

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 August 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 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 of 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 that rates will stay low until 2013.
- 2.4 The budget also projects an average cost of borrowing of 5% from the Public Works Loans Board for the plan period 2011/15, based on a mix of borrowing terms; and sets a range of prudential indicators which the Director of Finance monitors. This target rate is still achievable should the council decide to borrow.

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. 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.
- 4.2 All investments due to be realised during the period were returned with interest or reinvested. At the end of August outstanding investments were £33.4m, including £8.4m with the council's own bankers (**see appendix 1 and 1A**).
- 4.3 The historically low base rate means returns on investments continue to be very modest, an average of 0.59% 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.

Borrowing strategy

- 4.4 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 has not narrowed to 2%. 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.

- 4.5 Scheduled debt repayments continue and at the end of September repayments of £5.5m will reduce debt outstanding to £110.7m.
- 4.6 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 (£34.2m in August, gross of Icelandic investments, £33.4m after impairment).
- 4.7 Key performance indicators have been updated following the rephasing of the capital programme approved at Council on 28 June 2011. These are shown at **appendix 2**.

Icelandic Investments

- 4.8 The council has taken steps to recover investments with Icelandic banks in concert with other local authorities through the Local Government Association.
- 4.9 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 | 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 |
| 7 | 19.04.11 | 56.34 | 218,697 | 1,981,690 |
| 8 | 15.07.11 | 60.38 | 141,942 | 2,123,632 |

The next interim dividend is expected in October 2011.

- 4.10 The priority status of local authority creditors in Landsbanki has been upheld in Icelandic courts, but is now subject to challenge by unprotected creditors. If the Supreme Court upholds the judgement a return of 95 pence in the pound is possible. The 2010/11 accounts provide for a £0.85m impairment in the value of the combined investments, the best estimate at this 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 The financing budget is in balance for 2011/12, but will need to be reconsidered for future years if very low interest returns persist. 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; court judgements to date have been favourable on the Landsbanki investments.

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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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

INVESTMENT POSITION AS AT 31 AUGUST 2011

| CALL ACCOUNT BALANCES | £ | |
|---|-------------------|-------------------|
| Santander UK plc Call Account | 8,388 | On call |
| Barclays Bank plc Call Account | 5,000,000 | On call |
| Bank of Scotland Plc Call Account | 4,996,284 | On call |
| HSBC Bank Plc Call Account | 4,902,482 | On call |
| National Westminster Bank Plc Special Interest Bearing Account | 8,446,680 | On call |
| OTHER INVESTMENTS | | |
| Plymouth City Council | 3,000,000 | Repayment at term |
| Thurrock Borough Council | 4,500,000 | Repayment at term |
| Heritable bank Limited | 1,385,889 | In administration |
| Landsbanki Islands | 2,000,000 | In receivership |
| SUB-TOTAL | 34,239,723 | |
| LESS: | | |
| Impairments brought to account in 2010/11 relating to Icelandic Investments | 852,528 | |
| TOTAL | 33,387,195 | |

APPENDIX 1A

INVESTMENTS MADE AND REALISED APRIL 2011 TO 31 AUGUST 2011

| INVESTMENT INSTITUTION | DATE INVESTED | AMOUNT | STATUS/DUE DATE OF PAYMENT |
|------------------------|---------------|--------|----------------------------|
|------------------------|---------------|--------|----------------------------|

