TYNE AND WEAR FIRE AND RESCUE AUTHORITY **Item No. 07**

MEETING: 18TH JULY 2011

TREASURY MANAGEMENT – REVIEW OF PERFORMANCE 2010/2011

REPORT OF THE FINANCE OFFICER

1 Purpose of the Report

1.1 To inform members of the Treasury Management borrowing and investment performance for 2010/2011.

2 Description of Decision

2.1 The Committee is requested to note the Treasury Management performance for 2010/2011.

3 Introduction

3.1 Sunderland City Council performs the treasury management function on behalf of the Authority, as lead authority.

3.2 This report sets out the annual borrowing and investment performance for the financial year 2010/2011 in accordance with the requirements of the Treasury Management Policy and Strategy approved by the Authority on 22nd March 2010. The Treasury Management Strategy comprises a Borrowing and an Investment Strategy. These set out the Authority's policies for managing its borrowing and investments.

3.3 The Strategy complies with best practice and incorporates the recommendations included in the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management.

4 Review of Performance 2010/2011

4.1 Summary

The performance of the Authority's Treasury Management function continues to contribute significant financial savings that are used to provide funding to support future years capital programme and help support the Authority's revenue budget. New loans taken out in 2010/2011 to replace borrowing repaid as part of previous debt restructuring exercises has led to an ongoing debt interest saving to the Authority of £0.298 million per annum.

Borrowing Strategy and Performance – 2010/2011

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 Authority'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 was reviewed by this committee in September 2010 and March 2011 and has been updated where necessary to reflect changing circumstances. The Borrowing Strategy for 2010/2011 was based upon the views of the Finance Officer, supplemented with market data, market information and leading economic forecasts provided by the Authority's treasury adviser, Sector Treasury Services.

4.4 The view in February 2010, at the time the Treasury Management Policy and Strategy was drafted, was that variable rate borrowing was expected to become more expensive as the Base Rate was forecast to increase by 0.25% to 0.75% by the end of September 2010 and to 1.50% by the end of March 2011. Thereafter variable rate borrowing was expected to steadily increase until it reached an estimated level of 4.5% by the end of March 2013.

The forecast for the long-term PWLB rates was they would rise by between 0.40% and 0.55% in 2010/2011 and continue to gradually rise in 2011/2012 and 2012/2013 (i.e.10 year loans to increase from 4.00% to 5.15% and 50 year loans to increase from 4.60% to 5.45% over the 3 year period).

Actual interest rates did not increase to the levels anticipated as global and national economic growth remained low. This, alongside sovereign debt concerns in the Euro Zone led to a fall in gilt yields despite higher than anticipated levels of inflation. There remains a wide divergence of opinion on the timing of the start of increases in the Bank Rate and economic forecasts will continue to be closely monitored.

Reductions in gilt yields to historic lows should have led to reductions in PWLB borrowing rates during 2010/2011. However, as part of the Government's Spending Review 2010 in October 2010 the PWLB was instructed to increase the average interest rate on all new loans by an average of 1.00% above the Government's cost of borrowing. This unexpected increase across all PWLB rates of 0.87% made borrowing from this source more expensive overnight and also made debt rescheduling opportunities less likely.

4.5 The table overleaf, details the average borrowing rates at the end of each quarter in 2010/2011, and shows that had PWLB rates not been subject to a one off increase in October 2010 they would have remained lower than market forecasts:

		Actual Borrowing Rate				
Borrowing Period	Projected Rates %	Q1 2010 %	Q2 2010 %	Q3 2010 %	Q4 2010 %	Q1 2011 %
Base Rate	0.50 to 1.50	0.50	0.50	0.50	0.50	0.50
1 year	-	0.83	0.67	0.64	1.65	1.89
5 year	3.05 to 3.60	2.89	2.27	1.88	3.33	3.57
10 year	4.00 to 4.45	4.19	3.54	3.14	4.58	4.71
25 year	4.55 to 4.90	4.67	4.27	3.96	5.23	5.31
50 year	4.60 to 5.00	4.70	4.26	4.02	5.16	5.24

4.6 The lead authority's (of which the Authority forms a part of) borrowing requirement for 2010/2011 was assessed at £24.0 million to replace debt rescheduling carried out in January 2010 and £2.5 million to replace 11.75% redeemable stock that matured in November 2008. When the lead authority reschedules debt the average rate is adjusted accordingly. As this exercise has reduced borrowing costs the Fire Authority has benefited from lower debt charges.

