Report of the Director of Policy and Resources

Agenda Item No:
Meeting 28th June 2012

NORTH LINCOLNSHIRE COUNCIL

AUDIT COMMITTEE

TREASURY MANAGEMENT AND INVESTMENT STRATEGY ANNUAL REPORT 2011/12

1. **OBJECT AND KEY POINTS IN THIS REPORT**

1.1 This is a report on treasury performance in 2011/12. The benchmark for measuring performance is the treasury strategy which the council set at its meeting on 23 February 2011.

1.3 The report covers
- The legal and regulatory framework
- How the council performed
- The latest position on our investments with Icelandic banks.

1.4 The key results were that the council

- Invested with an ever narrowing range of counterparties
- Generated an average return of 0.5% for the year
- Deferred borrowing for the capital programme
- Kept the cost of borrowing below 6% of revenue stream
- Recovered further sums from Heritable bank, the UK subsidiary of Landsbanki, and directly from Landsbanki itself.

2. **BACKGROUND INFORMATION**

The legal and regulatory framework

2.1 The annual treasury management and investment strategy was prepared in line with

- The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management April 2009.
- The Prudential Code
- The Local Government Finance Act 2003
- And guidance on Local Government Investments from the Department for Communities & Local Government (DCLG).

2.2 The code of practice requires that full Council receive a report on treasury management strategy at the start of the financial year, at mid-year and at year end. The Audit Committee receives progress reports at each meeting and an annual report on the outturn position.

3 OPTIONS FOR CONSIDERATION

3.1 There are no options for consideration. However the performance against the approved strategy can be evaluated. The annual strategy covers:

- the investment strategy
- the borrowing strategy
- and the prudential indicators for external debt and treasury management.

The Strategy for 2011-12

3.2 The strategy for 2011/12 was based on the council's views on interest rates and appropriate counterparties for investment and borrowing based on experience, market intelligence including that provided by credit rating agencies, brokers, advisors and the financial press.

The key projections were:

- An average bank base rate of 0.5%
- An average PWLB loan rate of 5.46% (25 year maturity)

The Investment Strategy

3.3 The Investment strategy for 2011-12 aimed to reduce risk by;

- Investing for short periods
- Investing in UK institutions with high credit ratings or equivalent
- Applying a maximum limit to financial groups rather than separate institutions
- Applying a maximum investment limit of £5m for most groups
- Using the option of highly rated foreign banks when prudent to do so.
- Keeping an appropriate maturity profile of investments to minimize exposure to liquidity risk and interest rate risk.

(see Appendix 1 for list of approved counterparties)

The Borrowing Strategy

3.4 The Borrowing Strategy for 2011-12 aimed to;

- Delay borrowing in the plan period as and use cash balances instead
- Borrow only to support the capital programme
- Borrow at a time most advantageous on cost
- Maximise borrowing through the Public Works Loans Board (PWLB)
- Retain the option to borrow for shorter periods
- Consider debt rescheduling

How the council performed

3.5 The key investment statistics follow with further detail at appendix 2:

- It should be noted that all investments during the year were made against a backdrop of considerable uncertainty in the global financial systems, exacerbated by frequent adverse reports and downgrading of major financial institutions by the credit rating agencies.
- Therefore, throughout the year a conservative and prudent approach to the strategy was applied, with most investments being considerably less than the 6 months allowed within the strategy. This was considered necessary to maximise security and liquidity of council funds.
- Throughout the year the vast majority of investments were kept short, with 80% of all fixed rate investments being for 31 days or less. The average fixed term investment period was 17 days, with the maximum duration of investment being 44 days (this was with another local authority).
- To maximise security extensive use has been made throughout the year of investing with the UK Debt Management Office [DMO](65% of all fixed term investments), other Local Authorities (26%) and highly rated building societies (9%).
- No new investments were made in foreign banks.
- No use was made of Money Market Funds.
- Investments were made in building societies only where they met the same minimum credit rating applied to bank investments.
- To reduce risk, where institutions were given a negative rating watch or were under review for possible downgrade, no new investments were made if the resulting rating would then be likely to fall below the minimum criteria.
- That is with the exception of investments with institutions offering call account facilities, as in effect cash remained fully liquid. This included the council's bankers Natwest (RBS).
- The average balance invested was £33.6m
- This was in the form of 286 separate investments totalling £457m.
- Generating an average return of 0.5% for the year compared to a target of average base plus 0.1% i.e. 0.6%. The return reflects on the risk averse investment strategy applied, which involved the extensive use of the DMO for secure investment.
- The closing investment balance was £9.04m, a decrease of £10.17m on the starting balance of £19.21m.
- The historically low base rate and a greater emphasis of security over yield has meant that returns on investment have remained low

