Sunderland City Council

Item No. 8

AUDIT AND GOVERNANCE COMMITTEE **26 July 2019**

TREASURY MANAGEMENT – REVIEW OF PERFORMANCE 2018/2019

Report of the Executive Director of Corporate Services

1 Purpose of the Report

1.1 To report on the Treasury Management borrowing and investment performance for 2018/2019.

2 Description of Decision (Recommendation)

2.1 The Committee is requested to note the Treasury Management performance for 2018/2019.

3 Introduction

3.1 This report sets out the annual borrowing and investment performance for the financial year 2018/2019 in accordance with the requirements of the Treasury Management Policy Statement and Treasury Management Strategy approved by Council on 7th March 2018. 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 TM Policy Statement and Strategy complies with best practice, including the Ministry of Housing, Communities and Local Government's 'Statutory Guidance on Local Government Investments' updated in February 2018 and also incorporates the recommendations included in the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management, updated in December 2017.

4 Review of Performance 2018/2019

4.1 Summary

The performance of the Council's Treasury Management function continues to maximise financial savings. The average interest rate of the Council's borrowing at 3.04% is low and the Council's treasury management advisor reports this compares favourably with their other local authority clients as does the 0.93% rate of return achieved on investments.

Borrowing Strategy and Performance – 2018/2019

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 3.50% 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 2018 and was updated where necessary to reflect changing circumstances. The Borrowing Strategy for 2018/2019 was based upon internal expertise, supplemented with market data, market information and leading economic forecasts provided by the Council's treasury management adviser, Link Asset Services.

The view when the Treasury Management Policy and Strategy was drafted, was there would be further increases to the current Bank of England (BoE) 0.50% Base Rate of 0.25% by the end of 2018, 2019 and late summer 2020. Public Works Loan Board (PWLB) borrowing rates were expected to rise, albeit gently, during 2018/2019 across all periods but could be subject to exceptional levels of volatility due to uncertainty over the outcome of Brexit negotiations and geopolitical developments throughout the world.

The BoE announced the 0.25% increase in the base rate to 0.75% at its Monetary Policy Committee meeting on 1st August 2018 based on economic data at the time which indicated that ongoing tightening of monetary policy over the forecast period would be appropriate to return inflation sustainably to the 2% target. Subsequent BoE meetings left the base rate unchanged ahead of the original Brexit deadline of 29th March 2019 which has now been delayed until 31st October 2019. This continued uncertainty over the nature of the EU withdrawal and whether any proposal would be agreed by Parliament has raised the possibility of Britain leaving the EU without a deal. This has been reflected in the markets with 50-year PWLB rates beginning the year at 2.27%, climbing to 2.79% in October 2018 before falling back to end the year slightly lower at 2.23%.

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 2019.

4.4 The table below shows the average PWLB borrowing rates in 2018/2019.

2018/2019	**Qtr 1 (Apr - June) %**	**Qtr 2 (July – Sept) %**	**Qtr 3 (Oct – Dec) %**	**Qtr 4 (Jan – Mar) %**
7 days notice	0.36	0.51	0.58	0.57
1 year	1.44*	1.48*	1.54*	1.55*
5 year	1.86*	1.83*	1.82*	1.68*
10 year	2.29*	2.22*	2.23*	2.03*
25 year	2.66*	2.62*	2.76*	2.56*
50 year	2.40*	2.42*	2.62*	2.41*

* Rates take account of the 0.2% discount to PWLB rates available to eligible authorities from 1st November 2012.

The strategy for 2018/2019 was 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 3.50% for long-term borrowing was set for 2018/2019 in light of the views prevalent at the time the Treasury Management policy was set in March 2018.

There have been high levels of volatility in the financial markets during 2018/2019. PWLB interest rates were on a rising trend until early December when 50-year rates reduced by 0.36% and rates reduced again in late March. In line with discussions with the Council's economic advisors, the Council took advantage of the low borrowing rate troughs that have occurred and which will benefit the revenue budget over the longer term. The Council has taken out £60 million of new borrowing during the financial year as these rates were considered opportune. The new borrowing is summarised in the following table:

Duration	**Date of the transaction**	**Start**	**Matures**	**Rate %**	**Loan Amount £m**
49½ years	12/12/2018	14/12/2018	14/06/2068	2.44	20.0
50 years	29/01/2019	31/01/2019	31/01/2069	2.42	20.0
50 years	22/03/2019	26/03/2019	26/03/2069	2.20	20.0

PWLB rates continue to be volatile, the overall longer term expectation is for gilt yields and PWLB rates to rise and the Treasury Management team continues to closely monitor rates to assess the value of possible further new borrowing in line with future Capital Programme requirements.

