TYNE AND WEAR FIRE AND RESCUE AUTHORITY **Item 04**

MEETING: 15TH OCTOBER 2012

TREASURY MANAGEMENT – REVIEW OF PERFORMANCE 2011/2012

REPORT OF THE FINANCE OFFICER

1. Purpose of the Report

1.1 To report on the Treasury Management performance of the Authority for 2011/2012 in line with best practice as prescribed by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (2011). This report has already been considered by the Governance Committee at its meeting on 29th June 2012.

2. Description of Decision

2.1 The Committee is requested to note the Treasury Management performance of the Authority for 2011/2012.

3. Introduction

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

3.2 This report sets out the annual borrowing and investment performance for the financial year 2011/2012 in accordance with the requirements of the Treasury Management Policy Statement and Treasury Management Strategy approved by the Authority on 28th March 2011. The Treasury Management Strategy comprises a Borrowing and Investment Strategy which set out the Authority's strategy for borrowing and its policies for managing its investments (which give priority to the security and liquidity of those investments).

3.3 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 also 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 2011/2012 - Summary

4.1 **Cost of Borrowing**
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 programmes and help support the Authority's revenue budget. The average rate of the lead authority's borrowing at 3.46% is in the top quartile when benchmarked against other authorities. This has helped to keep the revenue cost of the Authority's borrowing low in comparison to other Authorities. A further saving of

£39,000 on debt charge costs was also achieved in year. Paragraph 5 sets out more details of the Authority's Borrowing Strategy, for the information of members.

4.2 **Rate of Return on Investments**
The Authority has benefitted from additional investment income during the year of £118,000 in cash terms based on a higher rate of return in 2011/2012 of 0.80% as compared to the benchmarked rate of 0.37%. The investment policy continues to reflect the priority to 'protect' the funds of the Authority first and foremost. More details are set out in paragraph 7 below on the Authority's Investment Strategy and Policy.

4.3 **Treasury Management Prudential Indicators**
In summary the Authority has not exceeded any of its Treasury Management Prudential Indicators during 2011/2012. These indicators help to control the day to day Treasury Management activity which is closely monitored to ensure limits set each year by the Authority are not exceeded and which means capital expenditure can be appropriately financed and is affordable within the constraints of the revenue budget.

It is also very important that the Authorised Borrowing Limit for External Debt for the Authority which is a statutory limit which must be set each year under section 3(1) of the Local Government Act 2003 is not exceeded. This limit was set at £46.363m for 2011/2012 and the highest level reached by the Authority of £42.785m during the year was well below this limit. More details of all of the Prudential Indicators are set out in paragraph 6.

5. Borrowing Strategy and Performance – 2011/2012

5.1 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 5.50% for long term borrowing (i.e. all borrowing for a period of one year or more);
- take advantage of debt rescheduling opportunities as appropriate.

5.2 The Borrowing Strategy has been reviewed regularly by this Committee in September 2011 (1st and 2nd quarterly reports) and also in March 2012 (3rd quarterly report) and was updated where necessary to reflect changing circumstances. The Borrowing Strategy for 2011/2012 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.

5.3 The view in February 2011, at the time the Treasury Management Policy and Strategy was drafted, was that variable rate borrowing was expected to become more expensive. The Bank Base Rate was expected to increase over the next three financial years from its current level of 0.50% to 0.75% by December 2011, and to 3.25% by March 2014. It was also anticipated that PWLB borrowing rates would steadily increase throughout 2011/2012 across all periods with the 5 years PWLB forecast to be around 3.5% by March 2012, and the 25 year and 50 year PWLB rates to be around 5.3%.

Economists are now forecasting that the first increase in the bank base rate will be 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 political developments in the Eurozone and the sovereign debt crisis within a number of Eurozone countries. This uncertainty is expected to remain, at least until the Eurozone issues are resolved, and which continues to have a significant and often unpredictable impact on the financial markets.

Interest rate forecasts have altered as a result of two major events:

1. The decision by the MPC to expand quantitative easing by a further £50bn in February 2012. This decision had an immediate effect of depressing (lowering) gilt yields at the long end of the curve. It also clearly underlined how concerned the MPC is about the prospects for UK growth and that recession was a much greater concern than inflation. The prospect of further quantitative easing as a result can not be ruled out.

2. The marked deterioration of growth prospects in the major world economies such as Spain. Even though the UK has moved into a double dip recession this has led to a further increase in safe haven flows into UK gilts which have depressed gilt yields and pushed PWLB rates to even lower levels.

