Sunderland City Council

Item No. 8

AUDIT AND GOVERNANCE COMMITTEE **28 June 2013**

TREASURY MANAGEMENT – REVIEW OF PERFORMANCE 2012/2013

Report of the Executive Director of Commercial and Corporate Services

1 Purpose of the Report

1.1 To report on the Treasury Management borrowing and investment performance for 2012/2013.

2 Description of Decision

2.1 The committee is requested to note the positive Treasury Management performance for 2012/2013.

3 Introduction

3.1 This report sets out the annual borrowing and investment performance for the financial year 2012/2013 in accordance with the requirements of the Treasury Management Policy Statement and Treasury Management Strategy approved by Council on 7th March 2012. 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 Policy Statement and Strategy complies with best practice, including the Department of Communities and Local Government Investment Guidance which came into effect from 1st 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 2012/2013

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 3.49% is in the top quartile when benchmarked against other authorities as is the rate of return achieved on investments of 1.91%.

Borrowing Strategy and Performance – 2012/2013

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 2012 and was updated where necessary to reflect changing circumstances. The Borrowing Strategy for 2012/2013 was based upon the views of the Executive Director of Commercial and Corporate Services, supplemented with market data, market information and leading economic forecasts provided by the Council's treasury management adviser, Sector Treasury Services.

4.4 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 rising to 1.25% by March 2014 and that PWLB borrowing rates would steadily increase throughout 2012/2013 across all periods. Economists have revised their forecasts and are not expecting any change to the Bank Base Rate, currently 0.5%, until March 2015 at the earliest due to slower than anticipated economic recovery.

The government announced in the March 2012 budget plans to introduce a 0.20% discount on PWLB loans under the prudential borrowing regime for those authorities that provided "improved information and transparency on their locally determined long-term borrowing and associated capital spending plans" and who successfully applied and were eligible for the lower rate. The Council successfully applied to access loans at the lower PWLB certainty rate, which came into effect on 1st November 2012 and eligibility lasts until 31st October 2013 when authorities must reapply to access the PWLB certainty rate for the following 12 months.

4.5 The table below shows the average borrowing rates in 2012/2013. The Council did not take out any new PWLB borrowing in 2012/2013 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.

2012/2013	**Qtr 1 (Apr - June) %**	**Qtr 2 (July – Sept) %**	**Qtr 3 (Oct – Dec) %**	**Qtr 4 (Jan – Mar) %**
7 days notice	0.35	0.34	0.31	0.31
1 year	1.24	1.10	1.07*	1.00*
5 year	1.92	1.68	1.68*	1.78*
10 year	2.95	2.68	2.66*	2.87*
25 year	4.13	3.94	3.93*	4.05*
50 year	4.24	4.14	4.09*	4.20*

* Qtr 3 and 4 rates take account of the 0.2% discount to PWLB rates available to eligible authorities that came into effect on 1st November 2012.

4.6 The Treasury Management Strategy for 2012/2013 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 2012/2013 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 31st March 2013 is set out below:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	142.9		
	Market	39.5		
	Other	1.7	184.1	3.91
Variable Rate Funding	Temporary / Other	29.0	29.0	0.78
Total Borrowing			**213.1**	**3.49**
Total Investments*	All managed In-House		**210.0**	**1.91**
Net Position			**(3.1)**	

* 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 £3.1 million representing the difference between gross debt and total investments. This position is expected to change over the next few years as the Council has to manage its finances with significantly less government funding. This could impact 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 – 2012/2013

4.8 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 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 2012/2013 in total as £377.324m which was detailed as follows:

	£m
Borrowing	342.396
Other Long Term Liabilities	34.928
Total	**377.324**

The Operational Boundary for External Debt for 2012/2013 was set at £339.011m as follows:

	£m
Borrowing	304.083
Other Long Term Liabilities	34.928
Total	**339.011**

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 2012/2013 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.

4.9 The table below shows that all other Treasury Management Prudential Indicators have been complied with during 2012/2013.

Prudential Indicators		2012/2013	
		Limit £'000	**Actual £'000**
P10	**Upper limit for fixed interest rate exposure**		
	Net principal re fixed rate borrowing / investments	130,000	42,735
P11	**Upper limit for variable rate exposure**		
	Net principal re variable rate borrowing / investments	60,000	13,902
P12	**Maturity Pattern**	Upper Limit	
	Under 12 months	50%	16.68%
	12 months and within 24 months	60%	4.70%
	24 months and within 5 years	80%	4.81%
	5 years plus	100%	79.07%
	A lower limit of 0% for all periods		
P13	**Upper limit for total principal sums invested for over 364 days**	75,000	20,000

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

5. Investment Strategy and Performance – 2012/2013

The Investment Strategy for 2012/2013 was approved by Council on 7th 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.

The Annual Investment Strategy has been fully complied with in 2012/2013.

5.1 At 31st March 2013, the Council had outstanding investments of £210.0 million. The table below shows the return made on the Council's total investments for 2012/2013 as compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Council uses to assess its performance.

	2012/2013 Return %	2012/2013 Benchmark %
In-house Managed Funds	**1.91**	**0.39**

This return far exceeded the benchmark set for 2012/2013 and represents a very good achievement especially when short-term investment rates continue to remain very low.

5.2 All investments placed in 2012/2013 have been made in accordance with the approved Investment Strategy and comply with the Criteria and the Approved Lending List set by Council on 7th March 2012 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 on 22nd February 2013 and subsequently by Fitch, however advice is that the guidance to restrict investment to very short-term periods 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). These part government owned organisations have the government's AA+ rating applied to them, or in respect of Money Market Funds which are AAA rated.

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 2012/2013 have already been reported to members previously and the latest Lending List and Criteria are included in the Treasury Management First Quarterly Review 2013/2014 reported to this meeting for information.

6. Reason for Decision

6.1 To note the performance for 2012/2013.

7. Alternative Options

7.1 No alternatives are submitted for consideration.