PERFORMANCE REVIEW TEAM

2009/10 Treasury Management Progress Report to 31 March 2010

Report of Head of Financial Services

1. Introduction

It is a requirement of the CIPFA Code of Practice on Treasury Management that regular monitoring reports are presented to Members on treasury activities. These reports will normally be presented soon after the end of June, September, December and March.

Cabinet approved the Treasury Strategy for 2009/10 on 17 February 2009 and the Investment Strategy was approved by Council at its meeting on 04 March 2009. This report outlines activities undertaken in pursuance of those strategies during the financial year.

2. Summary

- Regarding Icelandic investments, to 31 March total repayments of £614K have been received from KSF (against the 2M original deposit), meaning that around £1.4M was still outstanding. Whilst no repayment was made in Quarter 4, a further £103K repayment is anticipated in April 2010.

- As was reported in Quarter 3, the council's preferential creditor status in relation to Glitnir has been challenged. Whilst legal proceedings are now underway, there is no further progress to report regarding Glitnir or Landsbanki.

- There have been no changes to the debt portfolio. No temporary borrowing was required at the year end.

- There have been no material breaches of any prudential indicators or counterparty limits in the quarter and no other major risks have been identified.

- The County Council has put forward plans to offer a call account facility; officers have started the process of opening this account.

3. Icelandic Investments Update

A payment from KSF was received in late July for £410K and a further payment was received in December for £204K, another 5% payment is due in April 2010 but clearly the final settlement has still to be determined.

Updates from the Local Government Association suggest that the position regarding creditor status with Glitnir and Landsbanki will take another 12 months to resolve. DCLG has, however, granted the Council's request to capitalise a significant proportion of the estimated impairment losses arising, particularly in connection with Glitnir, should repayment ultimately be based on non preferential status.

It is anticipated that CIPFA will release guidance on the accounting for Icelandic deposits in early May 2010, this will inform treatment in the 2009/10 final accounts. This guidance could have significant implications for the Council's accounts, given the current difference in assumed creditor status for Glitnir (non-preferential) and Landsbanki (preferential).

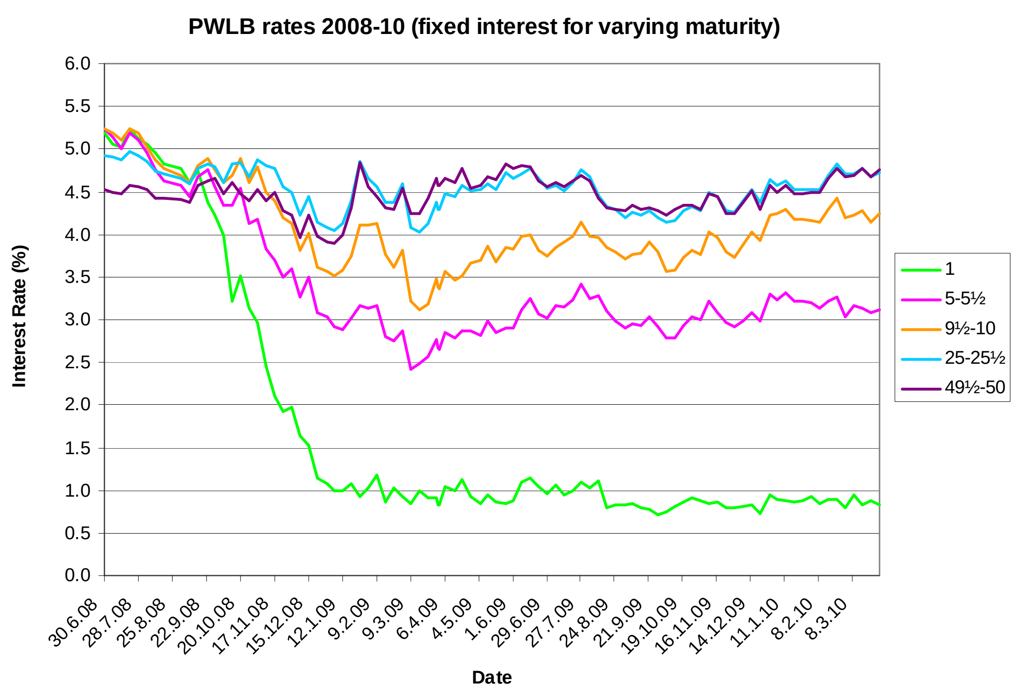
4. Debt Portfolio

There has been no change to the debt portfolio in the quarter and there is no immediate need to take out new long term loans. The Council's cash flow position remains strong, which is primarily because of the amounts being set aside each year from the budget for the future repayment of debt, through the Minimum Revenue Provision (MRP). Officers continue to monitor PWLB repayment rates for opportunities to reduce the outstanding debt balance without incurring an early repayment penalty; the rates need to rise by around 0.3% before this is a viable option.

