

AUDIT AND GOVERNANCE COMMITTEE

27 June 2014

TREASURY MANAGEMENT – FIRST QUARTERLY REVIEW 2014/2015

Report of the Head of Financial Resources

1. Purpose of Report

- 1.1 To report on the Treasury Management (TM) performance for the first quarter of 2014/2015.

2. Description of Decision

- 2.1 The Committee is requested to note the Treasury Management performance during Quarter 1 of 2014/2015.
- 2.2 To note amendments to the Lending List Criteria at Appendix B and the 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 2014/2015, in accordance with the requirements of the Treasury Management Policy and Strategy agreed by Council.

4. Review of Treasury Management Performance for 2014/2015 – 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 possible in 2014/15 as rates have not been considered sufficiently favourable. It should be noted the Council's interest rate on borrowing is very low, currently **3.55%**, and as such the Council continues to benefit from this low cost of borrowing and 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 all other authorities.
- 4.2 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 set at £440.123m for 2014/2015 and the Council, at £207.818m maximum position so far in the year, 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.

- 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 2014**, the funds managed by the Council's Treasury Management team have achieved a rate of return on its investments of **0.58%** compared with the benchmark 7 Day LIBID (London Interbank Bid) rate of **0.34%**. Performance is very 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 at the moment.
- 4.5 The rate of return on investments has fallen markedly in recent months as UK-based financial institutions access funding from alternative sources such as the Government's Funding for Lending Scheme to increase their capital/cash reserves in line with regulatory requirements. Consequently investment rates have reduced, with little prospect of an upturn in the short-term. Even special tranche investment rates (which offer better than market average returns) have reflected this downward trend. The implication is that returns on investments has fallen significantly from those achieved in recent years.
- 4.6 More detailed Treasury Management information is included in Appendix A for Members' information.
- 4.7 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 to reflect this.

5. Recommendation

- 5.1 Members are requested to note the Treasury Management (TM) performance for the first quarter of 2014/2015.
- 5.2 Members are requested to note amendments to the Lending List Criteria at Appendix B and the Approved Lending List at Appendix C.

Detailed Treasury Management Performance – Quarter 1 2014/2015

A1 Borrowing Strategy and Performance – 2014/15

A1.1 The Borrowing Strategy for 2014/2015 was reported to Cabinet on 12th February 2014 and approved by full Council on 5th March 2014.

The Borrowing Strategy is based upon interest rate forecasts from a wide cross section of City institutions. The view in February 2014, when the Treasury Management Policy and Strategy was drafted, was that the Bank Base Rate would remain at 0.50% until March 2016 before steadily rising to 1.25% by March 2017 and that PWLB borrowing rates would increase during 2014/2015 across all periods.

As noted in the Treasury Management – Review of Performance 2013/2014, economists have since revised their forecasts with most expecting a change to the current 0.50% Bank Rate at the start of 2015 at the earliest. The Council's economic advisers forecast the Bank Rate will remain static until the last quarter of 2015, which is slightly longer than most. Forecasts for PWLB interest rate levels have fallen slightly on the whole with benchmark rates of 2.6% for 5 years, 3.6% for 10 years and 4.3% for 25 and 50 years.

The Bank of England report inflation is below its 2% target although the CPI figure rose to 1.8% in April from 1.6% the month before which was its lowest level since October 2009. The Council's economic advisers believe economic recovery has maintained a healthy momentum and is broader based but exports remain weak. While the global recovery may continue, the outlook is by no means certain and markets are likely to be subject to further volatility throughout the year ahead. Economic commentators have voiced some concern that potential overheating in the housing market could push the Bank of England into raising interest rates earlier than it had projected but there are signs that demand has slowed recently. The Funding for Lending Scheme remains in place, albeit with changes to its terms and conditions, with banks and building societies able to apply for funds until January 2015.

The following table shows the average PWLB rates for Quarter 1, beginning April 2014 to date.

2014/2015	Qtr 1* (Apr - May) %
7 days notice	0.35
1 year	1.25*
5 year	2.61*
10 year	3.54*
25 year	4.21*
50 year	4.18*

*rates take account of the 0.2% discount to PWLB rates available to eligible authorities that came into effect on 1st November 2012.

A1.2 The strategy for 2014/2015 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 5.00% for long-term borrowing was set for 2014/2015. 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 2014, but will be kept under review.

A1.3 The Borrowing Strategy for 2014/2015 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 2014/2015 so far and the Treasury Management team will continue to monitor market conditions and secure early redemption if appropriate opportunities arise. Any rescheduling undertaken will be reported to Cabinet in line with the current Treasury Management reporting procedures.

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 31st October 2014.