INVESTMENTS MADE SINCE 1 APRIL 2010

£

| | | | |
|------------------------------|------------|--------------|--------|
| Birmingham City Council | 28/06/2011 | 3,000,000.00 | Repaid |
| City of Plymouth Council | 04/04/2011 | 5,000,000.00 | Repaid |
| City of Plymouth Council | 10/05/2011 | 3,000,000.00 | Repaid |
| Conwy County Borough Council | 15/04/2011 | 3,000,000.00 | Repaid |
| Coventry Building Society | 14/04/2011 | 3,000,000.00 | Repaid |
| Coventry Building Society | 03/05/2011 | 3,000,000.00 | Repaid |
| Debt Management Office | 26/04/2011 | 1,000,000.00 | Repaid |
| Debt Management Office | 04/05/2011 | 2,400,000.00 | Repaid |
| Debt Management Office | 05/05/2011 | 2,000,000.00 | Repaid |
| Debt Management Office | 05/05/2011 | 4,635,000.00 | Repaid |
| Debt Management Office | 09/05/2011 | 1,000,000.00 | Repaid |
| Debt Management Office | 11/05/2011 | 1,000,000.00 | Repaid |
| Debt Management Office | 18/05/2011 | 1,000,000.00 | Repaid |
| Debt Management Office | 19/05/2011 | 2,500,000.00 | Repaid |
| Debt Management Office | 01/06/2011 | 2,000,000.00 | Repaid |
| Debt Management Office | 07/06/2011 | 3,000,000.00 | Repaid |
| Debt Management Office | 15/06/2011 | 1,500,000.00 | Repaid |
| Debt Management Office | 23/06/2011 | 1,000,000.00 | Repaid |
| Debt Management Office | 07/07/2011 | 5,160,000.00 | Repaid |
| Debt Management Office | 11/07/2011 | 1,000,000.00 | Repaid |
| Debt Management Office | 15/07/2011 | 2,765,000.00 | Repaid |
| Debt Management Office | 19/07/2011 | 3,500,000.00 | Repaid |
| Debt Management Office | 19/07/2011 | 3,500,000.00 | Repaid |
| Debt Management Office | 28/07/2011 | 1,250,000.00 | Repaid |
| Debt Management Office | 01/08/2011 | 4,850,000.00 | Repaid |
| Debt Management Office | 02/08/2011 | 3,167,000.00 | Repaid |
| Debt Management Office | 03/08/2011 | 3,000,000.00 | Repaid |
| Debt Management Office | 15/08/2011 | 1,000,000.00 | Repaid |
| Debt Management Office | 26/08/2011 | 1,500,000.00 | Repaid |
| Dumfries & Galloway Council | 03/05/2011 | 3,000,000.00 | Repaid |
| Hertfordshire County Council | 17/06/2011 | 3,000,000.00 | Repaid |
| Lancashire County Council | 15/04/2011 | 2,000,000.00 | Repaid |

| | | | |
|--|-------------------|---------------------|-------------------|
| Nationwide Building Society | 04/04/2011 | 3,000,000.00 | Repaid |
| Nationwide Building Society | 14/04/2011 | 2,000,000.00 | Repaid |
| Nationwide Building Society | 28/04/2011 | 3,000,000.00 | Repaid |
| Nationwide Building Society | 20/05/2011 | 2,000,000.00 | Repaid |
| Nationwide Building Society | 27/05/2011 | 3,000,000.00 | Repaid |
| Nationwide Building Society | 01/07/2011 | 2,000,000.00 | Repaid |
| Nationwide Building Society | 04/07/2011 | 3,000,000.00 | Repaid |
| Newcastle City Council | 31/05/2011 | 5,000,000.00 | Repaid |
| Newcastle City Council | 07/06/2011 | 5,000,000.00 | Repaid |
| Plymouth City Council | 07/06/2011 | 3,000,000.00 | Repaid |
| Plymouth City Council | 27/06/2011 | 2,000,000.00 | Repaid |
| Plymouth City Council | 07/07/2011 | 3,000,000.00 | Repaid |
| Plymouth City Council | 27/07/2011 | 2,000,000.00 | Repaid |
| Plymouth City Council | 08/08/2011 | 3,000,000.00 | 05/09/2011 |
| Salford City Council | 13/05/2011 | 2,000,000.00 | Repaid |
| Salford City Council | 27/05/2011 | 2,000,000.00 | Repaid |
| Southampton City Council | 22/07/2011 | 2,300,000.00 | Repaid |
| Stockport Metropolitan Borough Council | 26/05/2011 | 2,000,000.00 | Repaid |
| Thurrock Borough Council | 03/08/2011 | 4,500,000.00 | 16/09/2011 |
| Torfaen County Borough Council | 22/07/2011 | 3,000,000.00 | Repaid |

INVESTMENTS MADE BEFORE 1 APRIL 2011

| | | | |
|------------------------|------------|--------------|-------------------|
| Heritable bank Limited | 01/09/2008 | 989,920.87 | In administration |
| Heritable bank Limited | 12/09/2008 | 395,968.34 | In administration |
| Landsbanki Islands | 08/08/2008 | 1,000,000.00 | In receivership |
| Landsbanki Islands | 01/09/2008 | 1,000,000.00 | In receivership |
| Salford City Council | 15/03/2011 | 3,500,000.00 | Repaid |

| | 2011/12 Budget | 2011/12 Revised |
|--|--|------------------------------------|
| (i) estimates of capital expenditure | £'000 68,738 | £'000 73,202 |
| (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 other long term liabilities total | 253,000 5,000 258,000 | no change |
| (v) the operational boundary for external debt borrowing other long term liabilities total | 172,000 5,000 177,000 | 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 |

No changes have been made to the parameters for borrowing in 2011/12. These limits were set in the treasury strategy and give authority to borrow should this be required

The change in capital spending is largely a timing issue with rephasing between 2010/11 and 2011/12