Report of the Director of Policy & Resources

Agenda Item No: 13
Meeting: 23rd January 2014

NORTH LINCOLNSHIRE COUNCIL

AUDIT COMMITTEE

QUARTERLY TREASURY MANAGEMENT AND STRATEGY REPORT

1. OBJECT AND KEY POINTS IN THIS REPORT

1.1 To provide a review of the treasury strategy approved each year by council.

1.2 To report on the treasury management performance between April and December 2013. 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 a current update on our Icelandic investments.

2. BACKGROUND INFORMATION

2.1 **The investment strategy for 2013/2014** aims 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
- Investing in a wider range of institutions through Money Market Funds

2.2 **The borrowing strategy for 2013/2014** aims to**;**

- Suspend external 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.

2.3 The council's budget was framed against the state of financial markets at the time of approval and prospects for the year ahead. This included the Bank of England Base Rate which was set on 5th March 2009 at 0.5% and continues at that level. The Monetary Policy Committee has indicated their intention to hold the bank base rate at that level until unemployment falls to a 7% threshold. This is not expected to happen until quarter four of 2014 at the very earliest.

2.4 The budget assumes a projected average cost of future external borrowing of 4% at the point when internal borrowing is no longer an option. Existing borrowing is based on a mix of borrowing terms. Both are used in setting a range of prudential indicators which are monitored against Council targets to ensure the capital investment programme remains affordable, prudent and is sustainable.

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 Generally the economic position appears more positive than in past quarters. The most recent figures for the UK economy from the Office for National Statistics show growth of 0.8% in the three months to September 2013. This had led the CBI to increase its growth forecast for 2013 from 1.2% to 1.4% and for 2014 to 2.4%. There are lack lustre signs of recovery from recession within the rest of the Europe with GDP across the block growing by only 0.1% in the third quarter of the year. While it is still early days and the high level of unemployment within Europe (12.2%) remains a cause for concern, signs of some improvement in Europe together with a broader global recovery gives cause for general optimism.

The forward guidance from the Bank of England on interest rates is seen as a positive for business investment. However a base lending rate at 0.5% for the medium term offers little to those seeking a return from investment, as this impacts on rates available from our bank and building society counter parties.

4.2 Although the economic position appears more positive the focus of cash management remains to maximise security and liquidity. Cash is currently being held in a range of call accounts with UK banks, on short-term (3 month maximum) deposit with banks and building societies, who maintain an adequate credit rating or as short-term (6 month maximum) investments with other local authorities and the Debt Management Office.

4.3 In addition to this, investments have been placed with Money Market funds meeting the council's investment criteria. These offer more competitive rates that many of the bank and building society counter parties while diversifying credit and interest rate risk.

4.4 Investments realised during the period were returned with interest or reinvested. At the end of December outstanding investments were £21.0m, including £9.3m with the council's own bankers (**see Appendix 1**

4.5 The continuing low base rate means returns on investments continue to be very modest, an average of 0.44% achieved in 2013/14 year to date. In addition to this the investment limits and risk criteria set in the strategy mean that in the earlier part of the financial year, when funds are at their highest, investment opportunities with counter parties offering more competitive investment rates were still limited. In such circumstances investment with institutions offering less competitive rates such as the DMO often remained the only option.

Borrowing strategy

4.6 In line with the approved strategy, there has been no new borrowing to finance the capital programme. Long-term borrowing rates (25 year fixed) has reached the 4.15% upper trigger point set in the strategy occasionally but as the differential between borrowing and lending rates has not narrowed to 2.5% a judgement has been made that internal borrowing continues to give best value for money. This is the sixth year in which the council has used cash balances to fund capital investment, and the saving on debt costs has been factored into the budget.

4.7 Scheduled debt repayments continue and by the end of December 2013 debt outstanding was £108.4m, with this scheduled to reduce to £107.8m by the end of March 2013.

4.8 The added benefit of this approach is to progressively reduce the amount of cash exposed to risk in the financial markets and the underlying balance is reducing (£21.0m as at 31st December 2013).