3.6 The key borrowing statistics were (also see related performance indicators at appendix 3):

- Overall capital spending of £57.4m against a revised budget of £63.4m.
- Debt financing costs of 4.97% of revenue stream, within the council's guideline of 6%, in part due to the decision to defer new borrowing

- Total debt kept within the authorised and operational boundaries set in the strategy
- And the maturity profile of debt also within the limits set

3.7 The decision to defer new borrowing for capital purposes continues the practice started in 2008/09. This avoids the short-term cost of paying the differential between the rates at which we can borrow and rate of return on our investment. It makes temporary use of cash balances which would otherwise be exposed to potential loss in volatile financial markets. Between 2008/09 to 2010/11 £42.6m of borrowing was deferred. A further £20m has been deferred in 2011/12. The strategy will be followed as long as it is prudent to do so and while cash reserves are sufficient.

Icelandic Investments

3.8 The council has investments with two Icelandic owned institutions, Landsbanki and Heritable. These investments pre-date the collapse of Lehman brothers, and the systemic threat to the world banking system which followed. North Lincolnshire Council's Icelandic investments were frozen in October 2008 and joint action to recover these funds has continued in concert with other local authorities through the Local Government Association.

3.9 The administration of Heritable is progressing well. The latest advice is to expect a return of 86-90 pence in the pound. The position with Landsbanki had been in doubt as other creditors had made a legal challenge to the preferential creditor status UK and Dutch Local Authorities had been granted by the Landsbanki Winding Up Board. However, the Icelandic High Court upheld the preferential status of the Local Authorities and made an initial repayment in February 2012 and a return of 100 pence in the pound is expected.

Institution	Claim	Paid	Estimated Recovery	Estimated % Recovery
Heritable	£3.52m	£2.52m	£3.10m	86-90%
Landsbanki	£2.26m	£0.84m	£2.26m	100%

The next interim payment from Heritable is expected in July 2012, with further repayments also anticipated from Landsbanki.

3.10 In line with government and formal guidance requirements a charge of £853k was made to the accounts in 2010/11 to cover the potential combined losses. Better than anticipated levels of recovery of the amounts invested has required that an adjustment be made to the impairment figure in the accounts so that the amount to be impaired is now £752k.

4. ANALYSIS OF OPTIONS

4.1 This is a report on past performance and there are no options to consider.

5. RESOURCE IMPLICATIONS

5.1 The financial implications to this report are covered in section 3.

5.2 More effective use has been made of staff time dedicated to the treasury function to sustain and build up research capacity and to inform borrowing and investment decisions. The council continues to be an active member of the CIPFA Treasury Management Network.

6. OTHER IMPLICATIONS

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

7. OUTCOMES OF CONSULTATION

7.1 Not applicable

8. RECOMMENDATIONS

8.1 That the Audit Committee considers the assurance provided by this report on the effectiveness of arrangements for treasury management, and:

8.2 That the Audit Committee notes the Treasury Managements performance for the 2011-12 financial year.

DIRECTOR OF POLICY AND RESOURCES

Civic Centre
Ashby Road
SCUNTHORPE
North Lincolnshire
DN16 1AB
Author: SC
Date: 31 May 2012

Background Papers used in the preparation of this report

CIPFA Code of Practice in the Public Service Fully Revised Second Edition 2009
CIPFA The Prudential Code Fully Revised Second Edition 2009
DCLG Guidance, April 2010
Local Government Act 2003