The lead authority borrowed £30.5 million from the PWLB in 2010/2011 as set out in the table below. The average interest rate payable on the new loans was 3.31% and well below the 4.50% target rate set for long term borrowing, representing a lower cost of borrowing to the Authority.

Long Term Borrowing 2010/2011						
Date	**Lender**	**Amount £m**	**Period (Years)**	**Rate %**	**Benchmark Rate %**	**Margin %**
11/05/10	PWLB	0.5	15	3.65	4.50	0.85
25/05/10	PWLB	10.0	4	1.99	4.50	2.51
25/05/10	PWLB	5.0	50	4.29	4.50	0.21
27/07/10	PWLB	5.0	11	3.75	4.50	1.25
27/07/10	PWLB	5.0	12	3.87	4.50	1.13
01/09/10	PWLB	5.0	50	3.96	4.50	0.54
		30.5		**3.31**		

4.7 The Treasury Management Strategy included provision for debt rescheduling should appropriate opportunities arise. However, as explained, the October 2010 PWLB borrowing rate increase was not accompanied by an increase in early debt redemption rates. This, and the very low underlying rate of the Authority's long term debt (arising from the proactive approach to debt rescheduling and borrowing taken by the Authority in recent years), has meant that rates have not been sufficiently favourable to undertake further debt rescheduling in 2010/2011. Market conditions will however continue to be closely monitored to identify and take advantage of any such opportunities should they arise in the future.

4.8 The lead authority has nine market Lender's Option / Borrower's Option (LOBO) loans totalling £39.5 million, of which £34.5 million are now 'flat rate vanilla' LOBO's which have three year roll-over periods. This essentially means that these loans have become fixed rate loans which are reviewed every 3 years. The other loan of £5.0 million still has a six monthly roll-over period. The Treasury Management team will continue to monitor this loan for an opportunity to renegotiate the loan on more favourable terms, but this is unlikely to happen in the current interest rate environment.

4.9 The lead authority's borrowing portfolio, which includes the Authority's position at 31st March 2011 was:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	138.0		
	Market	34.5		
	Other	0.3	172.8	3.86
Variable Rate Funding	Market	5.0		
	Temporary / Other	31.1	36.1	0.93
Total Borrowing			**208.9**	**3.35**
Total Investments	In House		**187.4**	**1.50**
Net Debt			**21.5**	

Prudential Indicators – 2010/2011

4.10 All external borrowing and investments undertaken in 2010/2011 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 Authority'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 Authority for 2010/2011 in total as £52.846m which was detailed as follows:

	£m
Borrowing	26.784
Other Long Term Liabilities	26.062
Total	**52.846**

The Operational Boundary for External Debt for 2010/2011 was set at £47.846m as follows:

	£m
Borrowing	21.784
Other Long Term Liabilities	26.062
Total	**47.846**

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 Authority's Balance Sheet in compliance with International Financial Reporting Standards.

The Authority's maximum external debt in 2010/2011 was £38.436 million (which includes long term liabilities in respect of Public Finance Initiative schemes), and is well within both of the above limits.

4.11 The table below shows that all other Treasury Management Prudential Indicators for the lead authority have been complied with during 2010/2011, and these are set out in the table overleaf

Prudential Indicators		**2010/2011**	
		Limit £'000	**Actual £'000**
P10	**Upper limit for fixed interest rate exposure** Net principal re fixed rate borrowing / investments	90,000	32,366
P11	**Upper limit for variable rate exposure** Net principal re variable rate borrowing / investments	50,000	27,497
P12	**Maturity Pattern**	Upper Limit	
	Under 12 months	40%	17.85%
	12 months and within 24 months	50%	0.05%
	24 months and within 5 years	75%	10.40%
	5 years plus	100%	76.98%
	A lower limit of 0% for all periods		

