

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 2010. The report explains how the strategy has been implemented to date, and the response to changing conditions in financial markets.
- 1.3 The report also provides an update on our Icelandic investments.

2. BACKGROUND INFORMATION

- 2.1 The **investment strategy for 2010/2011** aims to reduce risk by
 - Investing for shorter periods
 - Investing In UK institutions with high credit ratings or equivalent
 - Applying a maximum investment limit of £5m for most
 - Applying a maximum limit to financial groups rather than separate institutions
 - Using the option of highly rated foreign banks when prudent to do so.
- 2.2 The **borrowing strategy for 2010/2011** aims to
 - Delay borrowing in the plan period as long as it is prudent
 - Borrow only to support the capital programme
 - Borrow at a time which is most advantageous on cost
 - Maximize borrowing through the Public Works Loans Board (PWLB)
 - Retain the option to borrow for shorter periods and
 - Consider debt rescheduling.

2.3 The council's budget was framed against the current state of financial markets. This includes a Bank of England Base Rate of 0.5% since 5 March 2009 with an expectation that rates will remain at 0.5% at least until autumn 2010. Given the uncertainties surrounding the UK economic outlook the council's budget therefore takes a prudent view by building in short-term investment returns closely aligned to the average of market projections: 1% for 2010/11, 2% for 2011/12 and 3% for 2012/13.

2.4 The budget also projects an average cost of borrowing equivalent to a 25 year maturity rate of 5% from the Public Works Loans Board for the plan period 2010/13; and sets 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 continued to apply a range of criteria to reduce risk by narrowing further the investment options allowed by the strategy until the banking sector recovers greater stability and the implications of a change in government work through fully:

- From April to August the maximum term of one month was the norm for investments. The maximum term was extended to three months from early September where additional returns were justified.
- No new investments in foreign banks
- No use of Money Market Funds
- Investment only in those 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
- 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 a narrow range of UK institutions: UK banks, the Nationwide Building Society and governmental bodies including the Debt Management Office and other local authorities. All investments due to be realised during the period were returned with interest or reinvested. Outstanding investments at the end of December 2010 were £41.346m, including £4.428m with the council's own bankers (**see appendix 1**).
- 4.3 The price of increased security has been that interest earned has been below target: actual achieved April to December 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 £0.160m against a full year target of £0.49m.

Borrowing strategy

- 4.4 However, in line with the strategy, borrowing to finance the capital programme has been delayed. To date borrowing of £6.3m and £13.5m to fund the 2008/09 and 2009/10 capital programme has been deferred substituted by 'internal borrowing' from council cash balances. Similarly planned borrowing of £30.8m for the 2010/11 programme will be deferred for the time being. At this point it is estimated that this will save £1.012m in borrowing costs in 2010/11, a net £0.615m saving after deducting interest foregone on cash investments.
- 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 (typical cost of PWLB borrowing 5%, average investment return between 0.5% and 1%). The amount of cash exposed 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 On 20 October 2010, as part of the Comprehensive Spending Review, PWLB rates were raised by an average 1% with immediate effect. This was a government policy decision and increased the prevailing 25 year rate to a little over 5%. Rates fluctuate on a daily basis through the year and this uplift brought market rates into line with the budgeted 5%. It did not therefore warrant a change in our strategy of continuing to defer borrowing.
- 4.7 Key performance indicators have been updated following the rephasing of the capital programme approved at cabinet on 8 December 2010. These are shown at **appendix 2**. The reduction in planned spending in 2010/11 brings down the expected financing cost to revenue (5.13%) and the authorised and operational limits for external debt.

Icelandic Investments

- 4.8 The council has taken steps to recover investments with Icelandic banks in concert with other local authorities through the Local Government Association.
- 4.9 The administration of Heritable is progressing well. The latest advice is to expect a return of 85 pence in the pound. The table below shows current position against a claim of £3.518m.

Interim Payment Number	Date Received	Cumulative Pence in the Pound Received P	Amount Received £	Cumulative Amount Received £
1	30.07.09	16.13	567,384	567,384
2	18.12.09	28.79	445,414	1,012,798
3	30.03.10	34.98	217,899	1,230,697
4	16.07.10	41.25	220,761	1,451,458
5	18.10.10	45.39	145,571	1,597,029

The next interim dividend is expected in late January 2011.

- 4.10 For deposits with Landsbanki the latest advice is to expect a return of 95 pence in the pound assuming that local authorities' status as preferential depositors is upheld. A hearing was held in October 2010 to discuss the procedure to trial. At this, the single judge allocated to the case confirmed a panel of 3 judges is being appointed to hear the test cases, although details of the judges are yet to be confirmed. The trial of the test cases has been listed for 1- 9 February 2011.