Appendix 1

COUNTERPARTY LIST

BANKS	**Fitch Ratings**		**Moody's**		**Standard & Poor's**		**Counterparty Limit**
	ST	**LT**	**ST**	**LT**	**ST**	**LT**	**£**
Canada							
Bank of Montreal	F1+	AA-	P1	Aa2	A-1	A+	5,000,000
Bank of Nova Scotia	F1+	AA-	P1	Aa1	A-1+	AA1	5,000,000
Canadian Imperial Bank of Commerce	F1+	AA-	P1	Aa2	A-1	A+	5,000,000
National Bank of Canada	F1	A+	P1	Aa1	A-1	A	3,000,000
Royal Bank of Canada	F1+	AA	P1	Aa1	A-1+	AA-	5,000,000
Toronto-Dominion Bank	F1+	AA-	P1	Aaa	A-1+	AA-	5,000,000
Denmark							
Danske Bank	F1	A+	P1	Aa3	A-1	A	3,000,000
France							
Groupe Caisse Federal de Credit Mutuel							5,000,000
Credit Industriel et Commercial	F1+	AA-	P1	Aa3	A-1	A+	
Groupe Caisse D'Epargne							5,000,000
Banque Palatine	F1+	A+	P1	Aa3			
Credit Foncier de France	F1+	A+	P1	Aa3	A-1	A	
Groupe Credit Agricole							5,000,000
Credit Agricole	F1+	AA-	P1	Aa1	A-1+	AA-	
Societe Generale	F1+	A+	P1	Aa2	A-1	A+	5,000,000
BNP Paribas	F1+	AA-	P1	Aa2	A-1+	AA	5,000,000
Natixis	F1+	A+	P1	Aa3	A-1	A+	5,000,000
Germany							
Commerzbank Group							3,000,000
Commerzbank AG	F1+	A+	P1	Aa3	A-1	A	
Eurohypo AG	F1	A	P1	A1	A-2	A-	
Landesbank Baden-Wuerttemberg	F1+	A+	P1	Aa2			3,000,000
Bayerische Landesbank	F1+	A+	P1	A1			5,000,000
Bremer Landesbank	F1	A	P1	Aa2			3,000,000
Deutsche Bank	F1+	AA-	P1	Aa3			5,000,000
Deutsche Zentral AG	F1	A+	P1	Aa3	A-1	A+	3,000,000
HSH Nordbank	F1	A-	P1	A3			3,000,000
Landesbank Berlin	F1+	AA-	P1	A1			5,000,000
Landesbank Hessen-Thuringen	F1+	A+	P1	Aa2	A-1	A	5,000,000
Norddeutsche Landesbank	F1	A	P1	Aa2	A-2	A-	3,000,000
Netherlands							
ING Bank NV	F1+	A+	P1	Aa3	A-1	A+	5,000,000
Rabobank Group	F1+	AA+	P1	Aaa			5,000,000
Norway							

DnB NOR Bank	F1	A+	P1	Aa3	A-1	A+	3,000,000
Singapore							
Development Bank of Singapore	F1+	AA-	P1	Aa1	A-1+	AA-	5,000,000
Sweden							
Nordea Bank Group							5,000,000
Nordea Bank AB	F1+	AA-	P1	Aa2	A-1	AA-	
Nordea Bank Finland plc	F1+	AA-	P1	Aa2	A-1	AA-	
Skandinaviska Enskilda Banken (SEB)	F1	A+	P1	A1	A-1	A	3,000,000
Svenska Handelsbanken	F1+	AA-	P1	Aa2	A-1	AA-	5,000,000
Swedbank	F1	A	P1	A2	A-1	A	3,000,000
Switzerland							
Credit Suisse	F1+	AA-	P1	Aa1	A-1	A+	5,000,000
UBS AG	F1+	A+	P1	Aa3			5,000,000
United Kingdom							
Barclays Bank	F1+	AA-	P1	Aa3	-1+	AA-	5,000,000
Co-operative Bank	F2	AA-	P1	A2			3,000,000
HSBC Bank plc	F1+	AA	P1	Aa2	A-1+	AA	5,000,000
Lloyds Banking Group							5,000,000
Bank of Scotland	F1+	AA-	P1	Aa3	A-1	A+	
Lloyds TSB Bank	F1+	AA-	P1	Aa3	A-1	A+	
RBS Group							10,000,000
First Active Plc	F1+	A+	P1	A1			
National Westminster Bank	F1+	AA-	P1	Aa3	A-1	A+	
Royal Bank of Scotland	F1+	AA-	P1	Aa3	A-1	A+	
Northern Rock Asset Management Plc	F1+	A+	P1	Aa3	A-1	A	5,000,000
Standard Chartered Bank	F1+	AA-	P1	A1	A-1	A+	5,000,000
United States of America							
Bank of America NA	F1+	A+	P1	Aa3	A-1	A+	5,000,000
Bank of New York Mellon	F1+	AA-	P1	Aaa	A-1+	AA	5,000,000
Citibank NA	F1+	A+	P1	A1	A-1	A+	5,000,000
State Street Bank & Trust Co	F1+	A+	P1	Aa2	A-1+	AA-	5,000,000