5. Investment Strategy and Performance – 2010/2011

5.1 The general policy objective for the Authority in considering potential investments is the prudent investment of its treasury balances. The Authority's investment priorities in order of importance are:

1) The security of capital
2) The liquidity of its investments and then

3) The Authority aims to achieve the optimum yield on its investments but this is commensurate with the proper levels of security and liquidity

5.2 Annual Investment Strategy sets out the type of investments the Authority can use for the purpose of investments and makes specific reference to:

- the procedures for determining the use of each asset class, (advantages and associated risk), particularly if the investment falls under the category of "non-specified investments";
- the maximum periods for which funds may be prudently committed in each asset class;
- the amount or percentage limit to be invested in each asset class;
- whether the investment instrument is to be used by the lead authority's in-house officers and/or by the lead authority's appointed external fund managers (if used); and, if non-specified investments are to be used in-house, whether prior professional advice is to be sought from the Authority's treasury advisers;
- the minimum amount to be held in short-term investments (i.e. one which the Authority may require to be repaid or redeemed within 12 months of making the Investment).

The Annual Investment Strategy has been fully complied with in 2010/2011.

5.3 At 31st March 2011 the Authority had outstanding investments of £27.514 million. The table below shows the return made on the Authority's total investments for 2010/2011 as compared with the benchmark 7 Day LIBID rate, which the Authority uses to assess its performance.

	2010/2011 Return %	**2010/2011 Benchmark %**
In-house Managed Funds	**0.36**	**0.36**

5.4 All investments placed in 2010/2011 have been made in accordance with the approved Criteria and the Approved Lending List by the Authority on 22nd March 2010.

5.5 As members will be aware, the regular updating of the Authority's Authorised Lending List and Criteria is required in the light of financial institution mergers and changes in institutions' credit ratings. The Finance Officer has the delegated authority to vary the Lending List Criteria and Lending List itself should circumstances dictate, on the basis that changes be reported to Authority and the Governance Committee retrospectively, in accordance with normal Treasury Management reporting procedures The few changes made during

2010/2011 have already been reported to members previously but for information these are included in the attached Appendices..

6. **Reasons for Decisions**

6.1 To note the performance for 2010/2011.

7. **Alternative Options**

7.1 No alternatives are submitted for Members consideration.

Background Papers

Sector CityWatch (Monthly) and weekly credit rating list
Sector / Capital Economics / UBS Economic forecasts
Local Government Act 2003
The Prudential Code for Capital Finance
CIPFA Code of Practice on Treasury Management in Local Authorities
The Financial Times
Other financial websites

Lending List Criteria **Appendix 1**

Counterparty Criteria

The Authority 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.

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	50	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
Local Authorities (limit for each local authority)					30	364 Days
Money Market Funds Maximum amount to be invested in Money Market Funds is £50 million with a maximum of £30 million in any one fund.					50	2 Years

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 Authority can place with that institution.

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 limits are as follows:

Appendix 1

Country Limit
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.

In addition a total limit of £40 million has been set 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 Authority 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
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.

Group limits are set out in Appendix 2

Approved Lending List **Appendix 2**

	Fitch				Moody's			Standard & Poor's			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength	L Term	S Term	Limit £m	Max Deposit Period
UK	AAA	F1+			Aaa			AAA		300	364 days
Lloyds Banking Group (see Note 1)										**Group Limit 50**	
Lloyds Banking Group plc	AA-	F1+	C	1	A1	-	-	A	A-1	50	364 days
Lloyds TSB Bank Plc	AA-	F1+	C	1	Aa3	P-1	C-	A+	A-1	50	364 days
Bank of Scotland Plc	AA-	F1+	C	1	Aa3	P-1	D+	A+	A-1	50	364 days
Royal Bank of Scotland Group (See Note 1)										**Group Limit 50**	
Royal Bank of Scotland Group plc	AA-	F1+	C/D	1	A1	P-1	-	A	A-1	50	364 days
The Royal Bank of Scotland Plc	AA-	F1+	C/D	1	Aa3	P-1	C-	A+	A-1	50	364 days
National Westminster Bank Plc	AA-	F1+	-	1	Aa3	P-1	C-	A+	A-1	50	364 days
Ulster Bank Ltd	A+	F1+	E	1	A2	P-1	D-	BBB+	A-2	50	364 days
Santander Group *										**Group Limit 40**	
Santander UK plc	AA-	F1+	B	1	Aa3	P-1	C-	AA	A-1+	40	364 days
Cater Allen	AA-	F1+	B	1	Aa3	P-1	C-	AA	A-1+	40	364 days
Barclays Bank plc *	AA-	F1+	B	1	Aa3	P-1	C	AA-	A-1+	40	364 days
HSBC Bank plc *	AA	F1+	B	1	Aa2	P-1	C+	AA	A-1+	40	364 days

