

AUDIT AND GOVERNANCE COMMITTEE

26 June 2015

TREASURY MANAGEMENT – FIRST QUARTERLY REVIEW 2015/2016

Report of the Director of Finance

1. Purpose of Report

- 1.1 To report on the Treasury Management (TM) performance to date for the first quarter of 2015/2016.

2. Description of Decision

- 2.1 The Committee is requested to:

- Note the Treasury Management performance during Quarter 1 of 2015/2016;
- Approve the revised 2015/2016 Prudential Indicators for both the Authorised Borrowing Limit for External Debt of £516.048m and the Operational Boundary for External Debt Limit of £442.196m, as set in A2 of Appendix A;
- Note the Lending List Criteria at Appendix B and the updated Approved Lending List at Appendix C.

3. Introduction

- 3.1 This report sets out the Treasury Management performance to date for the first quarter of the financial year 2015/2016, in accordance with the requirements of the Treasury Management Policy and Strategy agreed by Council.

4. Summary of Treasury Management Performance for 2015/2016 – Quarter 1

- 4.1 The Council's Treasury Management function continues to look at ways to maximise financial savings and increase investment return to the revenue budget. PWLB rates have fluctuated since the start of 2015/2016 but the trend appears to be upward since the historically low levels witnessed during the last two quarters of 2014/2015. Consequently no new borrowing has been taken out to date during 2015/2016 but the position continues to be monitored closely.
- 4.2 One option to make savings is through debt rescheduling, however no rescheduling has been possible in 2015/2016 as rates have not been considered sufficiently favourable. It should be noted the Council's interest

rate on borrowing continues to be very low, currently 3.50%, and as such the Council benefits from this lower cost of borrowing and also from the ongoing savings from past debt rescheduling exercises. Performance continues to see the Council's rate of borrowing in the lowest quartile as compared to other authorities.

- 4.3 Treasury Management Prudential Indicators are regularly reviewed and the Council is within the limits set for all of its TM Prudential Indicators. The statutory limit under section 3(1) of the Local Government Act 2003, which is required to be reported separately, (also known as the Authorised Borrowing Limit for External Debt) was originally set at £454.227m for 2015/2016. The Council's maximum external debt limit at 31st May 2015 was £336.211m and is well within this limit. More details of all of the TM Prudential Indicators are set out in section A2 of Appendix A for information. The indicators however now reflect changes required to both the Authorised Borrowing Limit for External Debt and the Operational Boundary for External Debt Limit in response to the Council's share of its Waste Disposal Joint arrangement with Gateshead and South Tyneside now being considered in the accounts for 2014/2015 as a PFI arrangement. This means that Other Long Term Liabilities which is included in both debt limit calculations have had to be increased from £27.508m to £89.659m as a result of this change in accounting treatment, which has brought the Waste Disposal arrangement onto the Council's Balance Sheet.
- 4.4 The Council's investment policy is regularly monitored and reviewed to ensure it has flexibility to take full advantage of any changes in market conditions which will benefit the Council.
- 4.5 As at 31st May 2015, the funds managed by the Council's Treasury Management team have achieved a rate of return on its investments of 0.91% compared with the benchmark 7 Day LIBID (London Interbank Bid) rate of 0.36%. Performance is a little more positive and is significantly above the benchmark rate, whilst still adhering to the prudent policy agreed by the Council, in what remains a very challenging market.
- 4.6 The rate of return on investments, as previously reported, has remained at very low levels compared to previous years, mainly due to UK-based financial institutions having accessed funding from alternative sources (such as the Government's Funding for Lending Scheme which has been extended to January 2016) to increase their capital/cash reserves in line with revised regulatory requirements. Consequently demand for local authority funds continues to be low and whilst interest rates have improved slightly there is little prospect of a significant upturn until the Bank of England begins to increase the Base Rate. Even special tranche investment rates (which offer better than market average returns) have followed the downward trend.

Interest rates are being carefully monitored and managed so that the council can take full advantage of the expected increase in rates when it does occur.

4.7 More detailed Treasury Management information is included in Appendix A for Members' information.

4.8 The regular updating of the Council's authorised lending list is required to take into account financial institution mergers and changes in institutions' credit ratings since the last report. The updated Approved Lending List is shown in Appendix C for information.