In terms of expenditure, the capital programme for the next 5 years was approved at Council on 03 March and there may be some pressure to borrow over the next year depending on the progress made on South Lancaster land sales and the ultimate settlement of Luneside East compensation claims. There is, however, some scope for optimism on both these fronts. The capital programme and debt strategy will be updated as and when more detail emerge on these issues.

5. Current Borrowing Rates

The graph below shows that the pattern seen over the prior year has persisted with shorter term loans remaining well below the interest rates from 18 months ago, with higher rates for longer loans. In essence, short term borrowing rates remain historically low and longer term rates remain relatively low, although longer rates have seen an increase of around 0.25% over Quarter 4.

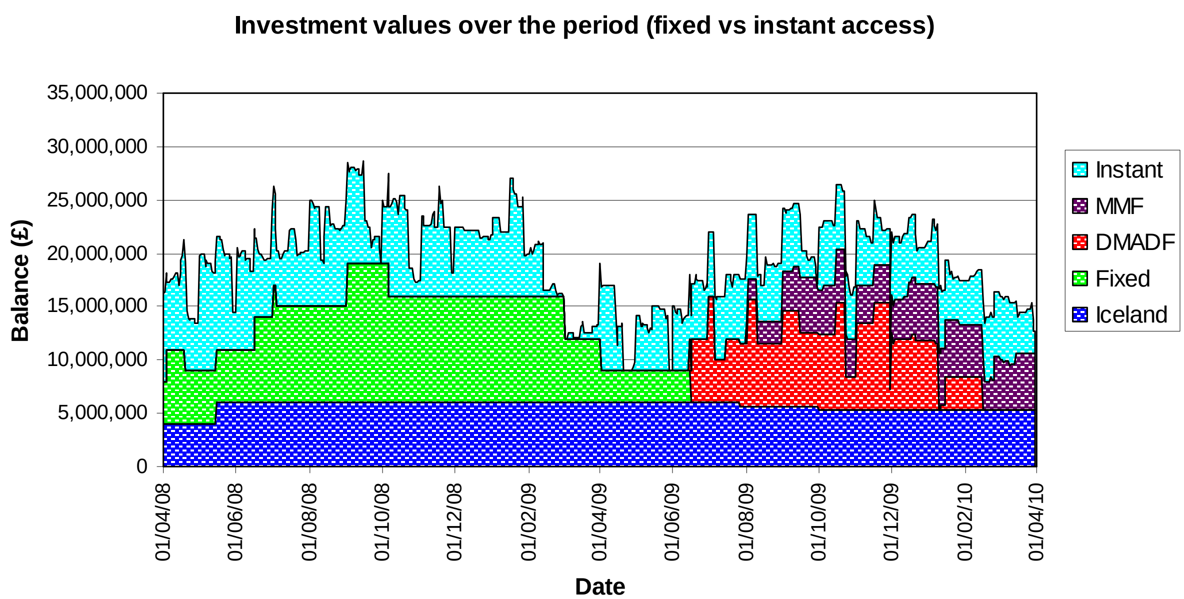


6. Investing Activities

As laid down in the approved Investment Strategy, the aim is to prioritise security and liquidity of the council's investments. This is to ensure that the Council has sufficient cash to support its business, but also to minimise any further chance of a counterparty failing and the council not being able to remove its deposits, as happened with the Icelandic banks.

All investment activity has been in line with the approved Treasury Strategy for 2009/10. No fixed term investments have been placed since September 2008, with the exception of Debt Management Accounts Deposit Facility (DMADF) deposits (i.e. with HM Government). Any other surplus cash has been managed on a day to day basis using the call accounts and Money Market Funds (MMF). A full list of the investments placed during the year is enclosed at ***Appendix B*** along with details of the balances on liquid deposits held.

