

AUDIT AND GOVERNANCE COMMITTEE

14 December 2012

TREASURY MANAGEMENT – THIRD QUARTERLY REVIEW 2012/2013

Report of the Executive Director of Commercial and Corporate Services

1. Purpose of Report

- 1.1 To report on the Treasury Management (TM) performance for the third quarter of 2012/2013.

2. Description of Decision

- 2.1 The Committee is requested to note the positive progress in implementing the Treasury Management Strategy and performance for Quarter 3 of 2012/2013.
- 2.2 To note amendments to the Approved Lending List at Appendix C.

3. Introduction

- 3.1 This report sets out the Treasury Management performance to date for the third quarter of the financial year 2012/2013, in accordance with the requirements of the Treasury Management Policy and Strategy agreed by Council.

4. Review of Treasury Management Performance for 2012/13 – Quarter 3

- 4.1 The Council's Treasury Management function continues to look at ways of maximising financial savings and increase investment return to the revenue budget. One option to make savings is through debt re-scheduling, however no rescheduling has been possible in 2012/13 as rates have not been considered sufficiently favourable. It should be noted that the Council's interest rate on borrowing is very low, currently averaging 3.51%, and as such the Council continues to benefit from this low cost of borrowing and from the ongoing savings from past debt rescheduling exercises. Where any new borrowing is undertaken this is reported as soon as possible after the event in accordance with the Council's agreed Treasury Management Policy and Strategy Statement for 2012/13.
- 4.2 Prudential Indicators are regularly reviewed and the Council is within the limits set for all of its TM Prudential Indicators. The statutory limit under section 3(1) of the Local Government Act 2003, which is required to be reported separately, (also known as the Authorised Borrowing Limit for External Debt) was set at £377.324m for 2012/2013 and the Council is well within this limit at £217.581m. More details of all of the TM Prudential Indicators are set out in section A2 of Appendix A for information.
- 4.3 The investment policy is regularly monitored and reviewed to ensure it has flexibility to take full advantage of any changes in market conditions which will benefit the Council.

- 4.4 As at 30th November 2012, the funds managed by the Council's Treasury Management team has achieved a rate of return on its investments of 1.90% compared with the benchmark 7 Day LIBID (London Interbank Bid) rate of 0.42%. Performance is very positive and is significantly above the benchmark rate, whilst still adhering to the prudent policy agreed by the Council.
- 4.5 More detailed Treasury Management information is included in Appendix A for Members' information.
- 4.6 The regular updating of the Council's authorised lending list is required to take into account financial institution mergers and changes in institutions' credit ratings. The Approved Lending List as shown in Appendix C has been updated to reflect this.

5. Recommendation

- 5.1 Members are requested to note the Treasury Management (TM) performance for the third quarter of 2012/2013.

Detailed Treasury Management Performance – Quarter 3 2012/13

A1 Borrowing Strategy and Performance – 2012/13

- A1.1 The Borrowing Strategy for 2012/13 was reported to Cabinet on 15th February 2012 and approved by full Council on 7th March 2012.

The Borrowing Strategy is based upon interest rate forecasts from a wide cross section of City institutions. The view in February 2012, when 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.

Following August's sharp cut in forecast medium-term growth, the Bank of England continues its pessimistic mood about the speed and strength of recovery; now only forecasting growth of around 1% in 2013 and 2% in 2014. However, there is some concern that even these modest figures may be overstated. The radical cut in the Bank Rate to 0.5% in March 2009 has failed to stimulate a consistently strong recovery in economic growth, with options limited by the government's determination to tackle the budget deficit. The Council's economic advisors believe there is little sign of a coordinated strategy for the private sector to finance a major expansion of infrastructure investment to boost UK growth. Furthermore, they project that growth will be held back for the next couple of years due to continued difficulties in the Eurozone, the UK's largest export market.

Economists are united in their forecasts for the Bank Base Rate, with no change to the current 0.5% predicted until after the December 2014 quarter at the earliest. PWLB rates and bond yields remain extremely unpredictable and there are still exceptional levels of volatility which are highly correlated to the sovereign debt crisis and to political developments in the Eurozone. This uncertainty is expected to continue into the medium term.

The following table shows the average PWLB rates for Quarter 1 to 3.

2012/2013	Qtr 1 (Apr - June) %	Qtr 2 (July – Sept) %	Qtr 3 (Oct – Nov) %
7 days notice	0.35	0.34	0.31
1 year	1.26	1.09	1.02*
5 year	1.96	1.66	1.61*
10 year	3.01	2.66	2.54*
25 year	4.18	3.91	3.78*
50 year	4.27	4.11	3.91*

*Qtr 3 rates reflect the position at 30th November 2012 and take account of the 0.20% discount to PWLB rates available to eligible authorities that came into effect on 1st November 2012.

