

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 March 2011. 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** aimed 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** aimed 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. Although there are expectations that the rate will rise in the near future, there still remains a large degree of uncertainty about when exactly this will happen, and how sharply the rate will then be incremented. Given the general uncertainties surrounding the UK economic outlook the council's revised 2010/11 budget therefore takes a prudent view by building in short-term investment returns closely aligned to the average of market projections: 0.5% for 2010/11, 1% for 2011/12 and 1.5% for 2012/13.

2.4 The budget also projects an average cost of borrowing 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 a maximum term of one month was the norm for investments. This 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 Management Network, 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 were £20m, including £7.4m with the council's own bankers (see **appendix 1 and 1A**) at the end of March.
- 4.3 The historically low base rate means returns on investments continue to be very modest, an average of 0.6% in 2010/11 against a base rate in the same period of 0.5%. The budget was revised in year to reflect this, and the return has been £0.211m against a full year target of £0.200m.

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, £13.5m and £30.8m to fund the 2008/09, 2009/10 and 2010/11 capital programme has been deferred, substituted by 'internal borrowing' from council cash balances. At this point it is estimated that this will save £1m in borrowing costs in 2010/11, a net £0.6m 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 Key performance indicators have been updated following the rephrasing of the capital programme approved at Council on 23 February 2011. These are shown at **appendix 2**. The reduction in planned spending in 2010/11 brings down the expected financing cost to revenue (5.1%) and reduces the authorised and operational limits for external debt.

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. 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
6	14.01.11	50.10	165,964	1,762,993

The next interim dividend is expected in April 2011.

4.9 For deposits with Landsbanki the latest advice is to expect a return of 85 to 90 pence in the pound. Following a hearing on test cases in February the Icelandic District Court has ruled that deposits placed by UK wholesale depositors – such as local authorities- have priority status in the winding up of Landsbanki. This confirms the Winding Up Board's position on the issue. The decision is likely to be subject to appeal by the other parties, whose claims are not secured.

5. RESOURCE IMPLICATIONS

5.1 Interest returns are in line with the revised budget for 2010/11. A positive outcome is still expected on the return of Icelandic investments. Over half the investment in Heritable Bank has now been realised, and further repayments are scheduled.

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: 4 April 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

APPENDIX 1**INVESTMENT POSITION AS AT 31 MARCH 2011****CALL ACCOUNT BALANCES**

£

Santander UK plc Call Account	4,741	On call
Barclays Bank plc Call Account	5,000,000	On call
Bank of Scotland Plc Call Account	396,282	On call
HSBC Bank Plc Call Account	1,916	On call
National Westminster Bank Plc Special Interest Bearing Account	7,400,851	On call

OTHER INVESTMENTS

Salford City Council	3,500,000	Repayment at term
Heritable bank Limited	1,746,528	In administration
Landsbanki Islands	2,000,000	In receivership