5. Recommendation

5.1 Members are requested:

- to note the Treasury Management (TM) performance for the first quarter of 2015/2016;
- to approve the revised Authorised Borrowing Limit for External Debt of £516.408m and the Operational Boundary for External Debt Limit of £422.196m;
- to note the Lending List Criteria at Appendix B and the updated Approved Lending List at Appendix C.

Detailed Treasury Management Performance – Quarter 1 2015/2016

A1 Borrowing Strategy and Performance – 2015/16

A1.1 The Borrowing Strategy for 2015/2016 was reported to Cabinet on 11th February 2015 and approved by full Council on 4th March 2015.

The Borrowing Strategy is based upon interest rate forecasts from a wide cross section of City institutions. The view in February 2015, when the Treasury Management Policy and Strategy was drafted, was that the Bank Base Rate would remain at 0.50% until September 2016 before steadily rising to 2.00% by March 2018 and that PWLB borrowing rates would increase during 2015/2016 across all periods.

The Bank Base Rate has remained at an all-time low of 0.50% since March 2009 with monetary policy set by the Bank of England (BoE) to meet a 2% inflation target in the medium-term. Financial analysts continue to speculate on the timing of an increase in the current Bank Rate. Most do not anticipate a rise until at least the second quarter of 2016, a view shared by the Council's economic advisers Capita Asset Services, with rates then increasing gradually to 1.75% by March 2018.

Despite strong growth in employment and reductions in the rate of unemployment, the BoE has reduced its growth forecasts from 2.9% to 2.5% in 2015 and to 2.7% in 2016. Its May Inflation Report identifies a number of contributing factors to these downward revisions including a slowdown in quarterly growth and the view that for recovery to be sustainable over the longer term there must be a recovery in the growth of productivity and real wages in excess of the rate of inflation. The election of a majority Conservative Government with its continued plans for significant cuts in government expenditure to reduce the budget deficit is also expected to slow growth marginally.

Forecasts for PWLB interest rate levels have fallen across the board with benchmark rates of 2.2% for 5 years, 2.8% for 10 years and 3.5% for 25 and 50 years. Exceptional levels of volatility in PWLB rates and bond yields are expected to continue during 2015 which are highly correlated to geo-political and sovereign debt crisis developments, with suggestions of movements of up to 0.5% in a quarter not unusual. The ECB began a huge programme of quantitative easing measures in March 2015 which will last up until September 2016. The initial reaction has been that this has had a beneficial impact in improving confidence and sentiment and moving the Eurozone out of deflation.

The following table shows the average PWLB rates for Quarter 1.

2015/2016	Qtr 1* (to 31 st May 2015) %
7 days notice	0.36
1 year	1.20*
5 year	2.02*
10 year	2.65*
25 year	3.28*
50 year	3.21*

*rates take account of the 0.20% discount to PWLB rates available to eligible authorities (which came into effect on 1st November 2012).

A1.2 The strategy for 2015/2016 is to adopt a pragmatic approach in identifying the low points in the interest rate cycle at which to borrow, and to respond to any changing circumstances to seek to secure benefit for the Council. A benchmark financing rate of 4.25% for long-term borrowing was set for 2015/2016 in light of the views prevalent at the time the Treasury Management policy was set in March 2015. Due to high levels of volatility in the financial markets, with borrowing rates still forecast to remain low over the short term, no new borrowing has been undertaken in the current financial year up to 31st May 2015, but this will be kept under review.

A1.3 The Borrowing Strategy for 2015/2016 made provision for debt rescheduling but due to 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 rescheduling in 2015/2016 so far and the Treasury Management team will continue to monitor market conditions and secure early redemption if appropriate opportunities should arise.

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 1st November 2012 and the Council has been successful in extending its access to the PWLB certainty rate until at least 31st October 2015.

A1.4 The Council's treasury portfolio position at 31st May 2015 is set out below:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	177.9		
	Market	39.6		
	Other	1.4	218.9	3.89
Variable Rate Funding	Temporary / Other		27.6	0.41
Total Borrowing			246.5	3.50

A2 Treasury Management Prudential Indicators – 2015/2016

A2.1 All external borrowing and investments undertaken in 2015/2016 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 TM Prudential Indicators.