- A1.2 The strategy for 2012/2013 is 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 4.50% for long-term borrowing was set for 2012/2013. Due to high levels of volatility in the financial markets, with borrowing rates still forecast to remain low over the short term, no new borrowing has been undertaken in the current financial year up to 30th November 2012.

- A1.3 The Borrowing Strategy for 2012/2013 made 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 rescheduling in 2012/2013 and the Treasury Management team will continue to monitor market conditions and secure early redemption if appropriate opportunities arise. Any rescheduling undertaken will be reported to Cabinet in line with the current Treasury Management reporting procedures.

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.

- A1.4 The Council's treasury portfolio position at 30th November 2012 is set out below:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	142.9	167.7	3.90
	Market	24.5		
	Other	0.3		
Variable Rate Funding	Market	15.0	44.2	2.01
	Temporary / Other	29.2		
Total Borrowing			211.9	3.51

A2 Treasury Management Prudential Indicators – 2012/2013

- A2.1 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 Council's performance for all of the other TM Prudential Indicators.
- A2.2 The statutory limit under section 3(1) of the Local Government Act 2003 (which is also known as the Authorised Borrowing Limit for External Debt) was set by the Council for 2012/2013 as follows:

	£m
Borrowing	342.396
Other Long-Term Liabilities	<u>34.928</u>
Total	<u>377.324</u>

The Operational Boundary for External Debt was set as shown below:-

	£m
Borrowing	304.083
Other Long Term Liabilities	<u>34.928</u>
Total	<u>339.011</u>

The maximum external debt in respect of borrowing in 2012/13 (to 30th November 2012) 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.

A2.3 The table below shows that all other Treasury Management Prudential Indicators have been complied with:

Prudential Indicators		2012/2013 (to 30/11/12)	
		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%	16.02%
	12 months and within 24 months	60%	2.38%
	24 months and within 5 years	80%	4.81%
	5 years plus	100%	79.02%
	A lower limit of 0% for all periods		
P13	Upper limit for total principal sums invested for over 364 days	75,000	20,000

A3 Investment Strategy – 2012/2013

A3.1 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

A3.2 As at 30th November 2012, the funds managed by the Council's in-house team amounted to £239.078 million and all investments complied with the Annual Investment Strategy. This includes monies invested on behalf of the North Eastern Local Enterprise Partnership for whom Sunderland City Council is the accountable body. The table below shows the return received on these investments compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Council uses to assess its performance.

	2012/2013 Actual to 30/11/12 %	2012/2013 Benchmark to 30/11/12 %
Return on investments	1.90	0.42

- A3.3 Investments placed in 2012/2013 have been made in accordance with the approved investment strategy and comply with the Counterparty Criteria in place, shown in Appendix B, that is used to identify organisations on the Approved Lending List.
- A3.4 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 Council's advantage.
- A3.5 Investment rates available in the market have continued at historically low levels.
- A3.6 Due to the continuing high volatility within the financial markets, particularly in the Eurozone, advice from our Treasury Management advisors (which we are in agreement with) is to continue to restrict investments with all financial institutions for shorter term periods.
- A3.7 Advice also continues that the above guidance 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) or in respect of Money Market Funds which are also AAA rated.
- A3.8 The regular updating of the Council's authorised lending list is required to take into account financial institution mergers and changes in institutions' credit ratings. The Approved Lending List is shown in Appendix C and has been updated with changes to credit ratings since submission of the Quarter 2 performance report.

Counterparty Criteria

The Council 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	<u>Maximum Deposit</u> £m	<u>Maximum Duration</u>
AAA	F1+	A1+	Aaa	P-1	90	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)					90	2 years
Money Market Funds Maximum amount to be invested in Money Market Funds is £80m with a maximum of £40m in any one fund.					80	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:

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 £350m 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 AAA; and
- that market intelligence and professional advice is taken into account.

Proposed group limits are set out in Appendix C.

Approved Lending List

Appendix C

	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				Aaa			AAA		350	2 years
Lloyds Banking Group (see Note 1)										Group Limit 90	
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
Royal Bank of Scotland Group (See Note 1)										Group Limit 90	
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
Santander Group *										Group Limit 40	
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+	aa-	1	Aa3	P-1	C	AA-	A-1+	40	364 days

Appendix C

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Appendix C

	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	Aa3	P-1	C+	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										80	Liquid
Prime Rate Stirling Liquidity	AAA							AAA		40	Liquid
Insight Liquidity Fund					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 AAA 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.