TOTAL **20,050,319**

APPENDIX 1A

INVESTMENTS MADE AND REALISED APRIL 2010 TO 31 MARCH 2011

INVESTMENT INSTITUTION	DATE INVESTED	AMOUNT	STATUS/DUE DATE OF PAYMENT
INVESTMENTS MADE SINCE 1 APRIL 2010			£
Aberdeen City Council	15/12/2010	3,000,000	Repaid
Bank of Scotland Fixed Term Deposit	10/09/2010	1,000,000	Repaid
Bank of Scotland Fixed Term Deposit	01/10/2010	1,000,000	Repaid
Bank of Scotland Fixed Term Deposit	05/11/2010	3,000,000	Repaid
Barnsley Borough Council	14/05/2010	2,200,000	Repaid
Birmingham City Council	21/07/2010	2,000,000	Repaid
Birmingham City Council	15/09/2010	3,000,000	Repaid
Birmingham City Council	12/11/2010	3,000,000	Repaid
Blaenau Gwent County Borough Council	30/06/2010	2,000,000	Repaid
Blaenau Gwent County Borough Council	03/08/2010	2,000,000	Repaid
Blaenau Gwent County Borough Council	03/09/2010	1,700,000	Repaid
Bristol City Council	07/09/2010	2,000,000	Repaid
Cheltenham Borough Council	30/07/2010	2,500,000	Repaid
Cheltenham Borough Council	01/12/2010	2,000,000	Repaid
City of Plymouth Council	01/06/2010	2,000,000	Repaid
City of Plymouth Council	28/06/2010	1,000,000	Repaid
City of Plymouth Council	21/07/2010	2,000,000	Repaid
City of Southampton Council	14/12/2010	1,000,000	Repaid
Coventry Building Society	15/10/2010	3,000,000	Repaid
Coventry Building Society	15/12/2010	3,000,000	Repaid
Coventry Building Society	17/01/2011	3,000,000	Repaid
Debt Management Office	06/04/2010	4,800,000	Repaid
Debt Management Office	06/04/2010	4,800,000	Repaid
Debt Management Office	14/04/2010	3,550,000	Repaid
Debt Management Office	04/05/2010	4,990,000	Repaid
Debt Management Office	05/05/2010	795,000	Repaid
Debt Management Office	06/05/2010	3,090,000	Repaid
Debt Management Office	10/05/2010	4,000,000	Repaid
Debt Management Office	11/05/2010	3,700,000	Repaid
Debt Management Office	27/05/2010	4,000,000	Repaid
Debt Management Office	02/06/2010	1,500,000	Repaid
Debt Management Office	02/06/2010	5,700,000	Repaid
Debt Management Office	02/06/2010	1,500,000	Repaid
Debt Management Office	02/06/2010	2,800,000	Repaid
Debt Management Office	11/06/2010	1,000,000	Repaid
Debt Management Office	15/06/2010	7,500,000	Repaid
Debt Management Office	15/06/2010	2,335,000	Repaid
Debt Management Office	01/07/2010	2,300,000	Repaid

Debt Management Office	05/07/2010	1,000,000	Repaid
Debt Management Office	06/07/2010	5,690,000	Repaid
Debt Management Office	15/07/2010	2,000,000	Repaid
Debt Management Office	23/08/2010	2,000,000	Repaid
Debt Management Office	01/09/2010	2,000,000	Repaid
Debt Management Office	01/09/2010	3,900,000	Repaid
Debt Management Office	22/09/2010	2,250,000	Repaid
Debt Management Office	20/10/2010	3,000,000	Repaid
Debt Management Office	22/11/2010	500,000	Repaid
Debt Management Office	15/12/2010	2,000,000	Repaid
Debt Management Office	15/12/2010	2,000,000	Repaid
Debt Management Office	20/12/2010	3,000,000	Repaid
Debt Management Office	05/01/2011	3,250,000	Repaid
Debt Management Office	07/01/2011	2,465,000	Repaid
Debt Management Office	17/01/2011	1,500,000	Repaid
Debt Management Office	07/03/2011	1,000,000	Repaid
Debt Management Office	23/03/2011	2,300,000	Repaid
Dumfries and Galloway Council	28/06/2010	2,000,000	Repaid
Dumfries and Galloway Council	15/11/2010	3,000,000	Repaid
Lancashire County Council	15/12/2010	3,000,000	Repaid
Leeds City Council	13/01/2011	3,000,000	Repaid
Leeds City Council	18/02/2011	3,000,000	Repaid
Merthyr Tydfil Borough Council	29/06/2010	1,000,000	Repaid
Mid Lothian Council	14/12/2010	3,000,000	Repaid
Nationwide Building Society	15/04/2010	3,000,000	Repaid
Nationwide Building Society	05/05/2010	2,000,000	Repaid
Nationwide Building Society	17/05/2010	3,000,000	Repaid
Nationwide Building Society	08/06/2010	2,000,000	Repaid
Nationwide Building Society	18/06/2010	3,000,000	Repaid
Nationwide Building Society	12/07/2010	2,000,000	Repaid
Nationwide Building Society	20/07/2010	3,000,000	Repaid
Nationwide Building Society	13/08/2010	2,000,000	Repaid
Nationwide Building Society	20/08/2010	3,000,000	Repaid
Nationwide Building Society	14/09/2010	2,000,000	Repaid
Nationwide Building Society	21/09/2010	3,000,000	Repaid
Nationwide Building Society	14/10/2010	2,000,000	Repaid
Nationwide Building Society	22/10/2010	3,000,000	Repaid
Nationwide Building Society	15/11/2010	2,000,000	Repaid
Nationwide Building Society	22/11/2010	3,000,000	Repaid
Nationwide Building Society	30/11/2010	2,000,000	Repaid
Nationwide Building Society	03/02/2011	3,000,000	Repaid
Newcastle Upon Tyne City Council	14/02/2011	3,000,000	Repaid
North Lanarkshire Council	18/02/2011	1,500,000	Repaid
Northamptonshire County Council	28/06/2010	1,000,000	Repaid
Plymouth City Council	17/09/2010	3,000,000	Repaid
Plymouth City Council	22/10/2010	3,000,000	Repaid
Reigate and Banstead Borough Council	20/04/2010	3,000,000	Repaid