A1.4 The Council's treasury portfolio position at 31st May 2014 is set out below:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	127.9		
	Market	39.5		
	Other	2.8	170.2	4.04
Variable Rate Funding	Temporary / Other		27.6	0.54
Total Borrowing			197.8	3.55

A2 Treasury Management Prudential Indicators – 2014/2015

A2.1 All external borrowing and investments undertaken in 2014/2015 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) was set by the Council for 2014/2015 as follows:

	£m
Borrowing	410.945

Other Long-Term Liabilities	<u>29.178</u>
Total	<u>440.123</u>

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

	£m
Borrowing	302.575
Other Long Term Liabilities	<u>29.178</u>
Total	<u>331.753</u>

The maximum external debt in respect of borrowing in 2014/15 (to 31st May 2014) was **£207.818 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		2014/2015 (to 31/05/14)	
		Limit £'000	Actual £'000
P10	Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	250,000	90,181
P11	Upper limit for variable rate exposure Net principal re variable rate borrowing / investments	60,000	-40,955
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%	19.57% 0.66% 4.59% 79.25%
P13	Upper limit for total principal sums invested for over 364 days	75,000	0

A3 Investment Strategy – 2014/2015

A3.1 The Investment Strategy for 2014/2015 was approved by Council on 5th March 2014. 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 2014**, the funds managed by the Council's in-house team amounted to **£216.577** 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.

	2014/2015 Actual to 31/05/14 %	2014/2015 Benchmark to 31/05/14 %
Return on investments	0.58	0.34

- A3.3 Investments placed in 2014/2015 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 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 historically 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 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) which have a AA+ rating applied to them, or 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 and changes in institutions' credit ratings. The Approved Lending List is shown in Appendix C and has been updated with notified changes to credit ratings.

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	110	2 Years
AA+	F1+	A1+	Aa1	P-1	90	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
Local Authorities (limit for each local authority)					30	2 years
UK Government (including debt management office, gilts and treasury bills)					90	2 years
Money Market Funds Maximum amount to be invested in Money Market Funds is £80m with a maximum of £40m in any one fund.					80	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.

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:

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 £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	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	350
Local Government	350
UK Banks	350
UK Building Societies	150
Money Market Funds	80
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 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			Max Deposit Period
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength Rating	L Term	S Term	Limit £m	
UK	AA+				Aa1			AAA		350	2 years
Lloyds Banking Group (see Note 1)										Group Limit 90	
Lloyds Banking Group plc	A	F1	a-	1	A2	-	-	A-	A-2	90	2 years
Lloyds TSB Bank Plc	A	F1	a-	1	A1	P-1	C-	A	A-1	90	2 years
Bank of Scotland Plc	A	F1	a-	1	A1	P-1	C-	A	A-1	90	2 years
Royal Bank of Scotland Group (See Note 1)										Group Limit 90	
Royal Bank of Scotland Group plc	A	F1	bbb	1	Baa2	P-2	-	BBB+	A-2	90	2 years
The Royal Bank of Scotland Plc	A	F1	bbb	1	Baa1	P-2	D+	A-	A-2	90	2 years
National Westminster Bank Plc	A	F1	-	1	Baa1	P-2	D+	A-	A-2	90	2 years
Ulster Bank Ltd	A-	F1	ccc	1	Baa3	P-3	E+	BBB+	A-2	90	2 years
Santander Group *										Group Limit 40	
Santander UK plc	A	F1	a	1	A2	P-1	C-	A	A-1	40	364 days
Cater Allen	-	-	-	-	-	-	-	-	-	40	364 days
Barclays Bank plc *	A	F1	a	1	A2	P-1	C-	A	A-1	40	364 days
HSBC Bank plc *	AA-	F1+	a+	1	Aa3	P-1	C	AA-	A-1+	40	364 days

Appendix C

	Fitch				Moody's			Standard & Poor's			Max Deposit Period
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength Rating	L Term	S Term	Limit £m	
Canada	AAA				Aaa			AAA		40	364 Days
Bank of Nova Scotia	AA-	F1+	aa-	1	Aa2	P-1	B-	A+	A-1	10	364 Days
Royal Bank of Canada	AA	F1+	aa	1	Aa3	P-1	C+	AA-	A-1+	20	364 Days
Toronto Dominion Bank	AA-	F1+	aa-	1	Aa1	P-1	B	AA-	A-1+	20	364 Days
Money Market Funds										80	Liquid
Prime Rate Stirling Liquidity	AAA				AAA			AAA		40	Liquid
Insight Liquidity Fund	AAA							AAA		40	Liquid
Ignis Sterling Liquidity	AAA							AAA		40	Liquid
Deutsche Managed Sterling Fund	-	-	-	-	AAA	-	-	AAA	-	40	Liquid

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 £90m.

* Banks / Building Societies which are part of the UK Government's Credit Guarantee scheme
The counterparties in this section will have an 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

*** 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.

