

GOVERNANCE COMMITTEE MEETING: 30 JULY 2018

TREASURY MANAGEMENT – ANNUAL REVIEW OF PERFORMANCE 2017/2018

REPORT OF THE STRATEGIC FINANCE MANAGER

1. Purpose of the Report

- 1.1 To report on the Treasury Management performance of the Authority for 2017/2018 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. Introduction

- 2.1 Sunderland City Council, as lead authority, performs the treasury management function on behalf of the Authority.
- 2.2 This report sets out the annual borrowing and investment performance for the financial year 2017/2018 in accordance with the requirements of the Treasury Management Policy Statement and Treasury Management Strategy approved by the Authority on 20th March 2017. 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 gave priority to the security and liquidity of those investments).
- 2.3 The TM 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 latest version of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management as revised in November 2011.

3. Review of Performance 2017/2018 - Summary

3.1 Cost of Borrowing

The performance of the Authority's Treasury Management function continues to contribute financial savings that are used to provide funding to support future years' capital programmes and help to support the Authority's revenue budget. The average rate of the lead authority's borrowing at 2.87% compares very favourably when benchmarked against other authorities and has helped to keep the revenue cost of the Authority's borrowing low in comparison to other Authorities. Section 4 of the report sets out more details of the Authority's Borrowing Strategy, for members' information.

3.2 Rate of Return on Investments

The Authority has benefited from the fact that its budgeted investment income has been maintained throughout the year at a rate of return of 0.41% in 2017/2018. The increase in the Bank of England Base Rate from 0.25% to 0.50% in November 2017 had little impact on investment rates available and the timing of the increase is further reflected in the benchmark rate for 2017/18 rising only slightly from 0.20% to 0.21% as a result. The investment policy continues to reflect the priority to 'protect' the funds of the Authority first and foremost. More details are set out in Section 6 of this report in respect of the Authority's Investment Strategy and Policy.

3.3 Treasury Management Prudential Indicators

The Authority has not exceeded any of its Treasury Management Prudential Indicators during 2017/2018. 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 £48.859m for 2017/2018 and the highest level reached by the Authority of £33.806m during the year was well below this limit. More details of all of the Prudential Indicators are set out in Section 5.

4. Borrowing Strategy and Performance – 2017/2018

4.1 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 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.

4.2 The Borrowing Strategy has been regularly reviewed by this Committee throughout the year and was updated where necessary to reflect changing circumstances. The Borrowing Strategy for 2017/2018 was based upon the views of the Lead Authority's Finance Officer, supplemented with market data, market information and leading economic forecasts provided by the Authority's treasury management adviser, Link Asset Services.

- 4.3 The view in February 2017, when the Treasury Management Policy and Strategy was drafted, was that the Bank of England (BoE) Base Rate would remain at 0.25% until the second quarter of 2019, after Brexit negotiations had concluded, and then rise to 0.75% by December 2019. PWLB borrowing rates were expected to remain flat or with only minor increases during 2017/2018 across all periods. The BoE announced the 0.25% increase in the base rate to 0.50% at its Monetary Policy Committee meeting on 2nd November 2017, the first rate rise since July 2007, and have indicated an expectation of a further two/three rises over the next two years. PWLB rates reflected continued volatility with 50 year PWLB rates beginning the year at 2.37%, climbing to 2.64% in February 2018 before falling back to end the year slightly lower at 2.29%.

Sunderland City 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 2018, which the Authority benefits from.

- 4.4 The table below shows the average borrowing rates in 2017/2018.

2017/2018	Qtr 1 (Apr - June) %	Qtr 2 (July – Sept) %	Qtr 3 (Oct – Dec) %	Qtr 4 (Jan – Mar) %
7 days notice	0.11	0.11	0.28	0.36
1 year	0.87*	1.01*	1.18*	1.36*
5 year	1.23*	1.37*	1.58*	1.83*
10 year	1.89*	2.01*	2.13*	2.30*
25 year	2.60*	2.69*	2.73*	2.73*
50 year	2.34*	2.44*	2.44*	2.43*

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

The strategy for 2017/2018 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 Authority. A benchmark financing rate of 3.50% for long-term borrowing was set for 2017/2018 in light of the views prevalent at the time the Treasury Management policy was set in March 2017.

