Report of the Service Director Finance

Agenda Item No:
Meeting: 13 October 2010

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 2010/11 budget. The report gives members details of progress to date.

1.2 It covers treasury management performance for the six months ending 30 September 2010. 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 2010/2011** aims to reduce risk by

- Investing for shorter periods
- 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
- Using the option of highly rated foreign banks when prudent to do so.

2.2 The **borrowing strategy for 2010/2011** aims to

- Delay borrowing in the plan period as long as it is prudent
- Borrow only to support the capital programme
- Borrow at a time which is most advantageous on cost
- Maximize borrowing through the Public Works Loans Board (PWLB)
- Retain the option to borrow for shorter periods and
- Consider debt rescheduling.

2.3 The council's budget was framed against the current state of financial markets. This includes a Bank of England Base Rate of 0.5% since 5 March 2009 with an expectation that rates would remain at 0.5% at least until autumn 2010. Given the uncertainties surrounding the UK economic outlook the council's budget therefore takes a prudent view by building in short-term investment returns closely aligned to the average of market projections: 1% for 2010/11, 2% for 2011/12 and 3% for 2012/13.

2.4 The budget also projects an average cost of borrowing equivalent to a 25 year maturity rate of 5% from the Public Works Loans Board for the plan period 2010/13; and sets a range of prudential indicators which the Service Director Finance is required to monitor. 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 We have continued to apply a range of criteria to reduce risk by narrowing further the investment options allowed by the strategy until the banking sector recovers greater stability and the implications of a change in government work through fully:

- From April to August the maximum term of one month was the norm for investments. The maximum term was extended to three months from early September where additional returns were justified.
- No new investments in foreign banks
- No use of Money Market Funds
- Investment only in those building societies which achieve the same minimum credit ratings as applied to banks
- To reduce risk further where an institution is given a negative rating watch or is under review for a possible downgrade no new investments are made
- Except that, for institutions backed by the UK government liquidity and capitalization scheme, overnight and seven day deposits can be made as in effect cash is on call. This includes the council's own bankers Natwest/RBS

Wider data has been used to determine the financial health of institutions including the CIPFA treasury forum, financial press, stock market data and other market intelligence as ratings cannot be relied upon in isolation.

4.2 As a result investments have been made in a narrow range of UK institutions: UK banks, the Nationwide building society and governmental bodies including the Debt Management Office and other local authorities. All investments due to be realised during the period were returned with interest or reinvested. Outstanding investments at the end of September 2010 were £38.4m, including £2.75m with the council's own bankers (see appendix 1).

4.3 The price of increased security has been that interest earned has been below target: actual achieved April to September 2010 was 0.56% against an average base rate in the same period of 0.5% and a budget target of 1%. In cash terms the return to date is £0.105m against a full year target of £0.49m.

Borrowing strategy

4.4 However, in line with the strategy, borrowing to finance the capital programme has been delayed. To date borrowing of £6.3m and £13.5m to fund the 2008/09 and 2009/10 capital programme has been deferred substituted by 'internal borrowing' from council cash balances. Similarly planned borrowing of £30.6m for the 2010/11 programme will be deferred for the time being. At this point it is estimated that this will save £0.93m in borrowing costs in 2010/11, a net £0.64m saving after deducting interest foregone on cash investments.

4.5 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%). The amount of cash exposed to risks in the financial markets is also reduced. However this needs to be kept under review to make sure that we change our policy at the appropriate time depending on risks diminishing in the banking sector, and the gap closing between borrowing and lending rates.

4.6 A comparison of actual to plan for the key performance indicators is in appendix 2. There are no forecast changes to most indicators. The phasing of capital programme spending is likely to be revised at the September and December budget reviews, but is shown here at the latest budgeted level.

Icelandic Investments

4.7 The council has taken steps to recover investments with Icelandic banks in concert with other local authorities through the Local Government Association.

4.8 The administration of Heritable is progressing well. The latest advice is to expect a return of 85 pence in the pound. A third interim dividend of 6.19p (£217,899 for North Lincolnshire Council) was paid to creditors on 30 March 2010 and a fourth interim dividend of 6.27p (£220,761 for North Lincolnshire Council) was paid to creditors on 16 July 2010. The amount received to date by the Council is now £1.451m on our claim totalling £3.518m. The next interim dividend is expected in October 2010.

4.9 For deposits with Landsbanki the latest advice is to expect a return of 95 pence in the pound assuming that local authorities' status as preferential depositors is upheld. This is to be tested shortly in the Icelandic courts, as a number of other creditors have challenged the priority status of local authorities.

5. RESOURCE IMPLICATIONS

5.1 No additional costs at this stage. The shortfall in interest is more than offset by the saving made through deferred borrowing (see para. 4.4).

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 consider the assurance provided by this report on the effectiveness of arrangements for treasury management, and

8.2 That Council notes the treasury management performance for the period.

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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 2010

CALL ACCOUNT BALANCES	**£**	
Bank of Scotland plc	3,932,734	On call
Barclays Bank PLC	5,000,000	On call
HSBC Bank plc	1,000,156	On call
NatWest Special Interest Bearing Account	2,749,998	On call
Santander UK plc	4,741	On call
OTHER INVESTMENTS		
Bank of Scotland fixed term deposit	1,000,000	Repayment at term
Blaenau Gwent Borough Council	1,700,000	Repayment at term
Heritable bank Limited	2,056,281	In administration
Landsbanki Islands	2,000,000	In receivership
Nationwide Building Society	5,000,000	Repayment at term
Thurrock Borough Council	3,000,000	Repayment at term
Southend On Sea Borough Council	3,000,000	Repayment at term
Bristol City Council	2,000,000	Repayment at term
Birmingham City Council	3,000,000	Repayment at term
Plymouth City Council	3,000,000	Repayment at term
TOTAL OUTSTANDING	**38,443,909**	

INVESTMENTS MADE IN 2010/2011	Number of occasions
Debt Management Office	24
Nationwide Building Society	11
Blaenau Gwent County Borough Council	3
City of Plymouth Council	3
Sheffield City Council	3
Birmingham City Council	2
Swindon Borough Council	2
Thurrock Borough Council	2
West Yorkshire Fire & Rescue Service	2
Bank of Scotland Fixed Term Deposit	1
Barnsley Borough Council	1
Bristol City Council	1
Cheltenham Borough Council	1
Dumfries and Galloway Council	1
Merthyr Tydfil Borough Council	1
Northamptonshire County Council	1
Plymouth City Council	1
Reigate and Banstead Borough Council	1
Salford City Council	1
Southend On Sea Borough Council	1
Stafford Borough Council	1
Stirling District Council	1
Torfaen County Borough Council	1
TOTAL VALUE	**£176,070,736**

PRUDENTIAL GUIDELINE INDICATORS 30 September 2010		APPENDIX 2
	2010/11	2010/11
	Budget	Forecast
(i)	£'000	£'000
estimates of capital expenditure*	88,587	78,472
(ii)		
General Fund ratio of financing		
costs to the net revenue stream	5.39%	no change
(iii)		
an estimate of the capital		
financing requirement	154,000	no change
(iv)		
the authorised limit for external debt		
borrowing	242,000	
other long term liabilities	5,000	no change
total	247,000	
(v)		
the operational boundary for external debt		
borrowing	162000	
other long term liabilities	5,000	no change
total	167,000	
(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	0	0
periods longer than 364 days		
* Changes to the capital programme cover the period to 30 September and reflect rephasing between years and in-year budget reductions		