

**AUDIT AND GOVERNANCE COMMITTEE**

**29 June 2012**

**TREASURY MANAGEMENT – FIRST QUARTERLY REVIEW 2012/2013**

**Report of the Executive Director of Commercial and Corporate Services**

**1. Purpose of Report**

- 1.1 To report on the Treasury Management, (TM) performance for the first quarter of 2012/2013.

**2. Description of Decision**

- 2.1 The Committee is requested to note the Treasury Management performance during Quarter 1 of 2012/2013,
- 2.2 To note amendments to the Lending List set out in Appendix C.

**3. Introduction**

- 3.1 The report sets out the Treasury Management performance to date for the first quarter of the financial year 2012/2013, in accordance with the requirements of the Treasury Management Policy and Strategy agreed by Council.

**4. Review of the Treasury Management Performance for 2012/2013 – Quarter 1**

- 4.1 The Council's treasury management function continues to look at ways of maximising financial savings and increase investment return to the revenue budget. One option to make savings is through debt rescheduling, however no rescheduling has been undertaken in 2012/2013 as rates have not been considered sufficiently favourable. It should noted the Council's interest rate on borrowing is very low, currently anticipated to average 3.50%, and as such the Council continues to benefit from this low cost of borrowing and from the ongoing savings from past debt rescheduling exercises.
- 4.2 Treasury Management Prudential Indicators are regularly reviewed and the Council is within the limits set for all of its Treasury Management Prudential Indicators.
- 4.3 The 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.

- 4.4 As at 31st May 2012, the funds managed by the Council's Treasury Management team has achieved a rate of return on its investments of 1.66% compared with the benchmark rate (i.e. the 7 day rate) of 0.45%. Performance is very positive and is significantly above the benchmark rate, whilst still adhering to the prudent policy agreed by the Council.
- 4.5 More detailed Treasury Management information is included in Appendix A for members' information.
- 4.6 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. The Approved Lending List as shown in Appendix C has been updated with to reflect this.

### **Background Papers**

Sector CityWatch (Monthly) and weekly credit rating list

Sector / Capital Economics / UBS Economic forecasts

Local Government Act 2003

Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (2011 Edition)

**Detailed Treasury Management Performance Quarter 1 - 2012/2013**

**A1. Borrowing Strategy and Performance - 2012/2013**

A1.1 The Borrowing Strategy for 2012/2013 was reported to Cabinet on 15<sup>th</sup> February 2012 and approved by full Council on 7<sup>th</sup> March 2012.

The Borrowing Strategy is based upon interest rate forecasts from a wide cross section of City institutions. The view in February 2012, at the time the Treasury Management Policy and Strategy was drafted, was that the Bank Base Rate would remain at 0.50% until June 2013 before steadily increasing to 1.25% by March 2014 and that PWLB borrowing rates would steadily increase throughout 2012/2013 across all periods.

As noted in the Treasury Management – Review of Performance 2011/2012, economists are now forecasting the Bank Base Rate will increase in the first quarter of 2014. PWLB rates and bond yields remain extremely unpredictable and there are exceptional levels of volatility which are highly correlated to the sovereign debt crisis and to political developments in the Eurozone. This uncertainty is expected to continue into the medium term.

The following table shows the average PWLB rates for Quarter 1, beginning April 2012 to date.

<b>2012/2013</b>	<b>Qtr 1 (Apr- June) %</b>
7 days notice	0.50
1 year	1.26
5 year	1.96
10 year	3.01
25 year	4.18
50 year	4.27

A1.2 The strategy for 2012/2013 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 4.50% for long-term borrowing was set for 2012/2013. 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 31<sup>st</sup> May 2012.

A1.3 The Borrowing Strategy for 2012/2013 made 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 rescheduling in 2012/2013 and the Treasury Management team will continue to monitor market conditions and secure early debt redemption if appropriate opportunities arise. Any rescheduling undertaken will be reported to Cabinet in line with the current Treasury Management reporting procedures.

A1.4 The Council's anticipated treasury portfolio position at 30th June 2012 is set out below:

		<b>Principal (£m)</b>	<b>Total (£m)</b>	<b>Average Rate (%)</b>
<b>Borrowing</b>				
Fixed Rate Funding	PWLB	147.9		
	Market	24.5		
	Other	0.3	172.7	3.90
Variable Rate Funding	PWLB	0.0		
	Market	15.0		
	Temporary/			
	Other	29.8	44.8	1.99
<b>Total Borrowing</b>			<b>217.5</b>	<b>3.50</b>

## **A2. Treasury Management Prudential Indicators – 2012/2013**

A2.1 All external borrowing and investments undertaken in 2012/2013 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 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) was set by the Council for 2012/2013 as follows:

	<b>£m</b>
Borrowing	342.396
Other Long-Term Liabilities	<u>34.928</u>
<b>Total</b>	<b><u>377.324</u></b>

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

	<b>£m</b>
Borrowing	304.083
Other Long-Term Liabilities	<u>34.928</u>
<b>Total</b>	<b><u>339.011</u></b>

The maximum external debt in respect of borrowing in 2012/2013 (to 31<sup>st</sup> May 2012) was £217.581 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.