Appendix 2

	Fitch				Moody's			Standard & Poor's			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength	L Term	S Term	Limit £m	Max Deposit Period
Nationwide BS *	AA-	F1+	B	1	Aa3	P-1	C-	A+	A-1	40	364 days
Standard Chartered Bank *	AA-	F1+	B	1	A1	P-1	B-	A+	A-1	40	364 days
Clydesdale Bank / Yorkshire Bank **	AA-	F1+	C	1	A1	P-1	C-	A+	A-1	10	364 days
Co-Operative Bank Plc	A-	F2	B/C	3	A2	P-1	D+	-	-	5	6 months
Northern Rock ***	BBB+	F2	C	2	-	-	-	A-	A-2	0	
Top 10 Building Societies (by asset value)											
Nationwide BS (see above)											
Yorkshire BS	A-	F2	B/C	5	Baa1	P-2	D+	A-	A-2	0	
Coventry BS	A	F1	B	5	A3	P-2	C-	-	-	5	6 Months
Skipton BS	A-	F2	B/C	5	Baa1	P-2	D+	-	-	0	
Leeds BS	A	F1	B/C	5	A2	P-1	C+	-	-	10	364 Days
West Bromwich BS ***	BBB-	F3	C/D	5	Baa3	P-3	E+	-	-	0	
Principality BS ***	BBB+	F2	C	5	Baa2	P-2	D-	-	-	0	
Newcastle BS ***	BBB-	F3	C/D	5	Baa2	P-2	D-	-	-	0	
Norwich and Peterborough BS ***	BBB+	F2	C	5	Baa2	P-2	D-	-	-	0	
Nottingham BS	-	-	-	-	A3	P-2	C-	-	-	0	-
Foreign Banks have a combined total limit of £40m											
Australia	AA+	-	-	-	Aaa	-	-	AAA		40	364 Days
National Australia Bank	AA	F1+	B	1	Aa2	P-1	B-	AA	A-1+	40	364 Days
Australia and New Zealand Banking Group Ltd	AA-	F1+	B	1	Aa2	P-1	B-	AA	A-1+	20	364 Days

Appendix 2

	Fitch				Moody's			Standard & Poor's			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength	L Term	S Term	Limit £m	Max Deposit Period
Commonwealth Bank of Australia	AA	F1+	A/B	1	Aa2	P-1	B-	AA	A-1+	40	364 Days
Westpac Banking Corporation	AA	F1+	A/B	1	Aa2	P-1	B-	AA	A-1+	40	364 Days
Canada	**AAA**				**Aaa**			**AAA**		40	364 Days
Bank of Nova Scotia	AA-	F1+	B	1	Aa1	P-1	B	AA-	A-1+	20	364 Days
Royal Bank of Canada	AA	F1+	A/B	1	Aa1	P-1	B+	AA-	A-1+	20	364 Days
Toronto Dominion Bank	AA-	F1+	B	1	Aaa	P-1	B+	AA-	A-1+	20	364 Days
Money Market Funds										50	
Prime Rate Stirling Liquidity	AAA MMF							AAAm		30	On Call
Insight Liquidity Fund					AAA MR1			AAAm		30	On Call
Ignis Sterling Liquidity	AAA MMF							AAAm		30	On Call

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 revised credit limit of £50 million for a maximum period of 364 days

* 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 revised credit limit of £40 million for a maximum period of 364 days

** 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.