

## NORTH LINCOLNSHIRE COUNCIL

### COUNCIL

## TREASURY MANAGEMENT AND STRATEGY REPORT MID-YEAR REVIEW

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

1.1 To provide a mid-year review of the treasury strategy approved by council as part of the 2011/12 budget. The report gives members details of progress to date.

1.2 It covers treasury management performance for the six months ending 30 September 2011. It explains how the strategy was implemented during the first part of the year, the state of the financial markets, what action has been taken to address the challenges and the results of that action.

1.3 The report also provides an update on the latest position on our Icelandic investments.

### 2. BACKGROUND INFORMATION

2.1 The **investment strategy for 2011/2012** aims to reduce risk by

- Investing for shorter periods up to six months
- 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
- Deferring use of highly rated foreign banks for now.

2.2 The **borrowing strategy for 2011/2012** aims 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.

- 2.3 The council's budget was framed against the state of financial markets at that time and prospects for the year ahead. This included a Bank of England Base Rate set at 0.5% since 5 March 2009. Most economists' expectations were that rates would increase to 1% during 2011/12, and to 1.5% in 2012/13; the governor of the Bank of England has now suggested rates will remain at the historically low rate of 0.5% until 2013.
- 2.4 The budget also projected an average cost of borrowing of 5% (Public Works Loans Board) for the period 2011/15, based on a mix of borrowing terms; and set a range of prudential indicators. 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 Markets have been volatile with recurring concerns about economic recovery in Europe and the US, the ability of governments to sustain the burden of debt, and the implications for the solvency of the banking sector. Therefore the focus of cash management has been to maximise security and liquidity.
- 4.2 In practice investments have been made for periods of up to one month. Cash is currently being held in a range of call accounts with UK banks or as short-term investments with other local authorities and the Debt Management Office. Recent downward revisions to the credit ratings of a number of British High Street banks in October 2011 has also necessitated a re-evaluation of the levels being invested with these institutions, including the amount held with our own bankers. We are now operating to a maximum limit of £5m for RBS, other UK banks and local authorities. There are no limits on investments in the government's Debt Management Office.
- 4.3 All investments due to be realised during the period were returned with interest or reinvested. At the end of September outstanding investments were £29.1m (**see appendix 1 and 1A**).
- 4.4 The historically low base rate means returns on investments continue to be very modest, an average of 0.6% achieved in 2011/12 against a base rate in the same period of 0.5% and a budget target of 1%. There is therefore a forecast shortfall in investment returns of around £100k this year with a further adjustment needed to our future forecasts. The shortfall is covered in 2011/12 by a reduction in the minimum revenue provision we are required to set aside for future debt repayments.

### **Borrowing strategy**

- 4.5 In line with the approved strategy, there has been no new borrowing to finance the capital programme. Long-term borrowing rates (25 year fixed) have not reached the 6% trigger point set in the strategy, and the differential between borrowing and lending rates is greater than 2%.
- 4.6 This is the fourth 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. 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%). This policy is kept under review to make sure we can borrow at the appropriate time-when risks diminish in the banking sector, and the cost of borrowing is favourable.
- 4.7 Scheduled debt repayments continue and by the end of the year repayments of £5.5m will reduce debt outstanding to £110.7m. 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 (£29.1m at September close, gross of Icelandic investments, £28.2m after impairment).
- 4.8 Key performance indicators have been updated following the changes to the phasing and cost of the capital programme made by cabinet on 27 September 2011. These are shown at **appendix 2**.

### **Icelandic Investments**

- 4.9 The council has taken steps to recover investments with Icelandic banks in concert with other local authorities through the Local Government Association.
- 4.10 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	Cumulative Amount Received £	Cumulative Amount Received £
1	30.07.09	16.13	567,384.39	567,384.39
2	18.12.09	28.79	445,413.55	1,012,797.94
3	30.03.10	34.98	217,899.15	1,230,697.09
4	16.07.10	41.25	220,761.02	1,451,458.11
5	18.10.10	45.39	145,571.36	1,597,029.47
6	14.01.11	50.11	165,963.61	1,762,993.08
7	19.04.11	56.36	219,955.64	1,982,948.72
8	15.07.11	60.42	142,759.12	2,125,707.84
9	20.10.11	64.60	147,119.53	2,272,827.37

The next interim dividend is expected in January 2012.

4.11 There have been further developments regarding our deposits with Landsbanki (£2m). On 28 October 2011 the Icelandic Supreme Court upheld the earlier decision of the District Court and found in favour of test case UK public bodies. This means their deposits have been recognised as deposits with priority status over other creditors' claims. We await confirmation from the winding up board of the bank that they will apply the Supreme Court decision to the non-test cases including ours, and/or their intended next steps. A return of 95 pence in the pound is possible.

4.12 The 2010/11 accounts provided for a £0.85m impairment in the value of the combined investments, the best estimate at that point. Should the final return be better the charge to revenue will reduce; there is cover in reserves should the loss be greater.

## **5. RESOURCE IMPLICATIONS**

5.1 No additional costs at this stage. The shortfall in interest is offset by the saving on the minimum revenue provision (see para. 4.3).

## **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 Council notes the mid-year treasury management performance.

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### **Background Papers used in the preparation of this report**

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

## APPENDIX 1

### INVESTMENT POSITION 30 SEPTEMBER 2011

<b>CALL ACCOUNT BALANCES</b>	<b>£</b>	
Bank of Scotland plc	4,999,227	On call
Barclays Bank PLC	5,000,000	On call
HSBC Bank plc	4,903,732	On call
NatWest Special Interest Bearing Account	5,769,274	On call
Santander UK plc	8,388	On call
<b>OTHER INVESTMENTS</b>		
Heritable bank Limited	1,385,889	In administration
Landsbanki Islands	2,000,000	In receivership
Birmingham City Council	5,000,000	Repayment at term
<b>TOTAL OUTSTANDING</b>	<b>29,066,510</b>	

**APPENDIX 1A****INVESTMENTS MADE IN 2011/2012****Number of occasions**

Debt Management Office	28
Nationwide Building Society	7
Plymouth City Council	5
Birmingham City Council	2
City of Plymouth Council	2
Coventry Building Society	2
Newcastle City Council	2
Salford City Council	2
Conwy County Borough Council	1
Dumfries & Galloway Council	1
Hertfordshire County Council	1
Lancashire County Council	1
Southampton City Council	1
Stockport Metropolitan Borough Council	1
Thurrock Borough Council	1
Torfaen County Borough Council	1

**TOTAL VALUE****£164,117,000**

<b>PRUDENTIAL GUIDELINE INDICATORS</b>		<b>APPENDIX 2</b>
<b>30 September 2011</b>		
	2011/12	2011/12
	Budget	Forecast
(i)	£'000	£'000
estimates of capital expenditure*	68,738	69,790
(ii)		
General Fund ratio of financing costs to the net revenue stream	5.4%	no change
(iii)		
an estimate of the capital financing requirement	159,000	no change
(iv)		
the authorised limit for external debt borrowing	253,000	
other long term liabilities	5,000	no change
total	258,000	
(v)		
the operational boundary for external debt borrowing	172,000	
other long term liabilities	5,000	no change
total	177,000	
(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	15	
12 months and within 24 months	15	
24 months and within 5 years	50	no change
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	no change
5 years and within 10 years	0	
10 years and above	25	
(ix)	£000	£000
total principal sums invested for periods longer than 364 days	0	0
* Changes to the capital programme cover the period to 30 September and reflect rephasing between years and in-year changes to budgets		