A2.3 The table below shows that all other Treasury Management prudential indicators have been complied with.

Prudential Indicators	2012/2013 (to 31/05/2012)	
	Limit £'000	Actual £'000
P10 Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	130,000	71,892
P11 Upper limit for variable rate exposure Net principal re variable rate borrowing / investments	60,000	29,767
P12 Maturity Pattern	Upper Limit	
Under 12 months	50%	16.0%
12 months and within 24 months	60%	2.3%
24 months and within 5 years	80%	4.7%
5 years plus	100%	77.0%
A lower limit of 0% for all periods		
P13 Upper limit for total principal sums invested for over 364 days	75,000	20,000

A2.4 The Council is currently within the limits set for all of its TM Prudential Indicators.

### A3. Investment Strategy – 2012/2013

A3.1 The Investment Strategy for 2012/2013 was approved by Council on 7<sup>th</sup> March 2012. 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 31<sup>st</sup> May 2012 the funds managed by the Council's in-house team amounted to £260.864 million and all investments complied with the Annual Investment Strategy. This includes monies invested on behalf of the North Eastern Local Enterprise Partnership for whom Sunderland City Council is the accountable body. 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.

	<b>2012/2013 Actual to 31/05/2012 %</b>	<b>2012/2013 Benchmark to 31/05/2012 %</b>
Return on investments (to 31 <sup>st</sup> May 2012)	1.66	0.45

A3.3 Investments placed in 2012/2013 have been made in accordance with the approved investment strategy and comply with the counterparty criteria in place, shown in Appendix B, that is used to identify organisations on the Approved Lending List.

A3.4 However 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. There are no changes to report.

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

A3.6 Due to the continuing high volatility within the financial markets, particularly in the euro zone, advice from our Treasury Management advisers (which we are in agreement with) is to continue to restrict investments to all financial institutions for shorter term periods.

A3.7 Advice also continues that the above guidance is not applicable to institutions considered to be very low risk because the government holds shares in these organisations (i.e. Lloyds TSB and RBS) or in respect of Money Market Funds which are also AAA rated.

A3.8 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. The Approved Lending List is shown in Appendix C and has been updated with the proposed changes outlined above.

**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 advisors.

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.

<b>Fitch / S&amp;P's Long Term Rating</b>	<b>Fitch Short Term Rating</b>	<b>S&amp;P's Short Term Rating</b>	<b>Moody's Long Term Rating</b>	<b>Moody's Short Term Rating</b>	<b><u>Maximum Deposit</u> £m</b>	<b><u>Maximum Duration</u></b>
AAA	F1+	A1+	Aaa	P-1	70	2 Years
AA+	F1+	A1+	Aa1	P-1	50	2 Years
AA	F1+	A1+	Aa2	P-1	40	364 days
AA-	F1+ / F1	A1+ / A-1	Aa3	P-1	20	364 days
A+	F1	A-1	A1	P-1	10	364 days
A	F1 / F2	A-1 / A-2	A2	P-1 / P-2	10	364 days
A-	F1 / F2	A-2	A3	P-1 / P-2	5	6 months
<b>Local Authorities</b> (limit for each local authority)					30	2 years
<b>UK Government</b> (including debt management office, gilts and treasury bills)					70	2 years
<b>Money Market Funds</b> Maximum amount to be invested in Money Market Funds is £50 million with a maximum of £30 million in any one fund.					50	Liquid Deposits

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

Where any banks / building societies are part of the UK Government's Credit Guarantee scheme (marked with \* in the Approved Lending List), these counterparties will have an AA rating applied to them thus giving them a credit limit of £40 million for a maximum period of 364 days

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:

## **Counterparty Criteria**

## **Appendix B (continued)**

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 advisors.

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.

