Appendix A

2010/11 Treasury Management Progress Report to 31 December 2010

Report of Head of Financial Services

1. Introduction

Council approved the Treasury Strategy including the Investment Strategy for 2010/11 at its meeting on 03 March 2010. This report outlines activities undertaken in pursuance of those strategies during the financial year up to the end of quarter 3.

2. Summary

- During the quarter there has been a further repayment from KSF of £163K, bringing the total to £1,084K representing 53% of the claim. The Council's creditor status for Glitnir and Landsbanki is still awaiting judgement from the Icelandic courts with test cases due to be tried during March and February 2011. The results of these will give a strong indication of the outcome of the Council's claims.

- Regarding investment interest to 31 December there has been £74K of cash interest on investments with £137K of 'accounting' interest on Icelandic investments. This is in line with the revised budget for 2010/11.

- On other treasury matters there have been no changes to the debt portfolio. No temporary borrowing was required during the quarter, no new long term debt has been taken on and there has been no opportunity for repayment of existing loans. PWLB have put their rates up by 1% across the board which may alter their position in the market should the Council need to take on new loans, for example due to the forthcoming dismantling of the HRA subsidy system.

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

3. Icelandic Investments Update

Regarding Icelandic investments, there is little new information from that reported as part of the 2009/10 outturn. During quarter 3 a further payment of £163K was received from KSF. This means that there is £940K still outstanding of the £2M invested, bringing total recoveries to 53%.

The legal action regarding preferential creditor status in relation to the Landsbanki and Glitnir investments (totalling £4M) is still underway in the Icelandic Courts. The Council continues as a party to the joint arrangements with other local authorities, organised through the Local Government Association and using Bevan Brittan which is judged to be both maximising the chance of a successful outcome and excellent value for money.

The test cases for Landsbanki and Glitnir are due to be heard in the Icelandic courts in February and March 2011. The outcome of these cases should give a strong indication of the outcome of the Council's claims.

4. Debt Portfolio

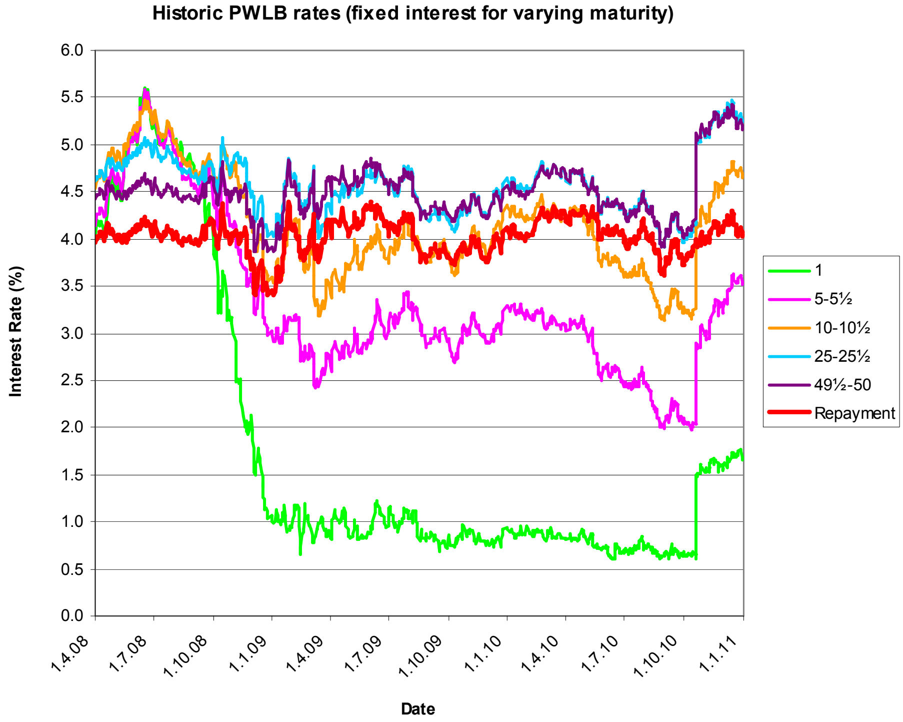
There has been no change to the long term debt portfolio since January 2009 and there is no immediate need to take out new long term loans. The Council's cash flow position remains strong, which is primarily because of the amounts being set aside each year from the budget for the future repayment of debt, through the Minimum Revenue Provision (MRP). Officers continue to monitor PWLB repayment rates for opportunities to reduce the outstanding debt balance without incurring early repayment penalties; the current position is reviewed in detail in section 5 below.

