Report of the Director of
Policy & Resources

Agenda Item No: 12
Meeting 25th June 2013

NORTH LINCOLNSHIRE COUNCIL

AUDIT COMMITTEE

TREASURY MANAGEMENT AND INVESTMENT STRATEGY ANNUAL REPORT 2012/13

1. OBJECT AND KEY POINTS IN THIS REPORT

1.1 This is a report on treasury performance in 2012/13. The benchmark for measuring performance is the treasury strategy which the council set at its meeting on 21 February 2012.

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

1.4 The key points are that the council

- A greater use has been made of longer investment terms of a month with our counterparties
- Generated an average return of 0.5% for the year
- Deferred borrowing for the capital programme
- Kept the total cost of borrowing below 10% of revenue stream
- Continued to recover further sums from Heritable bank, the UK subsidiary of Landsbanki, and directly from Landsbanki itself.
- Tendered for banking services , which resulted in the transfer from the RBS group to Barclays.

2. BACKGROUND INFORMATION

The legal and regulatory framework

2.1 The annual treasury management and investment strategy was prepared in line with
- The CIPFA Code of Practice for Treasury Management
- The Prudential Code
- The Local Government Finance Act 2003
- Investment guidance from the Department for Communities and Local Government (CLG)

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.

2.3 It also requires the Council to maintain suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve its Treasury Management policies and objectives, and prescribing how it will manage and control those activities. As part of this ongoing process the Treasury Management Practices adopted by the Council are reviewed on a regular basis.

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.

3.2 In addition the proposed changes to TMP's bring these policies up-to-date for the decisions already taken.

The Strategy for 2012-13

3.3 The strategy for 2012/13 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 3.94% (25 year maturity)

The Investment Strategy

3.4 The Investment strategy for 2012-13 aimed to reduce risk by;

- Investing for shorter periods up to six months
- Only investing In UK institutions with a minimum of an adequate credit rating or equivalent
- Applying a maximum investment limit of £5m for most counter-parties
- Applying a maximum limit to financial groups rather than separate institutions
- Excludes any foreign institutions from the counterparty list.

(see Appendix 1 for list of approved counterparties)

The Borrowing Strategy

3.5 The Borrowing Strategy for 2012-13 aimed to;

- Suspend borrowing in the plan period for as long as is prudent
- Track the differential between short-and long-term interest rates to determine when it is prudent to resume borrowing
- Borrow only to support the capital programme

- Maximize borrowing through the PWLB while this gives best value for money
- Borrow for shorter periods if cash flow requires and
- Consider debt rescheduling

How the council performed

3.6 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 continuing 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 all investments being considerably less than the 6 months allowed within the strategy. This was considered necessary to maximise security and liquidity of council funds.
- 43% of all investments made were placed in instant access call accounts held with high street banks.
- The remaining 57% of investments were made on a fixed term basis.
- Throughout the year the vast majority of these investments were kept short, with 96% of all fixed rate investments being for 31 days or less.
- The average fixed term investment period was 10 days, with the maximum duration of investment being 33 days.
- To maximise the security of our investments extensive use has been made throughout the year of investing with highly rated building societies (46% of all fixed term investments), highly rated banks (28%) and the UK Debt Management Office [DMO](26%).
- 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. (Royal Bank of Scotland [RBS])
- The average balance invested was £36.2m.
- This was in the form of 408 separate investments totalling £557m.
- 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 the risk averse investment strategy applied, which involved the extensive use of only the most secure investments and creating a difficulty in placing all balances in higher return accounts to ensure the investment risk was spread (e.g DMO paid only 0.25% for the whole year).
- The closing investment balance was £14.08m, an increase of £6.73m on the starting balance of £7.35m.
- The historically low base rate and a greater emphasis of security over yield has meant that returns on investment have remained low

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

- Overall capital spending of £29.1m against a revised budget of £36.9m.
- Requests for capital programme expenditure rephasing of £7.34m into 2013-14
- Debt financing costs of 8.06% of revenue stream, below the council's guideline range of 10% - 12%, 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
- No short term borrowing was needed as cash balances remained positive during the year.

3.8 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 2011/12 £62.6m of borrowing was deferred. A further £12.3m has been deferred in 2012/13. The strategy will be followed as long as it is prudent to do so and while cash reserves are sufficient.

3.9 The agreement reached with NLH to commute a lump sum of £3.5m rather than take an annual share of capital receipts up to 2017 should guarantee a saving of approximately £140k annually on capital financing costs from 2013-14.

Icelandic Investments

3.10 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.

3.11 The administration of Heritable is progressing well with the latest advice being to expect a return of 86-90 pence in the pound. Regular payments are now being received from Landsbanki and a return of 100 pence in the pound is expected.

Institution	Claim	Paid	Estimated Recovery	Estimated % Recovery
Heritable	£3.52m	£2.73m	£3.10m	86-90%
Landsbanki	£2.03m	£0.96m	£2.03m	100%
Total	£5.55m	£3.69m	£5.13m	

The next interim payment from Heritable is expected in July 2013, and a further repayment is also anticipated from Landsbanki in December 2013.