<b>Fitch / S&amp;P's Long Term Rating</b>	<b>Fitch Short Term Rating</b>	<b>S&amp;P's Short Term Rating</b>	<b>Moody's Long Term Rating</b>	<b>Moody's Short Term Rating</b>	<b><u>Maximum Deposit</u> <u>£m</u></b>	<b><u>Maximum Duration</u></b>
AAA	F1+	A1+	Aaa	P-1	70	2 Years
AA+	F1+	A1+	Aa1	P-1	50	2 Years
AA	F1+	A1+	Aa2	P-1	40	364 days
AA-	F1+ / F1	A1+ / A-1	Aa3	P-1	20	364 days
A+	F1	A-1	A1	P-1	10	364 days
A	F1 / F2	A-1 / A-2	A2	P-1 / P-2	10	364 days
A-	F1 / F2	A-2	A3	P-1 / P-2	5	6 months
<b>Local Authorities</b> (limit for each local authority)					30	2 Years
<b>UK Government</b> (including debt management office, gilts and treasury bills)					70	5 years
<b>Money Market Funds</b> Maximum amount to be invested in Money Market Funds is £50 million with a maximum of £30 million in any one fund.					50	Liquid Deposits

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

Where any banks / building societies are part of the UK Government's Credit Guarantee scheme (marked with \* in the Approved Lending List), these counterparties will have an AA rating applied to them thus giving them a credit limit of £40 million for a maximum period of 364 days.



## Appendix B Continued

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 £40 million which can be invested in other countries provided they meet the above criteria. A separate limit of £300 million 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	300
Non UK	40

### 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	300
Local Government	300
UK Banks	300
UK Building Societies	150
Money Market Funds	50
Foreign Banks	40

### 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 government's guarantee scheme is still in place;
- the UK continues to have a sovereign credit rating of AAA; and
- that market intelligence and professional advice is taken into account.

Current 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	Individual	Support	L Term	S Term	Fin Strength Rating	L Term	S Term		
<b>UK</b>	AAA	F1+			Aaa			AAA		300	2 years
<b>Lloyds Banking Group</b> (see Note 1)										Group Limit 70	
Lloyds Banking Group plc	A	F1	bbb	1	A2	-	-	A-	A-2	70	2 years
Lloyds TSB Bank Plc	A	F1	bbb	1	A1	P-1	C-	A	A-1	70	2 years
Bank of Scotland Plc	A	F1	-	1	A1	P-1	D+	A	A-1	70	2 years
<b>Royal Bank of Scotland Group</b> (See Note 1)										Group Limit 70	
Royal Bank of Scotland Group plc	A	F1	bbb	1	<b>A3</b>	P-2	-	A-	A-2	70	2 years
The Royal Bank of Scotland Plc	A	F1	bbb	1	<b>A2</b>	P-1	C-	A	A-1	70	2 years
National Westminster Bank Plc	A	F1	-	1	A2	P-1	C-	A	A-1	70	2 years
Ulster Bank Ltd	A-	F1	ccc	1	Baa1	P-2	D-	BBB+	A-2	70	2 years
<b>Santander Group *</b>										Group Limit 40	
Santander UK plc	A+	F1	a+	1	<b>A2</b>	P-1	C-	<b>A</b>	<b>A-1</b>	40	364 days
Cater Allen	A+	F1	a+	1	<b>A2</b>	P-1	C-	<b>A</b>	<b>A-1</b>	40	364 days
Barclays Bank plc *	A	F1	a	1	Aa3	P-1	C	A+	A-1	40	364 days
HSBC Bank plc *	AA	F1+	aa-	1	Aa2	P-1	C+	AA	A-1+	40	364 days



<b>Appendix C(continued)</b>											
	<b>Fitch</b>				<b>Moody's</b>			<b>Standard &amp; Poor's</b>			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength	L Term	S Term	Limit £m	Max Deposit Period
<b>Canada</b>	AAA				Aaa			AAA		40	364 Days
Bank of Nova Scotia	AA-	F1+	aa-	1	Aa1	P-1	B	AA-	A-1+	20	364 Days
Royal Bank of Canada	AA	F1+	aa	1	Aa1	P-1	B	AA-	A-1+	20	364 Days
Toronto Dominion Bank	AA-	F1+	aa-	1	Aaa	P-1	B+	AA-	A-1+	20	364 Days
<b>Money Market Funds</b>										50	Liquid
Prime Rate Stirling Liquidity	<b>AAA</b>							<b>AAA</b>		30	Liquid
Insight Liquidity Fund					<b>AAA</b>			<b>AAA</b>		30	Liquid
Ignis Sterling Liquidity	<b>AAA</b>							<b>AAA</b>		30	Liquid

## Notes

Note 1

### **Nationalised / Part Nationalised**

The counterparties in this section will have the UK Government's AAA rating applied to them thus giving them a credit limit of £70 million.

\*

Banks / Building Societies which are part of the UK Government's Credit Guarantee scheme

The counterparties in this section will have a AA rating applied to them thus giving them a credit limit of £40 million.

\*\*

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

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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 FSA is classed as a UK bank for the purposes of the Approved Lending List.