Some large schemes within the capital programme are now commencing (works at Lancaster and Morecambe town halls) however, there is likely to be significant slippage into 2011/12, any re-profiling and the implications on capital financing of this and any other additions or changes to the rolling 5 year programme will be reported through budget reports to Members. Luneside East compensation settlements, receipts from South Lancaster and the longer term liability linked to municipal buildings are still significant uncertainties which could impact on the debt position.

5. Current Borrowing Rates

The graph below shows that the pattern seen since January 2009 has persisted, with a marked spread between short term and long term borrowing. The main feature is the jump in rates across the board on the 20th October 2010 when central government added 1% to the cost of borrowing through the PWLB. This may have a significant impact in the future if the Council has to take on new debt through the review of the Housing Revenue Account Subsidy (HRAS) system. The repayment threshold has not been increased meaning that any new loans taken on would be less likely to be repayable early without incurring penalties. Together, these reduce the attractiveness of the PWLB as a lender and a thorough review of the market will be required for any new debt.

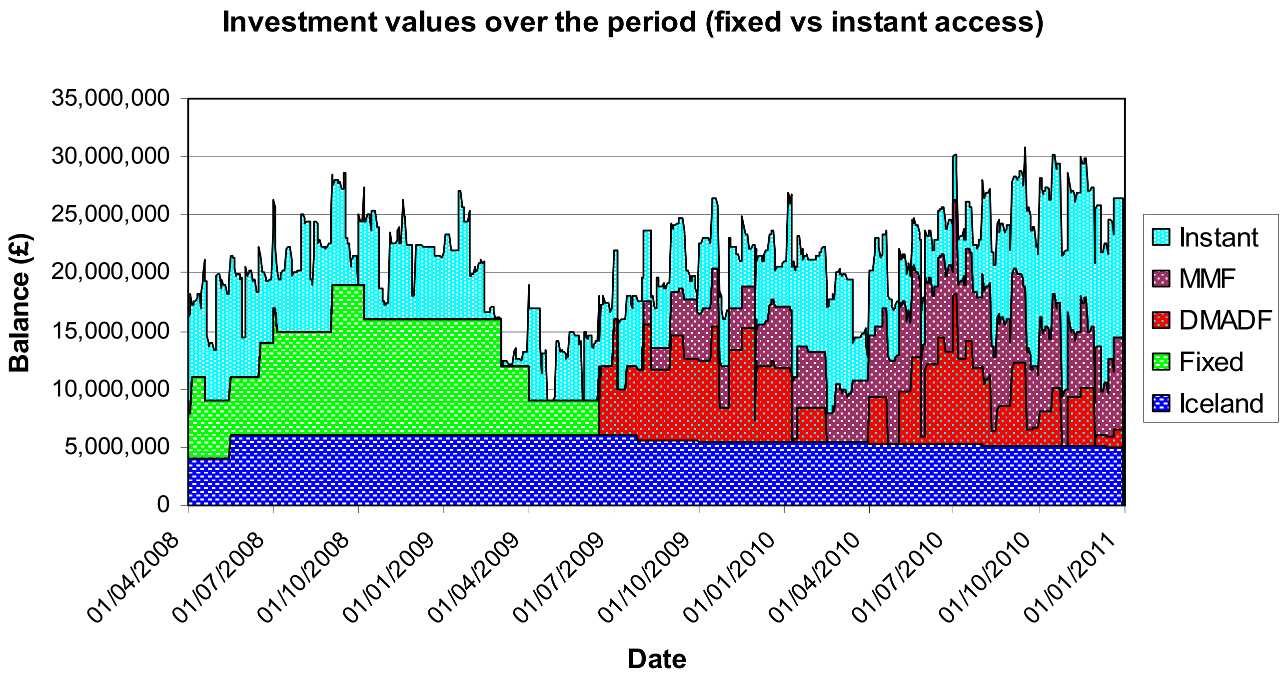
In relation to existing debt, the Council's cheapest major loan is at 4.6%; only when the repayment rate rises to 4.6% could we repay early without penalty and as can be seen from the graph the early repayment rate is still well below the level at which no penalty would be incurred, currently fluctuating around the 4% level.



