

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 2009 and February 2010. The report explains how the strategy has been implemented and the state of the financial markets.
- 1.3 The report also provides an update on the latest position with regard to our Icelandic investments; on the adoption of the revised code of practice for treasury management; and the approval of a revised treasury strategy for 2010/11 at council in February.
- 1.4 It seeks to provide assurance on the effectiveness of arrangements for 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)
 - Investing 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)
 - Applying the limit on the banking group not the individual institution (this tightens the previous policy)
 - Having 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 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 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 Investments have been made in only a narrow range of UK institutions. This includes banks, top building societies, Local Authorities and Debt Management Office (appendix 1). The price of increased security has been that interest earned has been below target: actual achieved April 2009 to February 2010 was 0.6% 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 £0.258m 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.

4.2 In the light of the experience of greater stability in money markets this financial year the working limit of one month was relaxed in September 2009 and the treasury team now have the flexibility to invest for periods of up to three months as allowed by the approved policy. This provides the double benefit of a wider spread of investments and better rates of return with no appreciable increase in investment risk.

4.3 Procedures are in place to provide assurance that in making deposits the investment strategy is adhered to. These include management sign off of each transaction; three officers required to authorise each transaction through the Bankline system; weekly reports on activity to the Corporate Finance Manager and Service Director Finance; regular

review meetings of the Corporate Finance Manager and the treasury team; an annual audit of the treasury function by the council's internal audit section. All of these checks have been applied in the reporting period.

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 £14.2m for the 2009/10 programme will be deferred for the time being. In 2009/10 this will save the Council an estimated £0.580m.
- 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 4.5%, 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 were reviewed ahead of Council in February 2010. These are shown at Appendix 2. Most parameters are unchanged. What has changed is the estimate of total 2009/10 capital expenditure (i), the funding of which in turn affects (ii) and (iii). Operational leases have for many years been the preferred funding method for vehicles, plant and some small items of equipment. Reclassifying these as funded from borrowing increases the capital financing requirement and ratio of financing costs to the net revenue stream. The budget therefore provides for the cost of borrowing, although it remains our intention to defer that borrowing for the time being.

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 On 28 January 2010, the administrators of Heritable wrote to creditors to advise that they were increasing their estimates of recoveries. Current projections now suggest a base case estimated return of 79-85p (up from 70-80p) and a 'stressed case' of 63-73p (up from 55-70p). A third interim payment was made on 30 March 2010 of £217,899. This means we have now received a total of £1,230,697 against our claim of £3,518,433.
- 4.9 For deposits with Landsbanki Bevan Brittan (acting on behalf of the Local Government Association) are currently undertaking a significant amount of work on objections to the decisions reached by the Landsbanki Winding Up Board. The decision to award priority

status to our claims has been challenged by other creditors, and objections raised in relation to the WUB's decisions on interest.

- 4.10 Challenges to the WUB decision will follow Icelandic legal processes. These involve three stages. First, the courts require that the parties go through a process of mediation to see whether the dispute can be resolved by agreement. If no agreement is reached, the case is then heard by the Icelandic District Court. If the party that is unsuccessful wishes to appeal the decision, that appeal is heard in the Icelandic Supreme Court. In the court hearings, the parties' cases are presented by Icelandic advocates qualified to represent litigants in the relevant court. The LGA's Icelandic lawyers Logos are representing local authorities,

Treasury management 2010/11

- 4.11 As reported to the committee in January 2010 a report was presented to Council in February 2010 to formally adopt the revised Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management (2009) and a fully revised Prudential Code for Capital Finance in Local authorities. Treasury Management Practice notes, which document the Council's day to day approach to treasury management, are in the process of being updated and will be presented to Cabinet when finalised.
- 4.12 Council also approved a revised treasury strategy for 2010/11. In most of its essential features this continues the policy adopted for 2009/10 (paras 2.1 and 2.2 of this report), with some changes of detail. It
- Formalises the use of credit ratings from all three (rather than two) rating agencies
 - Applies the criteria of 'strong' investment grade as defined by the Audit Commission report 'Risk and Return' as the minimum threshold for investment
 - Opens the possibility of investments of up to a 6 month term, while continuing with a three month operational limit for now
 - Limits investment in building societies to those with equivalent ratings to banks; and postpones use of Money Market Funds
 - Introduces trigger points for review of the policy of deferred borrowing at 4.75% and 5% for 25 year PWLB rates.

5. RESOURCE IMPLICATIONS

- 5.1 No additional costs at this stage. In closing the 2008/09 accounts a reserve was established to cover the costs of any potential Icelandic losses. Regulations require that this charge be made against the 2010/11 accounts, when the scale of any loss should be clearer.
- 5.2 The shortfall in interest is more than offset by the saving made through deferred borrowing (see para. 4.3).

6. OTHER IMPLICATIONS

6.1 The revised code has implications for the requirements placed on officers and members for the scrutiny and management of the treasury function. These were outlined in the previous report to this committee and to council in February. Any training needs arising from this will be addressed during 2010/11.