4.9 Key performance indicators have been updated following the rephasing of the capital programme. These are shown at **Appendix 2**.

Icelandic Investments

4.10 Recovery of funds placed with Icelandic banks before October 2008 is nearing completion. So far the council has been repaid £4.38m, which is 78.9% of the council's claims.

Institution	**Claim**	**Paid**	**% Recovery**
Heritable	£3.52m	£3.31m	94.0
Landsbanki	£2.03m	£1.07m	52.7
	£5.55m	**£4.38m**	**78.9**

i. Recovery from Heritable Bank is better than anticipated, 94 pence in the pound compared to an expectation of 85 to 90 pence. Additional payments are possible but unlikely, therefore the remaining balance of £21k has now been written off. Any further receipts will be credited to the council's revenue account.

ii. The Council is acting collectively with other local authority creditors through the LGA to sell its outstanding claims against Landsbanki. Deutsche Bank is acting on behalf of local authorities and will auction outstanding claims shortly. The aim is to offset the risk that the outstanding sum may take longer to recover, reducing its real value, and there are willing buyers in the market. Acting collectively will maximise the price we can obtain and the decision to sell will only be taken if the terms are favourable.

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

5.1 The treasury strategy aims to minimise risk to the council's finances from further instability in financial markets while seeking to achieve a favourable return from investment income.

5.2 The projected costs of financing debt are within budget and a positive outcome is expected on the return of Icelandic investments. This includes the potential for the early return of funds through the sale of the Landsbanki claim.

5.3 There has been an adjustment to the capital programme for 2013/14 largely due to a re-phasing of schemes spending and changes to programme financing. This is reflected in **Appendix 2.**

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 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.

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Background Papers used in the preparation of this report

CIPFA – Treasury Management in the Public Services. Code of Practice and Cross-Sectoral Guidance Notes: 2011 edition.

The Prudential Code for Capital Financing in Local Authorities 2011 edition.

APPENDIX 1

INVESTMENT POSITION AS AT 31 DECEMBER 2013

CALL ACCOUNT BALANCES	£	
Barclays Bank plc Flexible Interest Bearing Current Account	9,314,339	On call
Bank of Scotland Plc Call Account	3,808,066	On call
HSBC Bank Plc Call Account	2,206	On call
National Westminster Bank Plc Special Interest Bearing Account	2,049,497	On call
OTHER INVESTMENTS		
Leeds Building Society	2,000,000	Repayment at term
Virgin Money Plc	3,000,000	Repayment at term
CCLA Public Sector Deposit Fund	53,000	Money Market Fund
Landsbanki Islands	955,522	In receivership
SUB-TOTAL	**21,182,630**	
LESS:		
Impairments brought to account in 2011/12 relating to Icelandic Investments	223,383	
TOTAL	**20,959,247**	

In addition to those specified above, counterparties with whom investments have been placed in the period up until 31st December 2013 are as follows :

Bank of Scotland Fixed Term deposit
Coventry Building Society
Debt Management Office
Nationwide Building Society
Yorkshire Building Society

APPROVED PRUDENTIAL GUIDELINE INDICATORS **APPENDIX 2**

	2013/14 Budget (Feb 2013)	2013/14 Revised
(i) Estimates of capital expenditure	£m 68.045	£m 57.195
(ii) General Fund ratio of financing costs to the net revenue stream % (Based on Prudential Code 2011)	% 7.11	% 7.27
(iii) an estimate of the capital financing requirement	£m 172.35	£m 166.81
(iv) the authorised limit for external debt borrowing other long term liabilities total	£m 268,000 5,000 273,000	£m no change
(v) the operational boundary for external debt borrowing other long term liabilities total	£m 215,000 2,000 217,000	 no change
(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

(i). Capital Programme expenditure has changed for rephasing of spending and additional grant contributions

(ii). The ratio has been influenced by slippage of grant funded schemes which have reduced the value of the net revenue streams in 2013-14. This has been disproportionate to the reduction in financing costs. The ratio remains below the 10-12% maximum level set at Council in February 2013.