local Government Association.
- 4.8 The administration of Heritable is progressing well and a second dividend of 12.66p (£445,413.55 for North Lincolnshire Council) was paid to creditors on Friday 18 December 2009 meaning that creditors have now recovered just under 29p in the pound. The amount received by the Council is now £1.012m on our claim totalling £3.518m. The most likely scenario remains a return of 80p in the pound by the end of 2012.

- 4.9 The Landsbanki Winding-up Board has accepted local authority claims as having priority status. However, the key challenge from a local authority perspective is the objection filed by a number of non-priority creditors. Despite the objection the Local Government Association remain confident in the legal argument that local authorities are depositor creditors and do therefore have priority status. If upheld this would be likely to deliver a return of 83-90p in the pound. Without priority status, authorities would be likely to get in the region of 25-30 per cent of their deposits back.

Best practice in treasury management

- 4.10 In June the Audit committee received early advice on proposed changes to guidance on treasury management; this was also considered at Council on 8 July. The major focus of this guidance was the effective management of risk. Council agreed several steps to improve current arrangements, which have since been implemented:

- Cabinet now receives a treasury update with each budget review report;
- The audit committee in its scrutiny role receives quarterly treasury management reports of which this is the second;
- Initial training has been provided to members of the committee and more is planned;
- The evaluation of risk in the investment portfolio is regularly made by the Service Director Finance and the treasury team during the year and is documented.

- 4.11 The Chartered Institute of Public Finance and Accountancy (CIPFA) has now published (December 2009) its revised code 'Treasury Management in the Public Service: Code of Practice and Cross-Sectoral Guidance'. The code confirms that the steps we have taken to report to cabinet and council, and to audit committee in its scrutiny role, are appropriate. A report will be presented to Council in February 2010 to formally adopt the revised code.

- 4.12 Much of what the code recommends reflects current practice. Some additions will, however, be needed to update the Treasury Management Practice notes which document the Council's day to day approach to treasury management.

- 4.12 CIPFA has also updated (December 2009) 'The Prudential Code for Capital Finance in Local Authorities', which underpins the system of capital finance and borrowing in particular. The Code has been updated after a review of its original implementation and following the fall-out of the Icelandic Banks crisis. Local authorities are required by regulation to have regard to the Code when carrying out their duties under Part 1 of the Local Government Act 2003. The key changes are an increased emphasis on asset management and capital programming and the removal of some treasury management indicators to the Treasury Management Code. The report to council in

February 2010 will therefore invite the council to formally adopt the revised Code.

5. RESOURCE IMPLICATIONS

- 5.1 No additional costs at this stage. In closing the 2008/09 accounts a reserve has been established to cover the costs of any potential Icelandic losses.
- 5.2 The revised code may have implications for how the treasury function is resourced.

6. OTHER IMPLICATIONS

- 6.1 The revised codes, once adopted, will set out the requirements on officers and members for the scrutiny and management of the treasury function.

7. OUTCOMES OF CONSULTATION

- 7.1 Not applicable

8. RECOMMENDATIONS

- 8.1 That the Audit Committee consider the assurance provided by this report on the effectiveness of current arrangements for treasury management, and
- 8.2 That the Audit Committee notes the key findings on the operation of the current strategy in 2009/10.

SERVICE DIRECTOR FINANCE

Pittwood House
Ashby Road
SCUNTHORPE
North Lincolnshire
DN16 1AB
Author: PF/DL
Date: 8 January 2010

Background Papers used in the preparation of this report

'Treasury Management and Investment Strategy, Annual Report 2008/09', report to Audit Committee 30 June 2009 and to Council 8 July 2009
'Treasury Management in the Public Services. Code of Practice and Cross-Sectoral Guidance Notes: Fully Revised Second Edition 2009, CIPFA
'The Prudential Code for Capital Finance on Local Authorities; Fully Revised Second Edition 2009', CIPFA
Correspondence from the LGA dated 23.4.09, 08.09, 6.11.09, 30.11.09

INVESTMENTS MADE AND REALISED APRIL TO DECEMBER 2009

REF	INVESTMENT INSTITUTION	DATE INVESTED	AMOUNT £	STATUS/ DUE DATE OF PAYMENT
INVESTMENTS MADE SINCE 1 April 2009				
3466	Barclays Bank PLC	06/04/2009	5,000,000.00	Repaid
3483	Barclays Bank PLC	06/05/2009	5,000,000.00	Repaid
3510	Barclays Bank PLC	08/06/2009	1,000,000.00	Repaid
3532	Barclays Bank PLC	10/07/2009	5,000,000.00	Repaid
3557	Barclays Bank PLC	10/08/2009	5,000,000.00	Repaid
3610	Barclays Bank PLC	13/10/2009	5,000,000.00	Repaid
3628	Barclays Bank PLC	13/11/2009	5,000,000.00	Repaid
3643	Bank of Scotland Fixed Deposit	11/12/2009	3,000,000.00	11/03/2010
3633	City of Newcastle upon Tyne MBC	20/11/2009	2,400,000.00	19/01/2010
3467	Debt Management Office	07/04/2009	1,990,000.00	Repaid
3468	Debt Management Office	08/04/2009	2,500,000.00	Repaid
3469	Debt Management Office	09/04/2009	3,000,000.00	Repaid
3471	Debt Management Office	14/04/2009	4,000,000.00	Repaid
3472	Debt Management Office	15/04/2009	1,500,000.00	Repaid
3473	Debt Management Office	15/04/2009	1,210,000.00	Repaid
3474	Debt Management Office	15/04/2009	4,200,000.00	Repaid
3482	Debt Management Office	05/05/2009	1,000,000.00	Repaid
3485	Debt Management Office	07/05/2009	6,000,000.00	Repaid
3487	Debt Management Office	08/05/2009	2,000,000.00	Repaid
3491	Debt Management Office	15/05/2009	4,000,000.00	Repaid
3497	Debt Management Office	27/05/2009	3,700,000.00	Repaid
3498	Debt Management Office	27/05/2009	2,000,000.00	Repaid