These developments have meant forecasts for PWLB rates are greatly out of line (and higher) than the actual rates experienced during the year across the range and the expectation of the timing of the eventual start of increases in the bank base rate and PWLB rates are now substantially longer into the future..

5.4 The table below shows the average borrowing rates in 2011/2012.

2011/2012	Qtr 1 (Apr - June) %	Qtr 2 (July – Sept) %	Qtr 3 (Oct – Dec) %	Qtr 4 (Jan – Mar) %
7 days notice	0.40	0.38	0.37	0.35
1 year	1.69	1.50	1.39	1.30
5 year	3.29	2.59	2.25	2.05
10 year	4.51	3.82	3.33	3.19
25 year	5.22	4.84	4.22	4.19
50 year	5.16	4.88	4.28	4.24

Reductions in gilt yields to historic lows have led to reductions in PWLB borrowing rates during 2011/2012. However, these reductions should have been greater. The Government's October 2010 Spending Review instructed the PWLB to increase the 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. In the 2012 March Budget the government announced that PWLB rates may be decreased by 0.2% under certain circumstances and as such the Authority is keeping a watching brief on this in order to take advantage of this concession should the opportunity arise. Unfortunately the government has yet to provide detailed guidance on how this reduced rate can be acquired.

5.5 The Lead Authority borrowed £10.0 million from the PWLB in 2011/2012 as set out in the table below. The interest rate payable on the new loan was 3.99% and well below the 5.50% target rate set for long-term borrowing, representing an ongoing lower cost of borrowing to the Authority. The rate achieved is also well below the average rates for 50 year PWLB loans set out in the above table at paragraph 4.5.

Long Term Borrowing 2011/2012						
Date	**Lender**	**Amount £m**	**Period (Years)**	**Rate %**	**Benchmark Rate %**	**Margin %**
20/01/12	PWLB	10.0	50	3.99	5.50	1.51

5.6 The Treasury Management Strategy included provision for debt rescheduling should appropriate opportunities arise. However, 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 2011/2012. Market conditions however will continue to be monitored to identify and take advantage of any such opportunities should they arise.

5.7 The lead authority's borrowing portfolio position (of which the Authority forms a part) at 31st March 2012 is set out overleaf:

		Principal (£m)	**Total (£m)**	**Average Rate (%)**
Borrowing				
Fixed Rate Funding	PWLB	148.0		
	Market	24.5		
	Other	0.3	172.8	3.84
Variable Rate Funding	Market	15.0		
	Temporary / Other	29.8	44.8	1.99
Total Borrowing			**217.6**	**3.46**
Total Investments*	All managed In-House		**231.5**	**1.62**
Net Investments			**13.9**	

* Total investments includes monies invested on behalf of the North Eastern Local Enterprise Partnership for whom Sunderland City Council is the accountable body.

6. Prudential Indicators – 2011/2012

6.1 All external borrowing and investments undertaken in 2011/2012 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 2011/2012 in total as £46.363m which was detailed as follows:

	£m
Borrowing	25.622
Other Long Term Liabilities	20.741
Total	**46.363**

The Operational Boundary for External Debt for 2011/2012 was set at £43.363m as follows:

	£m
Borrowing	20.622
Other Long Term Liabilities	22.741
Total	**43.363**

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 2011/2012 was £42.785 million (which includes long term liabilities in respect of Public Finance Initiative schemes), and is well within both of the above limits.

6.2 The table below shows that all other Treasury Management Prudential Indicators for the lead authority have been complied with during 2011/2012.

	Prudential Indicators	**2011/2012**	
		Limit £'000	**Actual £'000**
P10	**Upper limit for fixed interest rate exposure**		
	Net principal re fixed rate borrowing / investments	105,000	47,553
P11	**Upper limit for variable rate exposure**		
	Net principal re variable rate borrowing / investments	60,000	26,173
P12	**Maturity Pattern**	Upper Limit	
	Under 12 months	50%	16.73%
	12 months and within 24 months	60%	2.44%
	24 months and within 5 years	80%	7.30%
	5 years plus	100%	77.07%
	A lower limit of 0% for all periods		

The Lead Authority is currently within the limits set for all of its TM Prudential Indicators.

7. Investment Strategy and Performance – 2011/2012

7.1 The general policy objective for the Authority 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.

The Annual Investment Strategy has been fully complied with in 2011/2012.