A2.2 The statutory limit under section 3(1) of the Local Government Act 2003 (which is also known as the Authorised Borrowing Limit for External Debt) has been set by the Council for 2015/2016 as follows:

	Original £m	Revised £m
Borrowing	426.719	426.719
Other Long-Term Liabilities	<u>27.508</u>	<u>89.659</u>
Total	<u>454.227</u>	<u>516.408</u>

The Operational Boundary for External Debt has been set as shown below:-

	Original £m	Revised £m
Borrowing	332.537	332.537
Other Long Term Liabilities	<u>27.508</u>	<u>89.659</u>
Total	<u>360.045</u>	<u>422.196</u>

The Council's maximum external debt position in 2015/2016 (to 31st May 2015) was £336.211 million and is well within the borrowing limits originally set for both of these key indicators. However as referred to in paragraph 4.3 of this report both of these limits need to be increased to take into account the Council's share of its Waste Disposal Joint Arrangement with Gateshead and South Tyneside which is now regarded as a PFI contract. This means that the Other Long Term Liabilities figures included in both limits need to be amended to take this accounting change into account. The borrowing figures in each measure have remained unchanged but Other Long Term Liabilities have both been increased from £27.508m to £89.659m as a result.

The revised Authorised Borrowing Limit for External Debt is now £516.408m and the revised Operational Boundary for External Debt is now £422.196m for 2015/2016.

A2.3 The table below shows that all other Treasury Management Prudential Indicators have been complied with:

Prudential Indicators		2015/2016 (to 31/05/15)	
		Limit £'000	Actual £'000
P10	Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	245,000	38,883
P11	Upper limit for variable rate exposure Net principal re variable rate borrowing / investments	60,000	9,314
P12	Maturity Pattern 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%	11.74% 0.04% 5.74% 82.48%
P13	Upper limit for total principal sums invested for over 364 days	75,000	0

A3 Investment Strategy – 2015/2016

A3.1 The Investment Strategy for 2015/2016 was approved by Council on 4th March 2015. 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.

A3.2 As at 31st May 2015, the funds managed by the Council's in-house team amounted to £309.320 million and all investments complied with the Annual Investment Strategy. This includes monies invested on behalf of all other external organisations. The table below shows the return received on these investments compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Council uses to assess its performance.

	Actual to 31/05/15 %	Benchmark to 31/05/15 %
Return on investments	0.91	0.36

A3.3 Investments placed in 2015/2016 have been made in accordance with the approved investment strategy and comply with the Counterparty Criteria in place, shown in Appendix B, which is used to identify organisations on the Approved Lending List.

A3.4 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 Council's advantage.

A3.5 Investment rates available in the market have continued at very low levels.

A3.6 Due to the continuing high volatility within the financial markets, particularly in the Eurozone, advice from our Treasury Management advisers is to continue to restrict investments with all financial institutions to shorter term periods.

A3.7 Advice also continues that the above guidance is not applicable to institutions considered to be very low risk, mainly where the government holds shares in these organisations (i.e. Lloyds and RBS) which have a AA+ rating applied to them, or separately in respect of Money Market Funds which are AAA rated.

A3.8 The regular updating of the Council's authorised Lending List is required to take into account financial institution mergers, changes in institutions' credit ratings and other revisions. Members should note that following a funds merger on 15th May 2015 the Ignis Liquidity Money Market Fund (MMF) has been renamed Standard Life Investments Liquidity Fund. There has been no change in the credit ratings applied to the fund, which remain AAA with Fitch and Standard & Poor, or trading arrangements. Following a review of establishments Goldman Sachs has been added to the authorised Lending List and offers additional investments options to the Council. Fitch and Standard & Poor have recently undertaken an extensive review of the credit ratings of a number of counterparties with changes highlighted on the authorised Lending List in Appendix C.