NOTE

Country limits of £5m apply except for the UK

BUILDING SOCIETIES	Society Asset's £m	Fitch		Moody's		Standard & Poor's		Counterparty Limit £m
		ST	**LT**	**ST**	**LT**	**ST**	**LT**	
Nationwide	190,497	F1+	AA-	P1	Aa3	A-1	A+	5,000,000
Coventry	25,194	F1	A	P2	A3			3,000,000

Leeds	9,556	F1	A	P1	A2			3,000,000
GOVERNMENT INSTITUTIONS								
Debt management office								unlimited
Local authorities								
District Council's								3,000,000
All Other LA's								5,000,000
Fire Authorities								5,000,000
Police authorities								5,000,000

Appendix 2

Investment Record 2011-12

Investments at start and end of year	Limit	01.04.11	31.03.12
	£	£	£
UK Clearing Banks			
LLOYDS BANKING GROUP	5,000,000	4,898,198	55
SANTANDER UK PLC	5,000,000	8,388	0
RBS GROUP	10,000,000	7,375,121	2,340,642
BARCLAYS BANKING GROUP	5,000,000	5,000,000	5,000,000
HSBC BANK PLC	5,000,000	1,916	7,675
Building Societies			
Local Authorities			
SALFORD CITY COUNCIL	5,000,000	3,500,000	0
Other Investment Institutions			
LANDSBANKI ISLANDS	5,000,000	2,000,000	1,417,163
HERITABLE BANK LIMITED	5,000,000	1,746,528	1,123,326
TOTAL INVESTED		**24,530,151**	**9,888,861**

Other organisations where funds were deposited during the year 2011/12

DEBT MANAGEMENT OFFICE
COVENTRY BUILDING SOCIETY
NATIONWIDE BUILDING SOCIETY
BIRMINGHAM CITY COUNCIL
CITY OF PLYMOUTH COUNCIL
CONWY COUNTY BOROUGH COUNCIL
DUMFRIES & GALLOWAY COUNCIL
HERTFORDSHIRE COUNTY COUNCIL
LANCASHIRE COUNTY COUNCIL
NEWCASTLE CITY COUNCIL
NORTHAMPTONSHIRE COUNTY COUNCIL
PLYMOUTH CITY COUNCIL
SALFORD CITY COUNCIL
SOUTHAMPTON CITY COUNCIL
STOCKPORT METROPOLITAN BOROUGH COUNCIL
THURROCK BOROUGH COUNCIL
TORFAEN COUNTY BOROUGH COUNCIL
WEST YORKSHIRE POLICE AUTHORITY

Appendix 3

PRUDENTIAL GUIDELINE INDICATORS

	2011/12	2011/12
	Budget	Actual
	£'000	£'000
(i) capital expenditure	63,400	57,434
(ii) General Fund ratio of financing costs to the net revenue stream	5.4%	4.97%
	£'000	£'000
(iii) The capital financing requirement	154,000	155,320
(iv) the authorised limit for external debt including borrowing and other long term liabilities	258,000	258,000
(v) the operational boundary for external debt including borrowing and other long term liabilities	177,000	177,000
	%	%
(vi) upper limit for fixed rate exposure	100	Target Met
(vii) upper limit for variable rate exposure	20	Target Met
(viii) upper and lower limits for maturity structure of borrowing		
UPPER LIMIT		
under 12 months	15	)
12 months and within 24 months	15	)
24 months and within 5 years	50	} Target Met
5 years and within 10 years	75	)
10 years and above	90	)
LOWER LIMIT		
under 12 months	0	)
12 months and within 24 months	0	)
24 months and within 5 years	0	} Target Met
5 years and within 10 years	0	)
10 years and above	25	)
(ix) total principal sums invested for periods longer than 364 days	none	none