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 arrangements for treasury management, and

8.2 That the Audit Committee notes the treasury management performance for the period.

SERVICE DIRECTOR FINANCE

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Date: 30 March 2010

STATEMENTS MADE AND REALISED APRIL 2009 TO FEBRUARY 2010**APPENDIX 1**

REF	INVESTMENT INSTITUTION	DATE INVESTED	AMOUNT	STATUS/ DUE DATE OF PAYMENT
INVESTMENTS MADE IN 2009/10				
3466	Barclays Bank PLC	06/04/2009	5,000,000	Repaid
3483	Barclays Bank PLC	06/05/2009	5,000,000	Repaid
3510	Barclays Bank PLC	08/06/2009	1,000,000	Repaid
3532	Barclays Bank PLC	10/07/2009	5,000,000	Repaid
3557	Barclays Bank PLC	10/08/2009	5,000,000	Repaid
3582	Barclays Bank PLC	11/09/2009	5,000,000	Repaid
3610	Barclays Bank PLC	13/10/2009	5,000,000	Repaid
3628	Barclays Bank PLC	13/11/2009	5,000,000	Repaid
3643	Bank of Scotland Fixed Deposit	11/12/2009	3,000,000	11/03/2010
3683	Basildon District Council	12/02/2010	3,000,000	26/03/2010
3633	City of Newcastle upon Tyne MBC	20/11/2009	2,400,000	Repaid
3467	Debt Management Office	07/04/2009	1,990,000	Repaid
3468	Debt Management Office	08/04/2009	2,500,000	Repaid
3469	Debt Management Office	09/04/2009	3,000,000	Repaid
3471	Debt Management Office	14/04/2009	4,000,000	Repaid
3472	Debt Management Office	15/04/2009	1,500,000	Repaid
3473	Debt Management Office	15/04/2009	1,210,000	Repaid
3474	Debt Management Office	15/04/2009	4,200,000	Repaid
3482	Debt Management Office	05/05/2009	1,000,000	Repaid
3485	Debt Management Office	07/05/2009	6,000,000	Repaid
3487	Debt Management Office	08/05/2009	2,000,000	Repaid
3491	Debt Management Office	15/05/2009	4,000,000	Repaid
3497	Debt Management Office	27/05/2009	3,700,000	Repaid
3498	Debt Management Office	27/05/2009	2,000,000	Repaid
3499	Debt Management Office	27/05/2009	1,500,000	Repaid
3500	Debt Management Office	27/05/2009	3,200,000	Repaid
3501	Debt Management Office	27/05/2009	1,300,000	Repaid
3502	Debt Management Office	27/05/2009	2,000,000	Repaid
3504	Debt Management Office	01/06/2009	3,895,000	Repaid
3505	Debt Management Office	02/06/2009	4,000,000	Repaid
3507	Debt Management Office	03/06/2009	2,000,000	Repaid
3515	Debt Management Office	15/06/2009	3,000,000	Repaid
3523	Debt Management Office	30/06/2009	3,485,000	Repaid
3524	Debt Management Office	01/07/2009	3,000,000	Repaid
3527	Debt Management Office	03/07/2009	5,000,000	Repaid
3531	Debt Management Office	09/07/2009	1,300,000	Repaid
3533	Debt Management Office	10/07/2009	1,000,000	Repaid
3536	Debt Management Office	15/07/2009	5,000,000	Repaid
3538	Debt Management Office	20/07/2009	5,000,000	Repaid
3540	Debt Management Office	22/07/2009	1,000,000	Repaid
3542	Debt Management Office	27/07/2009	4,540,000	Repaid
3546	Debt Management Office	31/07/2009	1,000,000	Repaid
3549	Debt Management Office	03/08/2009	5,000,000	Repaid
3550	Debt Management Office	03/08/2009	5,000,000	Repaid
3551	Debt Management Office	04/08/2009	1,000,000	Repaid
3555	Debt Management Office	07/08/2009	1,000,000	Repaid
3558	Debt Management Office	10/08/2009	3,000,000	Repaid
3562	Debt Management Office	17/08/2009	5,000,000	Repaid
3567	Debt Management Office	24/08/2009	1,225,000	Repaid
3570	Debt Management Office	28/08/2009	3,025,000	Repaid

