

**AUDIT AND GOVERNANCE COMMITTEE**

**27<sup>th</sup> June 2014**

**TREASURY MANAGEMENT – REVIEW OF PERFORMANCE 2013/2014**

**Report of the Head of Financial Resources**

**1 Purpose of the Report**

- 1.1 To report on the Treasury Management borrowing and investment performance for 2013/2014.

**2 Description of Decision**

- 2.1 The Committee is requested to note the positive Treasury Management performance for 2013/2014.

**3 Introduction**

- 3.1 This report sets out the annual borrowing and investment performance for the financial year 2013/2014 in accordance with the requirements of the Treasury Management Policy Statement and Treasury Management Strategy approved by Council on 6<sup>th</sup> March 2013. The Treasury Management Strategy comprises the approved Council strategy for borrowing and its policies for managing its investments (which give priority to the security and liquidity of those investments).

- 3.2 The TM Policy Statement and Strategy complies with best practice, including the Department of Communities and Local Government Investment Guidance which came into effect from 1<sup>st</sup> April 2010 and it incorporates the recommendations included in the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management. The Code of Practice was revised in November 2011 mainly to accommodate the changes to local authority housing finance regulations.

**4 Review of Performance 2013/2014**

**4.1 Summary**

The performance of the Council's Treasury Management function continues to contribute significant financial savings that are used to provide funding to support the Council's revenue budget. The average rate of the Council's borrowing at 3.47% is in the top quartile when benchmarked against other authorities as is the rate of return achieved on investments of 1.03%.

**Borrowing Strategy and Performance – 2013/2014**

- 4.2 The basis of the agreed Borrowing Strategy was to:

- continuously monitor prevailing interest rates and forecasts;
- secure long-term funds to meet the Council's future borrowing requirement when market conditions were favourable;
- use a benchmark financing rate of 4.50% for long-term borrowing (i.e. all borrowing for a period of one year or more);
- take advantage of debt rescheduling opportunities as appropriate.

4.3 The Borrowing Strategy has been reviewed by this Committee in June, September and December 2013 and was updated where necessary to reflect changing circumstances. The Borrowing Strategy for 2013/2014 was based upon the views of the Head of Financial Resources, supplemented with market data, market information and leading economic forecasts provided by the Council's treasury management adviser, Capita Asset Services (formerly Sector Treasury Services).

4.4 The view in February 2013, at the time the Treasury Management Policy and Strategy was drafted, was that the Bank Base Rate would remain at 0.50% until December 2014 before steadily rising to 1.75% by March 2016 and that PWLB borrowing rates would increase during 2013/2014 across all periods. Economists have revised their forecasts and most are not expecting any changes in rates until early 2015 at the earliest, although financial markets have built in an expected increase by the end of this year.

The Council successfully applied to access PWLB loans at a discount of 0.20%. This certainty rate is available for those authorities that provide "improved information and transparency on their locally determined long-term borrowing and associated capital spending plans". The discount came into effect on 1<sup>st</sup> November 2012 and the Council has been successful in extending its access to the PWLB certainty rate until 31<sup>st</sup> October 2014. The benefit is only accrued if new borrowing is taken out, and no new debt was made in the year.

4.5 The table below shows the average borrowing rates in 2013/2014. The Council did not take out any new PWLB borrowing in 2013/2014 and has instead used internal funds to finance its borrowing requirement. This policy has been taken as there is a short-term revenue cost in taking out new borrowing and PWLB interest rates are anticipated to remain low over the short-term.

<b>2013/2014</b>	<b>Qtr 1 (Apr - June) %</b>	<b>Qtr 2 (July – Sept) %</b>	<b>Qtr 3 (Oct – Dec) %</b>	<b>Qtr 4 (Jan – Mar) %</b>
7 days notice	0.31	0.31	0.35	0.37
1 year	1.02*	1.07*	1.13*	1.18*
5 year	1.75*	2.27*	2.43*	2.60*
10 year	2.81*	3.47*	3.59*	3.64*
25 year	3.95*	4.32*	4.32*	4.31*
50 year	4.09*	4.37*	4.31*	4.27*

\* Rates take account of the 0.2% discount to PWLB rates available to eligible authorities from 1<sup>st</sup> November 2012.

- 4.6 The Treasury Management Strategy for 2013/2014 included provision for debt rescheduling but also stated that because of the proactive approach taken by the Council in recent years, and because of the very low underlying rate of the Council's long-term debt it would be difficult to refinance long-term loans at interest rates lower than those already in place.

Rates have not been sufficiently favourable for debt rescheduling in 2013/2014 but the Treasury Management Team continue to monitor market conditions and secure early redemption if appropriate opportunities arise.

- 4.7 The Council's borrowing portfolio position at 31<sup>st</sup> March 2014 is set out below:

		<b>Principal (£m)</b>	<b>Total (£m)</b>	<b>Average Rate (%)</b>
<b>Borrowing</b>				
Fixed Rate Funding	PWLB	137.9		
	Market	39.5		
	Other	2.8	180.2	3.92
Variable Rate Funding	Temporary / Other		27.6	0.55
<b>Total Borrowing</b>			<b>207.8</b>	<b>3.47</b>
<b>Total Investments*</b>	All managed In-House		<b>187.9</b>	<b>1.03</b>
<b>Net Position</b>			<b>(19.9)</b>	

\* Total Investments includes monies invested on behalf of the North Eastern Local Enterprise Partnership for whom Sunderland City Council is the accountable body

The Council had a deficit of £19.9 million representing the difference between gross debt and total investments. This position is expected to continue over the next few years as the Council has to manage its finances with significantly less government funding. This could impact further in the form of increased borrowing and reductions to reserves, with the result that the net borrowing position of the Council will increase.