5. RESOURCE IMPLICATIONS

- 5.1 No additional costs at this stage. The shortfall in interest is more than offset by the saving made through deferred borrowing (see para. 4.4).

6. OTHER IMPLICATIONS

- 6.1 The agreed treasury strategy aims to minimise risk to the council finances from any further instability in financial markets.

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: 6 January 2011

Background Papers used in the preparation of this report

LAAP Bulletin 82 'Guidance on the impairment of deposits with Icelandic banks',
CIPFA – 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

INVESTMENT POSITION AS AT 31 DECEMBER 2010**CALL ACCOUNT BALANCES**

Santander UK plc Call Account	4,740	On call
Barclays Bank plc Call Account	5,000,000	On call
Bank of Scotland Plc Call Account	2,000,000	On call
HSBC Bank Plc Call Account	1,723	On call
National Westminster Bank Plc Special Interest Bearing Account	4,427,571	On call

OTHER INVESTMENTS

Aberdeen City Council	3,000,000	Repayment at term
Bank of Scotland Plc	3,000,000	Repayment at term
Cheltenham Borough Council	2,000,000	Repayment at term
City of Southampton Council	1,000,000	Repayment at term
Coventry Building Society	3,000,000	Repayment at term
Lancashire County Council	3,000,000	Repayment at term
Mid Lothian Council	3,000,000	Repayment at term
Nationwide Building Society	5,000,000	Repayment at term
Salford City Council	3,000,000	Repayment at term
Heritable bank Limited	1,911,542	In administration
Landsbanki Islands	2,000,000	In receivership

TOTAL	41,345,576	
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APPENDIX 1A

INVESTMENTS MADE AND REALISED APRIL TO DECEMBER 2010

INVESTMENT INSTITUTION	DATE INVESTED	AMOUNT £	STATUS/DUE DATE OF PAYMENT
INVESTMENTS MADE SINCE 1 APRIL 20			
Aberdeen City Council	15/12/2010	3,000,000.00	01.02.11
Bank of Scotland Fixed Term Deposit	10/09/2010	1,000,000.00	Repaid
Bank of Scotland Fixed Term Deposit	01/10/2010	1,000,000.00	Repaid
Bank of Scotland Fixed Term Deposit	05/11/2010	3,000,000.00	04.02.11
Barnsley Borough Council	14/05/2010	2,200,000.00	Repaid
Birmingham City Council	21/07/2010	2,000,000.00	Repaid
Birmingham City Council	15/09/2010	3,000,000.00	Repaid
Birmingham City Council	12/11/2010	3,000,000.00	Repaid
Blaenau Gwent County Borough Council	30/06/2010	2,000,000.00	Repaid
Blaenau Gwent County Borough Council	03/08/2010	2,000,000.00	Repaid
Blaenau Gwent County Borough Council	03/09/2010	1,700,000.00	Repaid
Bristol City Council	07/09/2010	2,000,000.00	Repaid
Cheltenham Borough Council	30/07/2010	2,500,000.00	Repaid
Cheltenham Borough Council	01/12/2010	2,000,000.00	28.01.11
City of Plymouth Council	01/06/2010	2,000,000.00	Repaid
City of Plymouth Council	28/06/2010	1,000,000.00	Repaid
City of Plymouth Council	21/07/2010	2,000,000.00	Repaid
City of Southampton Council	14/12/2010	1,000,000.00	17.01.11
Coventry Building Society	15/10/2010	3,000,000.00	Repaid
Coventry Building Society	15/12/2010	3,000,000.00	17.01.11
Debt Management Office	06/04/2010	4,800,000.00	Repaid
Debt Management Office	06/04/2010	4,800,000.00	Repaid
Debt Management Office	14/04/2010	3,550,000.00	Repaid
Debt Management Office	04/05/2010	4,990,000.00	Repaid
Debt Management Office	05/05/2010	795,000.00	Repaid
Debt Management Office	06/05/2010	3,090,000.00	Repaid
Debt Management Office	10/05/2010	4,000,000.00	Repaid
Debt Management Office	11/05/2010	3,700,000.00	Repaid
Debt Management Office	27/05/2010	4,000,000.00	Repaid
Debt Management Office	02/06/2010	1,500,000.00	Repaid
Debt Management Office	02/06/2010	5,700,000.00	Repaid
Debt Management Office	02/06/2010	1,500,000.00	Repaid
Debt Management Office	02/06/2010	2,800,000.00	Repaid
Debt Management Office	11/06/2010	1,000,000.00	Repaid
Debt Management Office	15/06/2010	7,500,000.00	Repaid
Debt Management Office	15/06/2010	2,335,000.00	Repaid
Debt Management Office	01/07/2010	2,300,000.00	Repaid
Debt Management Office	05/07/2010	1,000,000.00	Repaid