3571	Debt Management Office	01/09/2009	3,500,000	Repaid
3574	Debt Management Office	02/09/2009	1,000,000	Repaid
3575	Debt Management Office	03/09/2009	3,000,000	Repaid
3577	Debt Management Office	07/09/2009	2,500,000	Repaid
3587	Debt Management Office	15/09/2009	1,165,000	Repaid
3589	Debt Management Office	17/09/2009	750,000	Repaid
3591	Debt Management Office	18/09/2009	3,000,000	Repaid
3592	Debt Management Office	18/09/2009	1,300,000	Repaid
3594	Debt Management Office	22/09/2009	2,515,000	Repaid
3596	Debt Management Office	24/09/2009	1,000,000	Repaid
3599	Debt Management Office	28/09/2009	5,500,000	Repaid
3600	Debt Management Office	28/09/2009	3,500,000	Repaid
3604	Debt Management Office	02/10/2009	3,750,000	Repaid
3606	Debt Management Office	05/10/2009	3,000,000	Repaid
3612	Debt Management Office	15/10/2009	5,475,000	Repaid
3614	Debt Management Office	16/10/2009	5,075,000	Repaid
3615	Debt Management Office	19/10/2009	5,000,000	Repaid
3622	Debt Management Office	05/11/2009	3,850,000	Repaid
3629	Debt Management Office	16/11/2009	4,000,000	Repaid
3646	Debt Management Office	15/12/2009	3,000,000	Repaid
3647	Debt Management Office	15/12/2009	6,534,000	Repaid
3648	Debt Management Office	16/12/2009	6,200,000	Repaid
3653	Debt Management Office	22/12/2009	1,040,000	Repaid
3658	Debt Management Office	05/01/2010	3,250,000	Repaid
3659	Debt Management Office	06/01/2010	3,165,000	Repaid
3661	Debt Management Office	11/01/2010	1,300,000	Repaid
3662	Debt Management Office	12/01/2010	1,890,000	Repaid
3664	Debt Management Office	14/01/2010	6,285,000	Repaid
3665	Debt Management Office	15/01/2010	3,525,000	Repaid
3687	Debt Management Office	17/02/2010	2,000,000	Repaid
3597	Falkirk Council	25/09/2009	2,400,000	Repaid
3676	Halton Borough Council	02/02/2010	1,000,000	22/03/2010
3602	Leeds Building Society	01/10/2009	3,000,000	Repaid
3689	Leeds City Council	19/02/2010	2,000,000	23/03/2010
3667	London Borough of Brent	19/01/2010	3,000,000	Repaid
3632	London Borough of Hillingdon	19/11/2009	3,000,000	Repaid
3590	Nationwide Building Society	18/09/2009	5,000,000	Repaid
3598	North Warwickshire Borough Council	25/09/2009	1,000,000	Repaid
3608	Northern Rock PLC	07/10/2009	3,000,000	Repaid
3611	Northern Rock PLC	14/10/2009	2,000,000	Repaid
3682	Salford City Council	11/02/2010	1,000,000	26/03/2010
3678	South End on Sea Borough Council	04/02/2010	3,000,000	31/03/2010
3605	Stockport Metropolitan Borough Council	05/10/2009	400,000	Repaid
3638	The Highland Council	01/12/2009	3,000,000	Repaid
3675	West Yorkshire Fire & Rescue	01/02/2010	1,000,000	26/03/2010

3684	West Yorkshire Police Authority	15/02/2010	3,000,000	22/03/2010
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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 Building Society	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

INVESTMENT POSITION 28 February 2010

CALL ACCOUNT BALANCES

Santander UK Plc Call Account	4,957,034	On Call
Bank of Scotland Call Account	968,115	On Call
Barclays Bank Plc Call Account	5,000,000	On Call
HSBC Bank Call Account	0	On Call
NatWest Special Interest Bearing Account	5,254,115	On Call

OTHER INVESTMENTS

Bank of Scotland Plc	3,000,000	Repayment at Term
Basildon District Council	3,000,000	Repayment at Term
West Yorkshire Fire & Rescue	1,000,000	Repayment at Term
West Yorkshire Police Authority	3,000,000	Repayment at Term
Salford City Council	1,000,000	Repayment at Term
Halton Borough Council	1,000,000	Repayment at Term
Southend On Sea Borough Council	3,000,000	Repayment at Term
Leeds City Council	2,000,000	Repayment at Term
Heritable Bank Limited	2,492,488	In Administration
Landsbanki Islands	2,000,000	In Receivership

TOTAL INVESTED AS AT 28.02.10

37,671,752

	2009/10 Budget	2009/10 Forecast
(i) estimates of capital expenditure*	£'000 65,171	£'000 45,542
(ii) General Fund ratio of financing costs to the net revenue stream	5.60%	5.22%
(iii) an estimate of the capital financing requirement	£'000 126,275	£'000 127,271
(iv) the authorised limit for external debt borrowing other long term liabilities total	£'000 214,000 5,000 219,000	£'000 214,000 5,000 219,000
(v) the operational boundary for external debt borrowing other long term liabilities total	£'000 138,000 5,000 143,000	£'000 138,000 5,000 143,000
(vi) upper limit for fixed rate exposure	% 100	% 100
(vii) upper limit for variable rate exposure	% 20	% 20
(viii) upper and lower limits for maturity structure of borrowing UPPER LIMIT under 12 months 12 months and within 24 months 24 months and within 5 years 5 years and within 10 years 10 years and above LOWER LIMIT under 12 months 12 months and within 24 months 24 months and within 5 years 5 years and within 10 years 10 years and above	% 15 15 50 75 90 0 0 0 0 25	% 15 15 50 75 90 0 0 0 0 25
(ix) total principal sums invested for periods longer than 364 days	£000 0	£000 0

* Changes to the capital programme are a rephrasing of schemes from 2008/09 and additional external funding approvals received since the budget was set