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**TREASURY MANAGEMENT – REVIEW OF PERFORMANCE 2012/2013**

**REPORT OF THE FINANCE OFFICER**

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**1. Purpose of the Report**

- 1.1 To report on the Treasury Management performance of the Authority for 2012/2013 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).

**2. Description of Decision**

- 2.1 The Committee is requested to note the Treasury Management performance of the Authority for 2012/2013.

**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 2012/2013 in accordance with the requirements of the Treasury Management Policy Statement and Treasury Management Strategy approved by the Authority on 20<sup>th</sup> February 2012. 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 1<sup>st</sup> 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 2012/2013 - 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 3.49% is one of the lowest in the country and 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. 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 benefited from additional investment income during the year of £112,800 in cash terms based on a higher rate of return in 2012/2013 of 0.80% as compared to the benchmarked rate of 0.39%. 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 2012/2013. 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 £52.557m for 2012/2013 and the highest level reached by the Authority of £41.303m 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 – 2012/2013**

#### **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 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.

#### **5.2 The Borrowing Strategy has been reviewed regularly by this Committee in September 2012 (1<sup>st</sup> and 2<sup>nd</sup> quarterly reports) and also in March 2013 (3<sup>rd</sup> quarterly report) and was updated where necessary to reflect changing circumstances. The Borrowing Strategy for 2012/2013 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 management adviser, Sector Treasury Services.**

- 5.3 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 forecast and are not expecting any change to the Bank Base Rate, currently 0.5%, until March 2015 at the earliest.

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. Sunderland City Council successfully applied to access loans at the lower PWLB certainty rate, which came into effect on 1<sup>st</sup> November 2012 and eligibility lasts until 31<sup>st</sup> October 2013 when authorities must reapply to access the PWLB certainty rate for the following 12 months.

- 5.4 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.

<b>2012/2013</b>	<b>Qtr 1 (Apr - June) %</b>	<b>Qtr 2 (July – Sept) %</b>	<b>Qtr 3 (Oct – Dec) %</b>	<b>Qtr 4 (Jan – Mar) %</b>
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 1<sup>st</sup> November 2012.

- 5.5 The Treasury Management Strategy for 2012/2013 included provision for debt rescheduling but also stated that because of the proactive approach taken by the Authority 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.
- 5.6 The lead authority’s borrowing portfolio position (of which the Authority forms a part) at 31st March 2013 is set out overleaf:

		<b>Principal (£m)</b>	<b>Total (£m)</b>	<b>Average Rate (%)</b>
<b>Borrowing</b>				
Fixed Rate Funding	PWLB	142.9		
	Market	39.5		
	Other	1.7	184.1	3.91
Variable Rate Funding	Temporary / Other	29.8	44.8	1.99
<b>Total Borrowing</b>			<b>213.1</b>	<b>3.49</b>
<b>Total Investments*</b>	All managed In-House		<b>210.0</b>	
<b>Net Position</b>			<b>(3.1)</b>	

\* 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 – 2012/2013

6.1 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 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 2012/2013 in total as £52.557m which was detailed as follows:

	<b>£m</b>
Borrowing	28.525
Other Long Term Liabilities	<u>24.032</u>
<b>Total</b>	<b><u>52.557</u></b>

The Operational Boundary for External Debt for 2012/2013 was set at £47.557m as follows:

	<b>£m</b>
Borrowing	23.525
Other Long Term Liabilities	<u>24.032</u>
<b>Total</b>	<b><u>47.557</u></b>

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 (IFRS).

The Authority's maximum external debt in 2012/2013 was £41.303 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 2012/2013.

Prudential Indicators	2012/2013	
	Limit £'000	Actual £'000
<b>P10 Upper limit for fixed interest rate exposure</b> Net principal re fixed rate borrowing / investments	130,000	42,735
<b>P11 Upper limit for variable rate exposure</b> Net principal re variable rate borrowing / investments	60,000	13,902
<b>P12 Maturity Pattern</b> 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%	16.68% 4.70% 4.81% 79.07%

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

## 7. Investment Strategy and Performance – 2012/2013

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 2012/2013.

7.2 At 31<sup>st</sup> March 2013 the Authority had outstanding investments of £27.514 million. The table below shows the return made on the Authority's total investments for 2012/2013 compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Authority uses to assess its performance.

	2012/2013 Return %	2012/2013 Benchmark %
<b>In-house Managed Funds</b>	<b>0.80</b>	<b>0.39</b>

7.3 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 the Authority on 20<sup>th</sup> February 2012 and also taking into account subsequent revisions reported and approved 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 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 Eurozone, advice from our Treasury Management adviser is to continue to limit investments to all financial institutions for shorter term periods.

The UK sovereign rating was downgraded to AA+ by Moody's on 22<sup>nd</sup> 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.

- 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 2012/2013 have already been reported to Members previously but these are included in Appendix 1 for information.

## **8. Reasons for Decision**

- 8.1 To note the Treasury Management performance for 2012/2013.

## **9. Alternative Options**

- 9.1 No alternatives are submitted for Members consideration.

## 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 adviser.

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>Maximum Deposit £m</b>	<b>Maximum Duration</b>
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
<b>Local Authorities</b> (limit for each local authority)					30	2 years
<b>UK Government</b> (including debt management office, gilts and treasury bills)					90	2 years
<b>Money Market Funds</b> Maximum amount to be invested in Money Market Funds is £80 million with a maximum of £40 million in any one fund.					80	Liquid Deposits

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:

## 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 £350 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	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 2



## Approved Lending List

## Appendix 2

	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	
<b>UK</b>	AA+				Aa1			AAA		350	2 years
<b>Lloyds Banking Group</b> (see Note 1)										<b>Group Limit 90</b>	
Lloyds Banking Group plc	A	F1	bbb	1	A3	-	-	A-	A-2	90	2 years
Lloyds TSB Bank Plc	A	F1	bbb	1	A2	P-1	C-	A	A-1	90	2 years
Bank of Scotland Plc	A	F1	-	1	A2	P-1	D+	A	A-1	90	2 years
<b>Royal Bank of Scotland Group</b> (See Note 1)										<b>Group Limit 90</b>	
Royal Bank of Scotland Group plc	A	F1	bbb	1	Baa1	P-2	-	A-	A-2	90	2 years
The Royal Bank of Scotland Plc	A	F1	bbb	1	A3	P-2	D+	A	A-1	90	2 years
National Westminster Bank Plc	A	F1	-	1	A3	P-2	D+	A	A-1	90	2 years
Ulster Bank Ltd	A-	F1	ccc	1	Baa2	P-2	D-	BBB+	A-2	90	2 years
<b>Santander Group *</b>										<b>Group Limit 40</b>	
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 2

	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	
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	BBB-	F3	bbb-	3	Ba3	NP	E+	-	-	0	
Virgin Money ***	BBB	F3	bbb	5	-	-	-	BBB+	A-2	0	
<b>Top Building Societies (by asset value)</b>											
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 ***	-	-	-	-	B2	NP	E+	-	-	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	
<b>Foreign Banks have a combined total limit of £40m</b>											
<b>Australia</b>	AAA	-	-	-	Aaa	-	-	AAA		40	364 Days
National Australia Bank	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	20	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+	20	364 Days
Westpac Banking Corporation	AA-	F1+	aa-	1	Aa2	P-1	B-	AA-	A-1+	20	364 Days

## Appendix 2

	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	
<b>Canada</b>	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		40	Liquid
Insight Liquidity Fund	AAA				AAA			AAA		40	Liquid
Ignis Sterling Liquidity	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.