Debt Management Office	06/07/2010	5,690,000.00	Repaid
Debt Management Office	15/07/2010	2,000,000.00	Repaid
Debt Management Office	23/08/2010	2,000,000.00	Repaid
Debt Management Office	01/09/2010	2,000,000.00	Repaid
Debt Management Office	01/09/2010	3,900,000.00	Repaid
Debt Management Office	22/09/2010	2,250,000.00	Repaid
Debt Management Office	20/10/2010	3,000,000.00	Repaid
Debt Management Office	22/11/2010	500,000.00	Repaid
Debt Management Office	15/12/2010	2,000,000.00	Repaid
Debt Management Office	15/12/2010	2,000,000.00	Repaid
Debt Management Office	20/12/2010	3,000,000.00	Repaid
Dumfries and Galloway Council	28/06/2010	2,000,000.00	Repaid
Dumfries and Galloway Council	15/11/2010	3,000,000.00	Repaid
Lancashire County Council	15/12/2010	3,000,000.00	21.02.11
Merthyr Tydfil Borough Council	29/06/2010	1,000,000.00	Repaid
Mid Lothian Council	14/12/2010	3,000,000.00	28.02.11
Nationwide Building Society	15/04/2010	3,000,000.00	Repaid
Nationwide Building Society	05/05/2010	2,000,000.00	Repaid
Nationwide Building Society	17/05/2010	3,000,000.00	Repaid
Nationwide Building Society	08/06/2010	2,000,000.00	Repaid
Nationwide Building Society	18/06/2010	3,000,000.00	Repaid
Nationwide Building Society	12/07/2010	2,000,000.00	Repaid
Nationwide Building Society	20/07/2010	3,000,000.00	Repaid
Nationwide Building Society	13/08/2010	2,000,000.00	Repaid
Nationwide Building Society	20/08/2010	3,000,000.00	Repaid
Nationwide Building Society	14/09/2010	2,000,000.00	Repaid
Nationwide Building Society	21/09/2010	3,000,000.00	Repaid
Nationwide Building Society	14/10/2010	2,000,000.00	Repaid
Nationwide Building Society	22/10/2010	3,000,000.00	Repaid
Nationwide Building Society	15/11/2010	2,000,000.00	Repaid
Nationwide Building Society	22/11/2010	3,000,000.00	31.01.11
Nationwide Building Society	30/11/2010	2,000,000.00	28.01.11
Northamptonshire County Council	28/06/2010	1,000,000.00	Repaid
Plymouth City Council	17/09/2010	3,000,000.00	Repaid
Plymouth City Council	22/10/2010	3,000,000.00	Repaid
Reigate and Banstead Borough Council	20/04/2010	3,000,000.00	Repaid
Salford City Council	13/04/2010	3,000,000.00	Repaid
Salford City Council	15/12/2010	3,000,000.00	28.01.11
Sheffield City Council	25/05/2010	3,000,000.00	Repaid
Sheffield City Council	18/06/2010	3,000,000.00	Repaid
Sheffield City Council	23/07/2010	3,000,000.00	Repaid
Sheffield City Council	12/10/2010	3,000,000.00	Repaid
Sheffield City Council	12/11/2010	3,000,000.00	Repaid
Southend On Sea Borough Council	20/09/2010	3,000,000.00	Repaid
Stafford Borough Council	23/07/2010	1,000,000.00	Repaid
Stirling District Council	26/04/2010	2,000,000.00	Repaid

Swindon Borough Council	19/07/2010	3,000,000.00	Repaid
Swindon Borough Council	20/08/2010	3,000,736.44	Repaid
Thurrock Borough Council	16/08/2010	3,000,000.00	Repaid
Thurrock Borough Council	17/09/2010	3,000,000.00	Repaid
Thurrock Borough Council	15/10/2010	3,000,000.00	Repaid
Torfaen County Borough Council	23/07/2010	1,470,000.00	Repaid
West Yorkshire Fire & Rescue Service	24/05/2010	3,000,000.00	Repaid
West Yorkshire Fire & Rescue Service	25/06/2010	3,000,000.00	Repaid

INVESTMENTS MADE BEFORE 1 APRIL 2010

Heritable bank Limited	01/09/2008	1,365,387.33	In administration
Heritable bank Limited	12/09/2008	546,154.93	In administration
Landsbanki Islands	08/08/2008	1,000,000.00	In receivership
Landsbanki Islands	01/09/2008	1,000,000.00	In receivership
Bank of Scotland Fixed Term Deposit	25/03/2010	1,000,000.00	Repaid
Basildon District Council	26/03/2010	3,000,000.00	Repaid
Stirling District Council	25/03/2010	2,000,000.00	Repaid