Counterparty Criteria

The Council takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisers.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

Fitch / S&P's Long Term Rating	Fitch Short Term Rating	S&P's Short Term Rating	Moody's Long Term Rating	Moody's Short Term Rating	Maximum Deposit £m	Maximum Duration
AAA	F1+	A1+	Aaa	P-1	120	2 Years
AA+	F1+	A1+	Aa1	P-1	100	2 Years
AA	F1+	A1+	Aa2	P-1	80	2 Years
AA-	F1+ / F1	A1+ / A-1	Aa3	P-1	75	2 Years
A+	F1	A-1	A1	P-1	70	364 days
A	F1 / F2	A-1 / A-2	A2	P-1 / P-2	65	364 days
A-	F1 / F2	A-2	A3	P-1 / P-2	50	364 days
Local Authorities (limit for each local authority)					30	2 years
UK Government (including debt management office, gilts and treasury bills)					350	2 years
Money Market Funds Maximum amount to be invested in Money Market Funds is £120m with a maximum of £50m in any one fund.					120	Liquid Deposits
Local Authority controlled companies (# duration limited to 20 years in accordance with Capital Regulations)					20	# 20 years

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AA+ will be applied to that institution to determine the amount the Council can place with that institution for a maximum period of 2 years.

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above, these new limits are as follows:

Country Limit

It is proposed that only countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a total limit of £100 million which can be invested in other countries provided they meet the above criteria. A separate limit of £350m will be applied to the United Kingdom and is based on the fact that the government has done and is willing to take action to protect the UK banking system.

Country	Limit £m
UK	350
Non-UK	100

Sector Limit

The Code recommends a limit be set for each sector in which the Council can place investments. These limits are set out below:

Sector	Limit £m
Central Government	350
Local Government	350
UK Banks	350
Money Market Funds	120
UK Building Societies	100
Foreign Banks	100

Group Limit

Where institutions are part of a group of companies e.g. Lloyds Banking Group, Santander and RBS, then total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied. This will apply provided that:

- the UK continues to have a sovereign credit rating of AA+; and
- that market intelligence and professional advice is taken into account.

Proposed group limits are set out in Appendix C.

Approved Lending List

Appendix C

	Fitch		Moody's		Standard & Poor's		Limit £m	Max Deposit Period
	L Term	S Term	L Term	S Term	L Term	S Term		
UK	AA+	-	Aa1	-	AAA	-	350	2 years
Lloyds Banking Group (see Note 1)							Group Limit 100	
Lloyds Bank Plc	A+	F1	A1	P-1	A	A-1	100	2 years
Bank of Scotland Plc	A+	F1	A1	P-1	A	A-1	100	2 years
Royal Bank of Scotland Group (See Note 1)							Group Limit 100	
Royal Bank of Scotland Group plc	BBB+	F2	Ba1	NP	BBB-	A-3	100	2 years
The Royal Bank of Scotland Plc	BBB+	F2	A3	P-2	A-	A-2	100	2 years
National Westminster Bank Plc	BBB+	F2	A3	P-2	A-	A-2	100	2 years
Ulster Bank Ltd	BBB+	F2	Baa3	P-3	BBB+	A-2	100	2 years
Santander Group							Group Limit 65	
Santander UK plc	A	F1	A2	P-1	A	A-1	65	364 days
Barclays Bank plc	A	F1	A2	P-1	A-	A-2	50	364 days
Clydesdale Bank / Yorkshire Bank ^{*/**}	A	F1	Baa2	P-2	BBB+	A-2	0	
Co-Operative Bank Plc	B	B	Caa2	NP	-	-	0	
Goldman Sachs International Bank	A	F1	A1	P-1	A	A-1	65	364 days
HSBC Bank plc	AA-	F1+	Aa2	P-1	AA-	A-1+	75	2 years
Nationwide BS	A	F1	A2	P-1	A	A-1	65	364 days
Standard Chartered Bank	AA-	F1+	Aa2	P-1	A+	A-1	70	364 days
Top Building Societies (by asset value)								
Nationwide BS (see above)								
Coventry BS	A	F1	A3	P-2	-	-	50	364 days
Leeds BS	A-	F1	A3	P-2	-	-	50	364 days
Newcastle BS ^{**}	BB+	B	-	-	-	-	0	
Nottingham BS ^{**}	-	-	Baa2	P-2	-	-	0	
Principality BS ^{**}	BBB+	F2	Baa3	P-3	-	-	0	
Skipton BS ^{**}	BBB	F2	Baa3	P-3	-	-	0	
West Bromwich BS ^{**}	-	-	B2	NP	-	-	0	
Yorkshire BS ^{**}	A-	F1	Baa1	P-2	-	-	0	