#### **Prudential Indicators – 2013/2014**

- 4.8 All external borrowing and investments undertaken in 2013/2014 have been subject to the monitoring requirements of the Prudential Code. Under the Code, Authorities must set borrowing limits (Authorised Borrowing Limit for External Debt and Operational Boundary for External Debt) and must also report on the Council's performance for all of the other Prudential Indicators as follows:

The statutory limit under section 3(1) of the Local Government Act 2003 (known as the Authorised Borrowing Limit for External Debt) was originally set by the Council for 2013/2014 in total as £398.602m which was detailed as follows:

	<b>£m</b>
Borrowing	366.139
Other Long Term Liabilities	<u>32.463</u>
<b>Total</b>	<b><u>398.602</u></b>

The Operational Boundary for External Debt for 2013/2014 was set at £355.326m as follows:

	<b>£m</b>
Borrowing	322.863
Other Long Term Liabilities	<u>32.463</u>
<b>Total</b>	<b><u>355.326</u></b>

Both the Authorised Limit and the Operational Limit include an element for long-term liabilities relating to PFI schemes and finance leases. These have been brought onto the Council's Balance Sheet in compliance with International Financial Reporting Standards (IFRS).

The Council's maximum borrowing level in 2013/2014 was £213.106 million (which includes borrowing in respect of other organisations such as Tyne and Wear Fire and Rescue Authority but excludes other long-term liabilities such as PFI and Finance leases which already include borrowing instruments) and is well within the borrowing limits set by both of these indicators.

4.9 The table below shows that all other Treasury Management Prudential Indicators have been complied with during 2013/2014.

Prudential Indicators		2013/2014	
		Limit £'000	Actual £'000
<b>P10</b>	<b>Upper limit for fixed interest rate exposure</b> Net principal re fixed rate borrowing / investments	235,000	90,180
<b>P11</b>	<b>Upper limit for variable rate exposure</b> Net principal re variable rate borrowing / investments	50,000	-3,387
<b>P12</b>	<b>Maturity Pattern</b> Under 12 months 12 months and within 24 months 24 months and within 5 years 5 years plus A lower limit of 0% for all periods	Upper Limit 50% 60% 80% 100%	15.99% 5.41% 2.67% 79.05%
<b>P13</b>	<b>Upper limit for total principal sums invested for over 364 days</b>	75,000	0

The Council is currently within the limits set for all of its Treasury Management Prudential Indicators.

## 5. Investment Strategy and Performance – 2013/2014

The Investment Strategy for 2013/2014 was approved by Council on 6<sup>th</sup> March 2013. The general policy objective for the Council is the prudent investment of its treasury balances. The Council's investment priorities in order of importance are:

- (A) The **security** of capital;
- (B) The **liquidity** of its investments and then
- (C) The Council aims to achieve the **optimum yield** on its investments but this is commensurate with the proper levels of security and liquidity.

The Annual Investment Strategy has been fully complied with in 2013/2014.

- 5.1 At 31<sup>st</sup> March 2014, the Council had outstanding investments of £187.9 million. The following table shows the return made on the Council's total investments for 2013/2014 as compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Council uses to assess its performance.

	<b>2013/2014 Return</b>	<b>2013/2014 Benchmark</b>
	<b>%</b>	<b>%</b>
<b>In-house Managed Funds</b>	<b>1.03</b>	<b>0.35</b>

This return far exceeded the benchmark set for 2013/2014 and represents a very good achievement especially when short-term investment rates continue to remain very low.

- 5.2 All investments placed in 2013/2014 have been made in accordance with the approved Investment Strategy and comply with the Criteria and the Approved Lending List set by Council on 6<sup>th</sup> March 2013 and also taking into account subsequent revisions reported and approved by Cabinet during the year.

The investment policy is regularly monitored and reviewed to ensure it has flexibility to take full advantage of any changes in market conditions to the benefit of the Council. Investment rates available in the market have continued at historically low levels and due to the continuing high volatility within the financial markets, particularly in the Eurozone, advice from our Treasury Management advisers is to continue to limit investments to all financial institutions to shorter term periods.

The UK sovereign rating was downgraded to AA+ by Moody's in February 2013 and subsequently by Fitch in April 2013 and these rating remain. However, our view in conjunction with advice from our advisors is that the above guidance does not apply to institutions considered to be very low risk because the government holds shares in these organisations (i.e. Lloyds TSB

and RBS) which we consider should have the government's AA+ rating applied to them, or in respect of Money Market Funds which are AAA rated in their own right.

5.3 As members will be aware, the regular updating of the Council's Authorised Lending List and Criteria is required in the light of financial institution mergers and changes in institutions' credit ratings. Changes made during 2013/2014 have been reported to members previously and the latest Lending List and Criteria are included in the Treasury Management First Quarterly Review 2014/2015 reported to this meeting for information.

6. **Reason for Decision**

6.1 To note the performance for 2013/2014.

7. **Alternative Options**

7.1 No alternatives are submitted for consideration.