3.12 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 has required that an adjustment be made to the impairment figure in the accounts so that the amount to be impaired is now £655k. This will eventually reduce to leave an estimated cash loss of around £400k.

Banking arrangements

3.13 In accordance with the Council's Contract Procurement Rules it is necessary to open up the provision of the banking services we receive to the marketplace. As part of this process we tendered for suitable providers during 2012/13 and as a result Barclays were successful with their tender and officially took over our banking from NatWest Bank, part of the RBS group, in December 2012.

4. ANALYSIS OF OPTIONS

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

5. RESOURCE IMPLICATIONS (FINANCIAL, STAFFING,PROPERTY,IT)

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

5.2 Staff time has been effectively dedicated to the gathering of intelligence and the building up of research capacity to aid, sustain and inform the treasury management function in making borrowing and investment decisions. The Council continues to be an active member of the CIPFA Treasury Management Network and to promote staff training.

6. OUTCOMES OF INTEGRATED IMPACT ASSESSMENT (IF APPLICABLE)

6.1 Not applicable

7. OUTCOMES OF CONSULTATION AND CONFLICTS OF INTERESTS DECLARED

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 2012-13 financial year.

DIRECTOR OF POLICY AND RESOURCES
Civic Centre
Ashby Road
SCUNTHORPE
North Lincolnshire
DN16 1AB
Author: Steve Cowlbeck
Date: 4 June 2012

Background Papers used in the preparation of this report

CIPFA Code of Practice in the Public Service Fully 2011 Edition
CIPFA The Prudential Code Fully Revised Second Edition 2009
DCLG Guidance, April 2010
Local Government Act 2003
CIPFA Local Authority Accounting Panel (LAAP) bulletin 82 –guidance on the Impairment of deposits with Icelandic Banks – Update No. 7 May 2013

Appendix 1

COUNTERPARTY LIST 2012/13

BANKS	**Fitch**		**Moody's**		**Standard & Poor's**		**Counterparty Limit**
	ST	**LT**	**ST**	**LT**	**ST**	**LT**	**£**
United Kingdom							
Barclays Bank	F1	A	P1	A2	A-1	A+	£5,000,000
HSBC Bank plc	F1+	AA-	P1	Aa3	A-1+	AA-	£5,000,000
Lloyds Banking Group							£5,000,000
Bank of Scotland	F1	A	P2	A3	A-1	A	
Lloyds TSB Bank	F1	A	P1	A2	A-1	A	
RBS Group							£10,000,000
National Westminster Bank	F1	A	P2	A3	A-1	A	
Royal Bank of Scotland	F1	A	P2	A3	A-2	A-	
Standard Chartered Bank	F1+	AA-	P1	A1	A-1+	AA-	£5,000,000
Virgin Money Plc	F3	BBB			A2	BBB+	£3,000,000

BUILDING SOCIETIES	**Fitch**		**Moody's**		**Standard & Poor's**		**Counterparty Limit**
	ST	**LT**	**ST**	**LT**	**ST**	**LT**	**£**
Nationwide	F1	A+	P1	A2	A-1	A+	£5,000,000
Yorkshire	F2	BBB	P2	Baa	A-2	A-	£3,000,000
Coventry	F1	A	P2	A3			£5,000,000
Leeds	F2	A-	P2	A3			£5,000,000
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

NOTE:
Credit Ratings correct at 17 May 2013.

Appendix 2

Investment Record 2012-13

Investments at start and end of year	Limit	01.04.12	31.03.13
	£	£	£
UK Clearing Banks			
Lloyds Banking Group	5,000,000	55	973
RBS Group	10,000,000	2,340,642	9,904,857
Barclays Banking Group	5,000,000	5,000,000	4,153,137
HSBC Bank PLC	5,000,000	7,675	20,024
Building Societies			
Local Authorities			
Other Investment Institutions			
Landsbanki Islands	5,000,000	2,000,000	1,055,923
Heritable Bank LTD	5,000,000	1,746,528	795,936
TOTAL INVESTED		**11,094,900**	**15,930,850**

Other organisations where funds were deposited during the year 2012/13

CO-OP Bank PLC
Coventry Building Society
Debt management Office
Nationwide Building Society
Northern Rock PLC
Virgin Money PLC

Appendix 3

PRUDENTIAL GUIDELINE INDICATORS

	2012/13	2012/13
	Budget	Actual
	£'000	£'000
(i) capital expenditure	36,888	29,065
(ii) General Fund ratio of financing costs to the net revenue stream	7.77%	8.06%
	£'000	£'000
(iii) The capital financing requirement	164,744	152,798
(iv) the authorised limit for external debt including borrowing and other long term liabilities	233,000	233,000
(v) the operational boundary for external debt including borrowing and other long term liabilities	173,000	173,000
	%	%
(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