The split of investments is shown graphically below (see also further details in ***Appendix B***). It is clear from this that the investment portfolio is split between Call accounts, the DMADF and MMFs. This keeps deposits secure, liquid and spread over a number of counterparties. As mentioned earlier, £614K has been repaid to date by KSF, which has reduced the balance outstanding with Icelandic banks (at this stage, it is assumed all of this relates to the principal).



7. Summary of Budget Position and Performance

In terms of performance against external benchmarks, the return on investments compared to the LIBID and bank rates over the year to date is as follows:

Base Rate	0.50%
3 Month LIBID	0.83%
Lancaster CC Investments*	0.59%
Lancaster CC investments	0.86%

*This rate includes £5.4M frozen in Icelandic banks, but with interest assumed at 0%. Although as per accounting guidance, interest can be accrued on these investments, it is notional in part and subject to amendment, depending on the terms of the ultimate settlement.

This performance appears good but it should be noted that it is affected by fixed term investments that were taken out before the global economic down-turn.

In terms of performance against budget, the details are as follows:

Annual budget	£86K	
Profiled budget	£86K	
Actual to date	£108K	(see details in ***Appendix B)***
Variance	£22K	(favourable)

The reason for the favourable position is due to increased cash balances compared to prior years, albeit at much lower yields. The cash flow model uses prior year figures as a model to predict levels of cash, the current year has a far smaller capital programme than in prior periods and in addition there has been a recovery in the cash position since the repayment of PWLB loans in 2008/09.

These figures do not take account of interest from Icelandic investments. At this stage it is considered likely that the Council will be able to recognise interest from these investments although, as previously reported, accounting requirements mean that this will be used to offset some of the losses expected. As highlighted earlier, further guidance is expected from CIPFA in time for closure of the 2009/10 accounts.

In terms of legal costs associated with Icelandic investments, to 31 March these are estimated at £5K, which is in line with the Revised Budget. The joint arrangements organised through the LGA have resulted in the costs being very low, in comparison to what there would have been had the City Council commissioned such support separately.

8. Risk management

The main focus of risk within treasury management currently is security of deposits and their liquidity. The Council's investment strategy is designed to engineer risk management into investment activity largely by reference to credit ratings and length of deposit, together with supporting advice. Officers have been maintaining the portfolio well within the agreed limits by utilising instant access call accounts and avoiding any new fixed term investments except for short term deposits with the DMADF. The view is, therefore, that associated risks have reduced over the period and were low, as at 31 March. Since Quarter 1 the portfolio has been diversified by using AAA rated Money Market Funds. At present these accounts are paying lower rates than the call accounts, but slightly higher than the DMADF, and they have added further capacity that is considered both secure and liquid. They are therefore judged to be acceptable in risk terms.

There is also a liquidity risk associated with needing access to cash on a day to day basis. At the end of the period the Authority had cash balances of £7.3M all of which were held on instant access. As such, liquidity is not judged to be a significant risk at the present time.

Aside from the above, there is also financial risk attached to the longer term debt portfolio, associated with interest rate exposure. Currently the Council is paying higher rates of interest on existing loans than it would be if new equivalent loans could be taken out now. However, until PWLB repayment rates improve, there will be no opportunities to restructure or repay loans without incurring significant penalties.

In addition, due to the unknowns linked to capital programme, there is a risk that the Council may have to take on further borrowing. However, with rates at very low levels, particularly on shorter term loans, this is a relatively good period to take on new borrowings if so required.

Finally, with regard to recovery of Icelandic investments, this is still being managed with legal support organised through the Local Government Association. It is judged that this is the most effective way of maximising recovery on the Council's behalf. Following Glitnir Winding Up Board's decision regarding creditor status, there is a risk of increased losses, although this is now being challenged through the courts and a capitalisation bid has been accepted by DCLG to defer the full impact of the potential impairment which may result from the Board's decision. Future views on recovery prospects will be informed by accounting guidance and information arising from the legal proceedings.

9. Conclusion

Consistent with the year as a whole, the final quarter of the year has been steady in treasury management terms.

The appetite for risk has remained low with the use of either AAA rated money market funds, instant access deposit accounts or deposits with HM Treasury. These have been used in preference to making the general fixed terms deposits which would previously have been used.

Whilst some progress has been made in recovering icelandic investments, the bulk of monies outstanding is subject to court action, which is likely to take around 12 months to resolve.

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Overall, however, it is judged that for 2009/10 activities, the key treasury objectives relating to investment security and cash flow liquidity have been met, whilst still achieving some comparatively small financial returns.