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 2010/11. 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 at the end of quarter 3 is enclosed at ***Appendix A1.*** Towards the end of quarter 2, the Council had brought the Santander Call account back into use following relaxing of concerns around its credit worthiness. In addition, there has been a full quarter of using the County Council Call account. These factors combined have helped to reduce the number of deposits in the DMADF and have allowed both improved liquidity and improved returns without loss of security.



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	0.72%
Lancaster CC investments	0.51%

The return is just above base but well below 3 month LIBID. The Council has focussed on secure and highly liquid deposits. This is a slight improvement on quarter 2 (4.6%) due to increased use of the Santander Call account and the County council facility. The portfolio is still spread over a variety of investments with DMADF (0.25%) and governmental money market fund (0.39%) both paying below Bank rate but still forming a core of the balances invested.

The approved Investment Strategy also allows for fixed term deposits up to 1 year with other local authorities, which means that the Council could take advantage of the County Council's fixed term investment offer that would match the market rate. This would pay a significant margin over the instant access rates albeit at the expense of liquidity. Current market rates for a 12 month deposit are in the region of 1.5% (as per Sector investment monitor).

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

Annual budget	£254K	(revised)
Evenly profiled budget	£191K	
Actual to date	£74K	(see details in ***Appendix A1)***
"Icelandic" to date	£137K	(see details in ***Appendix A1)***
Total	£211K	
Variance	£20K	

Although investment interest is showing a positive variance against the evenly profiled budget, it is expected that investment balances will drop off in the final quarter of the year as Council tax and NNDR income fall away after January. The revised annual budget is the expected out-turn. This takes into account both the 'real' interest from active external investments as well as the 'accounting' interest applied to Icelandic investments that have defaulted, as per the accounting regulations.

8. Risk management

There has been no material change in the policy or operation of the Treasury function over the quarter, the view is, therefore, that associated risks have remained consistently very low.

Cash balances have remained healthy as in the previous quarter; although there may be lower cash balances by the end of the year due to the profile of local taxation income, liquidity is not anticipated to create significant risk for the Council over the remainder of the year.

Aside from the above, there is also financial risk attached to the longer term debt portfolio, associated with interest rate exposure; there has been no change to this over the quarter. Although PWLB have increased their rates for new loans, this is not judged to impact on the risks linked to the current portfolio. To manage the risk attached to any new borrowing, market data will be used to ensure value for money is assured on any new debt.

As noted in section 4 above, there is uncertainty over some material elements of the capital programme. The financial risk that this creates is managed through regular reviews of expenditure to date as well as integration between capital budgeting and the treasury strategy, so that this can be factored into any decisions on whether to invest or borrow.

Finally, as per the previous quarterly updates, recovery of Icelandic investments is still being managed with legal support organised through the Local Government Association. Future views on recovery prospects will be informed by accounting guidance and information arising from the legal proceedings; hopefully there will be a clearer indication of the levels of recovery following the test cases on Landsbanki and Glitnir which are due to be heard during 2010/11 quarter 4.

A further element of risk management is the prudential framework; there have been no breaches of any prudential indicators in the quarter.

9. Conclusion

Consistent with the prior quarter, the third quarter of the 2010/11 has been steady in treasury management terms.

The appetite for risk has remained very low with the use of either AAA rated MMFs, instant access call accounts or deposits with HM Treasury. It is anticipated that this will remain low for the next annual strategy, which is currently under development.

Whilst some progress has been made in recovering Icelandic investments, the bulk of monies outstanding are still subject to court action with no new significant information as yet in terms of a likely outcome.