4.5 The Treasury Management Strategy for 2018/2019 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 2018/2019 but the Treasury Management Team continue to monitor market conditions and secure early redemption if appropriate opportunities arise.

4.6 The Council's borrowing portfolio position at 31st March 2019 is set out below.

		Principal (£m)	**Total (£m)**	**Average Rate (%)**
Borrowing				
Fixed Rate Funding	PWLB	298.7		
	Market	39.6		
	Other	9.6	347.9	3.23
Variable Rate Funding	Temporary / Other		27.6	0.65
Total Borrowing			**375.5**	**3.04**
Total Investments*	All managed In-House		**182.9**	**0.93**
Net Position			**(192.6)**	

* The total investments figure includes monies invested on behalf of ANEC which agreed with its member authorities that the Council would invest its surplus funds.

The Council had a net borrowing position of £192.6 million representing the difference between gross debt and total investments. The net borrowing position is expected to widen (increase) further over the next few years as the Council will need to take out additional borrowing to fund its capital programme whilst earmarked revenue reserves will be used to fund agreed programmes.

Prudential Indicators – 2018/2019

4.7 All external borrowing and investments undertaken in 2018/2019 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 set by the Council for 2018/2019 in total at £584.123m which is detailed as follows:

	£m
Borrowing	505.092
Other Long Term Liabilities	79.031
Total	**584.123**

The Operational Boundary for External Debt for 2018/2019 was set at £559.123m as follows:

	£m
Borrowing	480.092
Other Long Term Liabilities	79.031
Total	**459.123**

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 external debt in respect of borrowing in 2018/2019 was £454.847 million (which includes borrowing in respect of other organisations such as Tyne and Wear Fire and Rescue Authority) and is within the borrowing limits set by both of these indicators.

4.8 The table below shows that all other Treasury Management Prudential Indicators have also been complied with during 2018/2019.

	Prudential Indicators	**2018/2019**	
		Limit £'000	**Actual £'000**
P10	**Upper limit for fixed interest rate exposure**		
	Net principal re fixed rate borrowing / investments	350,000	250,087
P11	**Upper limit for variable rate exposure**		
	Net principal re variable rate borrowing / investments	58,000	- 5,101
P12	**Maturity Pattern**	Upper Limit	
	Under 12 months	50%	10.63%
	12 months and within 24 months	60%	2.21%

	Prudential Indicators	2018/2019	
		Limit	**Actual**
	24 months and within 5 years	80%	6.25%
	5 years plus	100%	85.07%
	A lower limit of 0% for all periods		
P13	**Upper limit for total principal sums invested for over 365 days**	75,000	0

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

5 **Investment Strategy and Performance - 2018/2019**

5.1 The Investment Strategy for 2018/2019 was approved by Council on 7th March 2018. 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 2018/2019.

5.2 At 31st March 2019, the Council had outstanding investments of £182.946 million. The following table shows the return made on the Council's total investments for 2018/2019 as compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Council uses to assess its performance.

	2018/2019 Return %	**2018/2019 Benchmark %**
In-house Managed Funds	**0.93**	**0.51**

This return far exceeded the benchmark set for 2018/2019 and represents a good achievement especially when short-term investment rates continue to remain very low.

5.3 All investments placed in 2018/2019 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 2018 and also taking into account subsequent revisions reported to this Committee 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. The rate of return on investments, as reported during the year, has remained at the very low levels seen in previous years although there has been some upward movement since the increase in the base rate to 0.75% announced by the Bank of England at it Monetary Policy Committee meeting on 1st August 2018.

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 shorter term periods.

5.4 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 2018/2019 have been reported to members previously and the latest Lending List and Criteria are included in the Treasury Management First Quarterly Review 2019/2020 report appearing elsewhere on today's agenda for information.

6 Reason for Decision

6.1 To note the performance for 2018/2019.

7 Alternative Options

7.1 No alternatives are submitted for consideration