7.2 At 31st March 2012 the Authority had outstanding investments of £27.514 million. The table below shows the return made on the Authority's total investments for 2011/2012 compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Authority uses to assess its performance.

	2011/2012 Return %	**2011/2012 Benchmark %**
In-house Managed Funds	**0.80**	**0.37**

7.3 All investments placed in 2011/2012 have been made in accordance with the approved Criteria and the Approved Lending List by the Authority on 28th March 2011 and to any subsequent revisions approved during the year. Investments placed in 2011/2012 have been made in accordance with the approved Investment Strategy and comply with the counterparty criteria used to identify financial organisations on the Approved Lending List.

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 Authority. 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 euro zone, advice from our Treasury Management advisers (which we agree with) is to continue to restrict investments to all financial institutions for shorter term periods.

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

7.4 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 2011/2012 have already been reported to Members previously but these are included in the attached Appendices for information.

8. Reasons for Decision

8.1 To note the Treasury Management performance for 2011/2012.

9. Alternative Options

9.1 No alternatives are submitted for Members consideration.

10. Background Papers

10.1 There are no back ground papers to this report

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	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
Local Authorities (limit for each local authority)					30	2 years
UK Government (including debt management office, gilts and treasury bills)					70	2 years
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	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:

Appendix 1

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.

Proposed 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 Rating	L Term	S Term	Limit £m	Max Deposit Period
UK	AAA	F1+			Aaa			AAA		300	2 years
Lloyds Banking Group (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
Royal Bank of Scotland Group (See Note 1)										**Group Limit 70**	
Royal Bank of Scotland Group plc	A	F1	bbb	1	A3	P-2	-	A-	A-2	70	2 years
The Royal Bank of Scotland Plc	A	F1	bbb	1	A2	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
Santander Group *										**Group Limit 40**	
Santander UK plc	A+	F1	a+	1	A2	P-1	C-	A	A-1	40	364 days
Cater Allen	A+	F1	a+	1	A2	P-1	C-	A	A-1	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

	Fitch				Moody's			Standard & Poor's			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength Rating	L Term	S Term	Limit £m	Max Deposit Period
Nationwide BS *	A+	F1	a+	1	A2	P-1	C	A+	A-1	40	364 days
Standard Chartered Bank *	AA-	F1+	aa-	1	A1	P-1	B-	AA-	A-1+	40	364 days
Clydesdale Bank / Yorkshire Bank **/***	A	F1	bbb	1	A2	P-1	C-	BBB+	A-2	0	
Co-Operative Bank Plc	A-	F2	a-	3	A3	P-2	C-	-	-	5	6 months
Northern Rock ***	BBB+	F3	bbb	5	-	-	-	BBB+	A-2	0	
Top Building Societies (by asset value)											
Nationwide BS (see above)											
Yorkshire BS ***	BBB+	F2	bbb+	5	Baa2	P-2	C-	A-	A-2	0	
Coventry BS	A	F1	a	5	A3	P-2	C	-	-	5	6 Months
Skipton BS ***	BBB	F3	bbb	5	Ba1	NP	D+	-	-	0	
Leeds BS	A-	F2	a-	5	A3	P-2	C	-	-	5	6 Months
West Bromwich BS ***	-	-	-	-	-	-	-	-	-	0	
Principality BS ***	BBB+	F2	bbb+	5	Ba1	NP	D+	-	-	0	
Newcastle BS ***	BB+	B	bb+	5	-	-	-	-	-	0	
Nottingham BS ***	-	-	-	-	Baa2	P-2	C-	-	-	0	
Foreign Banks have a combined total limit of £40m											
Australia	AAA	-	-	-	Aaa	-	-	AAA		40	364 Days
National Australia Bank	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	40	364 Days
Australia and New Zealand Banking Group Ltd	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	20	364 Days
Commonwealth Bank of Australia	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	40	364 Days
Westpac Banking Corporation	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	40	364 Days

	Fitch				Moody's			Standard & Poor's			
	L Term	S Term	Individual	Support	L Term	S Term	Fin Strength Rating	L Term	S Term	Limit £m	Max Deposit Period
Canada	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
Money Market Funds										50	Liquid
Prime Rate Stirling Liquidity	AAA							AAA		30	Liquid
Insight Liquidity Fund					AAA			AAA		30	Liquid
Ignis Sterling Liquidity	AAA							AAA		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 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 classified as a UK bank for the purposes of the Approved Lending List.