Report of the Director of Policy & Resources

Agenda Item No: 8
Meeting: 10 December 2013

NORTH LINCOLNSHIRE COUNCIL

COUNCIL

TREASURY MANAGEMENT AND STRATEGY REPORT MID YEAR REVIEW 2013/14

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 2013/14 budget. The report gives details of progress to date.

1.2 It covers treasury management performance for the seven months between April and October 2013. The report explains how the strategy has been implemented during the first part of the year, the state of the financial markets, and the response to changing conditions in those markets.

1.3 The report also provides an update on the recovery of the Council's 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 that 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 2016, although recent economic indicators have suggested that conditions may be conducive to an increase in rates from as early as quarter 3 of 2014.

2.4 The budget provides for an average annual cost of 9% (interest and principal repayment) for future external borrowing once internal borrowing is no longer an option. No long-term borrowing is expected this year. Existing debt is based on a mix of borrowing terms. The rates are taken into account when the council sets prudential indicators for the treasury function. Performance is monitored against these 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 to be heading in a more positive direction than previously. 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 in the Euro zone, 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 in the Euro zone (12.2%) remains a cause for concern, signs of improvement in Europe together with the broader global recovery give cause for optimism.

4.2 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.

4.3 The focus of cash management continues to be to maximise security and liquidity. Over the year to date cash has been held in a range of call accounts with UK banks; on short (3 month maximum) deposit with banks and building societies who maintain an adequate credit rating; or as short-term (6 month maximum) investments with the Debt Management Office. In addition modest investments of up to £3m have been placed with a Money Market Fund which meets the council's investment criteria. Funds of this kind 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 October outstanding investments were £30.0m, including £9.6m with the council's own bankers (**see Appendix).**

4.5 The low base rate means returns on investments continue to be very modest, an average of 0.434% so far this year. Prudent investment limits and risk criteria set in the strategy mean that, in the early part of the financial year particularly when funds are at their highest, the scope to take advantage of investment opportunities offering more competitive investment rates is limited. This is an area which merits further consideration when the strategy is reviewed for 2014/15 as banks continue to increase their financial resilience.

Borrowing strategy

4.6 In line with the approved strategy, there has been no new borrowing to finance the capital programme. A balance has to be struck between avoiding external borrowing in the short-term to maximise revenue savings now, and the longer term costs if interest rates rise. Long-term borrowing rates (25 year fixed) have exceeded the 4.15% trigger point on a few occasions, 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 have continued and by the end of October 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 (£30m at 31st October 2013).

4.9 Key performance indicators have been updated following the rephasing of the capital programme. There is a small reduction in the cost of debt expressed as a percentage of the Council's revenue stream (see **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 £4.37m, which is 78.7% of the council's claims.

Institution	**Claim**	**Paid**	**% Recovery**
Heritable	£3.52m	£3.31m	94.0
Landsbanki	£2.03m	£1.06m	52.2
	£5.55m	£4.37m	78.7

i. Recovery from Heritable Bank is much better than expected, 94 pence in the pound compared to an expectation of 85 to 90 pence. Additional payments are possible but less likely, therefore the remaining balance of £21k has now been written off. Any further receipts will be a bonus.

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 in January 2014. The aim is to offset the risk that the outstanding sum may take much 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 rephasing 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 Council notes the mid-year treasury management performance.

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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 OCTOBER 2013

CALL ACCOUNT BALANCES	£	
Barclays Bank plc Flexible Interest Bearing Current Account	9,599,362	On call
Bank of Scotland Plc Call Account	90,792	On call
HSBC Bank Plc Call Account	2,148	On call
National Westminster Bank Plc Special Interest Bearing Account	4,990,656	On call
OTHER INVESTMENTS		
Bank of Scotland Plc	3,000,000	Repayment at term
Leeds Building Society	2,000,000	Repayment at term
Nationwide Building Society	3,580,000	Repayment at term
Coventry Building Society	5,000,000	Repayment at term
Virgin Money Plc	1,000,000	Repayment at term
CCLA Public Sector Deposit Fund	25,311	Money Market Fund
Landsbanki Islands	955,522	In receivership
TOTAL	**30,243,792**	

In addition to those specified above, the only counterparties with whom any investments have been placed in the period up until 31st October 2013 are the Yorkshire Building Society and the Debt Management Office.

APPROVED PRUDENTIAL GUIDELINE INDICATORS **APPENDIX 2**

	2013/14 Budget (Feb 2013)	2013/14 Revised
(i) Estimates of capital expenditure	£m 68.045	£m 63.572
(ii) General Fund ratio of financing costs to the net revenue stream % (Based on Prudential Code 2011)	% 7.11	% 6.96
(iii) an estimate of the capital financing requirement	£m 172.35	£m 171.50
(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 haschanged for rephasing of spending and additional grant contributions
(ii). There has been a slight reduction in the general fund ratio for 2013-14 as the council's revenue stream has increased with extra funding