Salford City Council	13/04/2010	3,000,000	Repaid
Salford City Council	15/12/2010	3,000,000	Repaid
Salford City Council	15/03/2011	3,500,000	28.04.11
Sheffield City Council	25/05/2010	3,000,000	Repaid
Sheffield City Council	18/06/2010	3,000,000	Repaid
Sheffield City Council	23/07/2010	3,000,000	Repaid
Sheffield City Council	12/10/2010	3,000,000	Repaid
Sheffield City Council	12/11/2010	3,000,000	Repaid
Sheffield City Council	10/01/2011	3,000,000	Repaid
Southend On Sea Borough Council	20/09/2010	3,000,000	Repaid
Stafford Borough Council	23/07/2010	1,000,000	Repaid
Stirling District Council	26/04/2010	2,000,000	Repaid
Swindon Borough Council	19/07/2010	3,000,000	Repaid
Swindon Borough Council	20/08/2010	3,000,736	Repaid
Thurrock Borough Council	16/08/2010	3,000,000	Repaid
Thurrock Borough Council	17/09/2010	3,000,000	Repaid
Thurrock Borough Council	15/10/2010	3,000,000	Repaid
Thurrock Borough Council	14/01/2011	3,000,000	Repaid
Torfaen County Borough Council	23/07/2010	1,470,000	Repaid
West Yorkshire Fire & Rescue Service	24/05/2010	3,000,000	Repaid
West Yorkshire Fire & Rescue Service	25/06/2010	3,000,000	Repaid

INVESTMENTS MADE BEFORE 1 APRIL 2010

Heritable bank Limited	01/09/2008	1,365,387	In administration
Heritable bank Limited	12/09/2008	546,155	In administration
Landsbanki Islands	08/08/2008	1,000,000	In receivership
Landsbanki Islands	01/09/2008	1,000,000	In receivership
Bank of Scotland Fixed Term Deposit	25/03/2010	1,000,000	Repaid
Basildon District Council	26/03/2010	3,000,000	Repaid
Stirling District Council	25/03/2010	2,000,000	Repaid

PRUDENTIAL GUIDELINE INDICATORS AT 31 MARCH 2011

APPENDIX 2

	2010/11 Budget	2010/11 Forecast
(i) estimates of capital expenditure*	£'000 88,587	£'000 67,112
(ii) General Fund ratio of financing costs to the net revenue stream	5.4%	5.1%
(iii) an estimate of the capital financing requirement	154,000	150,000
(iv) the authorised limit for external debt borrowing other long term liabilities total	242,000 5,000 247,000	240,000 5,000 245,000
(v) the operational boundary for external debt borrowing other long term liabilities total	162,000 5,000 167,000	161,000 5,000 166,000
(vi) upper limit for fixed rate exposure	% 100	no change
(vii) upper limit for variable rate exposure	20	no change
(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	 no change no change
(ix) total principal sums invested for periods longer than 364 days	£000 0	£000 0

*The budget is reviewed and rephased regularly through the year