3499	Debt Management Office	27/05/2009	1,500,000.00	Repaid
3500	Debt Management Office	27/05/2009	3,200,000.00	Repaid
3501	Debt Management Office	27/05/2009	1,300,000.00	Repaid
3502	Debt Management Office	27/05/2009	2,000,000.00	Repaid
3504	Debt Management Office	01/06/2009	3,895,000.00	Repaid
3505	Debt Management Office	02/06/2009	4,000,000.00	Repaid
3507	Debt Management Office	03/06/2009	2,000,000.00	Repaid
3515	Debt Management Office	15/06/2009	3,000,000.00	Repaid
3523	Debt Management Office	30/06/2009	3,485,000.00	Repaid
3524	Debt Management Office	01/07/2009	3,000,000.00	Repaid
3527	Debt Management Office	03/07/2009	5,000,000.00	Repaid
3531	Debt Management Office	09/07/2009	1,300,000.00	Repaid
3533	Debt Management Office	10/07/2009	1,000,000.00	Repaid
3536	Debt Management Office	15/07/2009	5,000,000.00	Repaid
3538	Debt Management Office	20/07/2009	5,000,000.00	Repaid
3540	Debt Management Office	22/07/2009	1,000,000.00	Repaid
3542	Debt Management Office	27/07/2009	4,540,000.00	Repaid
3546	Debt Management Office	31/07/2009	1,000,000.00	Repaid
3549	Debt Management Office	03/08/2009	5,000,000.00	Repaid
3550	Debt Management Office	03/08/2009	5,000,000.00	Repaid
3551	Debt Management Office	04/08/2009	1,000,000.00	Repaid
3555	Debt Management Office	07/08/2009	1,000,000.00	Repaid
3558	Debt Management Office	10/08/2009	3,000,000.00	Repaid
3562	Debt Management Office	17/08/2009	5,000,000.00	Repaid
3567	Debt Management Office	24/08/2009	1,225,000.00	Repaid
3570	Debt Management Office	28/08/2009	3,025,000.00	Repaid
3571	Debt Management Office	01/09/2009	3,500,000.00	Repaid
3574	Debt Management Office	02/09/2009	1,000,000.00	Repaid
3575	Debt Management Office	03/09/2009	3,000,000.00	Repaid
3604	Debt Management Office	02/10/2009	3,750,000.00	Repaid

3606	Debt Management Office	05/10/2009	3,000,000.00	Repaid
3612	Debt Management Office	15/10/2009	5,475,000.00	Repaid
3614	Debt Management Office	16/10/2009	5,075,000.00	Repaid
3615	Debt Management Office	19/10/2009	5,000,000.00	Repaid
3622	Debt Management Office	05/11/2009	3,850,000.00	Repaid
3629	Debt Management Office	16/11/2009	4,000,000.00	Repaid
3646	Debt Management Office	15/12/2009	3,000,000.00	Repaid
3647	Debt Management Office	15/12/2009	6,534,000.00	Repaid
3648	Debt Management Office	16/12/2009	6,200,000.00	14/01/2010
3653	Debt Management Office	22/12/2009	1,040,000.00	Repaid
3602	Leeds Building Society	01/10/2009	3,000,000.00	04/01/2010
3632	London Borough of Hillingdon	19/11/2009	3,000,000.00	05/01/2010
3608	Northern Rock PLC	07/10/2009	3,000,000.00	11/01/2010
3611	Northern Rock PLC	14/10/2009	2,000,000.00	12/01/2010
3605	Stockport Metropolitan Borough Council	05/10/2009	400,000.00	15/10/2009
3638	The Highland Council	01/12/2009	3,000,000.00	29/01/2010

INVESTMENTS MADE BEFORE 1 April 2009

3305	Heritable bank Limited	01/09/2008	2,500,000	In administration
3319	Heritable bank Limited	12/09/2008	1,000,000	In administration
3290	Landsbanki Islands	08/08/2008	1,000,000	In receivership
3306	Landsbanki Islands	01/09/2008	1,000,000	In receivership
3401	Leeds B.S.	06/01/2009	1,000,000	Repaid
3427	Nationwide Building Society	10/02/2009	5,000,000	Repaid
3250	Newcastle Building Society	24/06/2008	1,000,000	Repaid
3247	Skipton Building Society	17/06/2008	1,000,000	Repaid
3462	Skipton Building Society	01/04/2009	2,000,000	Repaid

3208	Close Brothers Limited	30/04/2008	1,000,000	Repaid
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INVESTMENT POSITION 31 DECEMBER 2009

CALL ACCOUNT BALANCES

Abbey National Call Account	4,957,034	On call
Bank of Scotland Call Account	1,965,347	On call
NatWest Special Interest Bearing Account	884,115	On call

OTHER INVESTMENTS

Bank of Scotland	3,000,000	Repayment at term
Barclays Bank PLC	5,000,000	Repayment at term
Debt Management Office	6,200,000	Repayment at term
Heritable Bank Limited	2,492,488	In administration
Landsbanki Islands	2,000,000	In receivership
Northern Rock plc	5,000,000	Repayment at term
London Borough of Hillingdon	3,000,000	Repayment at term
City of Newcastle Upon Tyne MBC	2,400,000	Repayment at term
The Highland Council	3,000,000	Repayment at term
Leeds Building Society	3,000,000	Repayment at term

TOTAL	42,898,984	
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