	Fitch		Moody's		Standard & Poor's		Limit £m	Max Deposit Period
	L Term	S Term	L Term	S Term	L Term	S Term		
Money Market Funds							120	Liquid
Prime Rate Stirling Liquidity	AAA		Aaa		AAA		50	Liquid
Insight Liquidity Fund	AAA		-		AAA		50	Liquid
Standard Life Investments Liquidity Fund	AAA		-		AAA		50	Liquid
Deutsche Managed Sterling Fund	-		Aaa		AAA		50	Liquid
Foreign Banks have a combined total limit of £100m								
Australia	AAA		Aaa		AAA		100	2 years
Australia and New Zealand Banking Group Ltd	AA-	F1+	Aa2	P-1	AA-	A-1+	75	2 years
Commonwealth Bank of Australia	AA-	F1+	Aa2	P-1	AA-	A-1+	75	2 years
National Australia Bank	AA-	F1+	Aa2	P-1	AA-	A-1+	75	2 years
Westpac Banking Corporation	AA-	F1+	Aa2	P-1	AA-	A-1+	75	2 years
Canada	AAA		Aaa		AAA		100	2 years
Bank of Nova Scotia	AA-	F1+	Aa2	P-1	A+	A-1	70	364 days
Royal Bank of Canada	AA	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Toronto Dominion Bank	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Finland	AAA		Aaa		AA+		100	2 years
Nordea Bank Finland plc	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Pohjola Bank	A+	F1	Aa3	P-1	AA-	A-1+	70	364 days
Germany	AAA		Aaa		AA+		100	2 years
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	AA-	F1+	A1	P-1	AA-	A-1+	70	364 days
Landwirtschaftliche Rentenbank	AAA	F1+	Aaa	P-1	AAA	A-1+	100	2 years
NRW Bank	AAA	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Hong Kong	AA+		Aa1		AAA		100	2 years
The Hong Kong and Shanghai Banking Corporation Ltd	AA-	F1+	Aa2	P-1	AA-	A-1+	75	2 years
Luxembourg	AAA		Aaa		AAA		100	2 years
Banque et Caisse d'Epargne de l'Etat	-	-	Aa1	P-1	AA+	A-1+	100	2 years
Clearstream Banking	AA	F1+	-	-	AA	A-1+	80	2 years

	Fitch		Moody's		Standard & Poor's		Limit £m	Max Deposit Period
	L Term	S Term	L Term	S Term	L Term	S Term		
Netherlands	AAA		Aaa		AA+		100	2 years
Bank Nederlandse Gemeenten	AA+	F1+	Aaa	P-1	AA+	A-1+	100	2 years
Cooperatieve Centrale Raiffeisen Boerenleenbank BA (Rabobank Nederland)	AA-	F1+	Aa2	P-1	A+	A-1	70	364 days
Nederlandse Waterschapsbank N.V	-	-	Aaa	P-1	AA+	A-1+	100	2 years
Singapore	AAA		Aaa		AAA		100	2 years
DBS Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Oversea Chinese Banking Corporation Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
United Overseas Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Sweden	AAA		Aaa		AAA		100	2 years
Nordea Bank AB	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Svenska	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
USA	AAA		Aaa		AA+		100	2 years
Bank of New York Mellon	AA	F1+	Aa1	P-1	AA-	A-1+	75	2 years
HSBC Bank USA, N.A.	AA-	F1+	Aa2	P-1	AA-	A-1+	75	2 years
JPMorgan Chase Bank NA	AA-	F1+	Aa2	P-1	A+	A-1	70	364 days
Northern Trust Company	AA-	F1+	Aa2	P-1	AA-	A-1+	75	2 years
State Street Bank and Trust Company	AA	F1+	Aa2	P-1	AA-	A-1+	75	2 years
U.S. Bancorp	AA-	F1+	A1	P-1	A+	A-1	70	364 days
Wells Fargo Bank NA	AA	F1+	Aa1	P-1	AA-	A-1+	75	2 years

Notes

Note 1 **Nationalised / Part Nationalised**

The counterparties in this section will have the UK Government's AA+ rating applied to them thus giving them a credit limit of £100m.

* The Clydesdale Bank (under the UK section) is owned by National Australia Bank

** These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the Prudential Regulation Authority (PRA) is classed as a UK bank for the purposes of the Approved Lending List.