There was considerable volatility in the financial markets throughout 2017/2018 reflecting concern that despite the agreed Brexit transition deal, little progress appears to have been made to address the significant hurdles that remain around trade and customs borders. Worsening relations with Russia and the possibility of a trade war as the USA implements protectionist policies have added to the uncertainty and impacted on UK equities. The overall longer term expectation is that gilt yields and PWLB rates will rise slowly with a move back from bonds to equities after a historic long term trend of falling bonds yields.

In line with discussions with the Authority's Treasury Management adviser, Sunderland City Council took advantage of low borrowing rate troughs that have occurred and has taken out £50 million of new borrowing during the financial year. These rates were considered opportune and will benefit the Authority's revenue budget over the longer term. The new borrowing is summarised in the following table.

Duration	Date of the transaction	Start	Matures	Rate %	Loan Amount £m
48½ years	03/11/2017	07/11/2017	07/05/2066	2.41	10.0
50 years	16/03/2018	20/03/2018	20/03/2068	2.35	20.0
50 years	20/03/2018	22/03/2018	22/03/2068	2.32	20.0

- 4.5 The Treasury Management Strategy for 2017/2018 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 for long-term debt it would be difficult to refinance long-term loans at interest rates lower than those already in place.

- 4.6 The lead authority's borrowing portfolio position (of which the Authority forms part) at 31st March 2018 is set out below:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	243.8		
	Market	39.5		
	Other	6.1	289.4	3.10
Variable Rate Funding	Temporary / Other		27.6	0.41
Total Borrowing			317.0	2.87
Total Investments	All Council managed		153.6	
Net Position			(163.4)	

5. Prudential Indicators – 2017/2018

- 5.1 All external borrowing and investments undertaken in 2017/2018 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 set by the Authority for 2017/2018 in total as £48.859m which is detailed as follows:

	£m
Borrowing	28.774
Other Long Term Liabilities	<u>20.085</u>
Total	<u>48.859</u>

The Operational Boundary for External Debt for 2017/2018 was set at £43.858m as follows:

	£m
Borrowing	23.773
Other Long Term Liabilities	<u>20.085</u>
Total	<u>43.858</u>

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 2017/2018 was £33.806 million and is well within the borrowing limits set by both of these indicators.

- 5.2 The table below shows that all other Treasury Management Prudential Indicators for the lead authority have been complied with during 2017/2018.

Prudential Indicators		2017/2018	
		Limit £'000	Actual £'000
P10	Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	340,000	253,564
P11	Upper limit for variable rate exposure Net principal re variable rate borrowing / investments	58,000	5,526
P12	Maturity Pattern Under 12 months	Upper Limit 50%	11.97%
	12 months and within 24 months	60%	2.26%
	24 months and within 5 years	80%	6.43%
	5 years plus	100%	83.66%
	A lower limit of 0% for all periods		
P13	Upper limit for total principal sums invested for over 364 days	75,000	0

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

6. Investment Strategy and Performance – 2017/2018

6.1 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 2017/2018.

6.2 At 31st March 2018 the Authority had outstanding investments of £27.514 million. The table below shows the return made on the Authority's total investments for 2017/2018 compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Authority uses to assess its performance.

	2017/2018 Return %	2017/2018 Benchmark %
In-house Managed Funds	0.41	0.21

- 6.3 All investments placed in 2017/2018 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 20th March 2017 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. The rate of return on investments, as reported during the year, has remained at very low levels compared to previous years

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 to shorter term periods.

- 6.4 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 Lead Authority's 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 via the Strategic Finance Officer to Authority and the Governance Committee retrospectively, in accordance with normal Treasury Management reporting procedures. All changes made during 2017/2018 have already been reported to Members previously.

7. Recommendation

- 7.1 The Committee is requested to note and comment upon the Treasury Management performance of the Authority for 2017/2018.

