

AUDIT AND GOVERNANCE COMMITTEE

26 June 2015

TREASURY MANAGEMENT – REVIEW OF PERFORMANCE 2014/2015

Report of the Director of Finance

1 Purpose of the Report

- 1.1 To report on the Treasury Management borrowing and investment performance for 2014/2015.

2 Description of Decision

- 2.1 The Committee is requested to note the positive Treasury Management performance for 2014/2015.

3 Introduction

- 3.1 This report sets out the annual borrowing and investment performance for the financial year 2014/2015 in accordance with the requirements of the Treasury Management Policy Statement and Treasury Management Strategy approved by Council on 5th March 2014. 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 Department of Communities and Local Government Investment Guidance which came into effect from 1st April 2010 and 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 (last updated November 2011).

4 Review of Performance 2014/2015

4.1 Summary

The performance of the Council's Treasury Management function continues to contribute significant financial savings that are used to provide funding to support the Council's revenue budget. The average interest rate of the Council's borrowing at 3.11% is low and is in the top quartile of performers when benchmarked against other authorities as is the rate of return achieved on investments of 0.76%.

Borrowing Strategy and Performance – 2014/2015

- 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 5.00% 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 2014 and was updated where necessary to reflect changing circumstances. The Borrowing Strategy for 2014/2015 was based upon the views of the Director of Finance, supplemented with market data, market information and leading economic forecasts provided by the Council's treasury management adviser, Capita Asset Services.

The view in February 2014, at the time the Treasury Management Policy and Strategy was drafted, was that the Bank Base Rate would remain at 0.50% until March 2016 before steadily rising to 1.25% by March 2017 and that PWLB borrowing rates would increase during 2014/2015 across all periods. Financial analysts continue to speculate over the precise timing of any change in rates with most not expecting any movement until the second quarter of 2016.

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 2015.

- 4.4 The table below shows the average PWLB borrowing rates in 2014/2015.

2014/2015	Qtr 1 (Apr - June) %	Qtr 2 (July – Sept) %	Qtr 3 (Oct – Dec) %	Qtr 4 (Jan – Mar) %
7 days notice	0.35	0.35	0.35	0.41
1 year	1.29*	1.40*	1.24*	1.14*
5 year	2.66*	2.66*	2.23*	1.92*
10 year	3.56*	3.39*	2.91*	2.49*
25 year	4.22*	3.98*	3.60*	3.16*
50 year	4.18*	3.96*	3.60*	3.14*

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

The strategy for 2014/2015 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 5.00% for long-term borrowing was set for

2014/2015 in light of the views prevalent at the time the Treasury Management policy was set in March 2014.

The Greek Debt crisis and expectations of low inflation and economic growth have forced the Eurozone via the European Central Bank (ECB) into implementing a significant package of financial support measures to bolster the EU economy. Added to this, is the continuing conflict in the Ukraine and other geopolitical concerns which have weighed heavily on global markets in 2014/15 with the result that there has been considerable movement of funds into UK gilts as investors have sought safer investment options. This has had the effect of pushing down both gilt yields and PWLB rates to historic lows. In line with discussions with the Council's economic advisors, the Council took advantage of the low borrowing rate troughs that have occurred at each stage during the year, which will benefit the council's revenue budget over the longer term. As a result the Council took out £50 million of new borrowing during the financial year as these rates were considered opportune at each point in time. The new borrowing is summarised in the following table.

Duration	Date of the transaction	Start	Matures	Rate %	Loan Amount £m
50 years	08/08/2014	12/08/2014	12/08/2064	3.84	10.0
50 years	29/08/2014	02/09/2014	02/09/2064	3.72	10.0
50 years	16/10/2014	20/10/2014	20/10/2064	3.54	10.0
49.5 years	03/02/2015	05/02/2015	05/08/2064	2.84	10.0
14.5 years	12/02/2015	16/02/2015	16/08/2029	2.84	10.0

Since taking out this new borrowing, rates have fluctuated with a comparable 50 year rate of 3.08% at 31st March 2015 and have continued to fluctuate upwards since, (standing at 3.25% at the end of May 2015).

- 4.5 The Treasury Management Strategy for 2014/2015 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 2014/2015 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 2015 is set out below.

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	177.9		
	Market	39.5		
	Other	1.5	218.9	3.45
Variable Rate Funding	Temporary / Other		27.6	0.41
Total Borrowing			246.5	3.11
Total Investments*	All managed In-House		229.7	0.76
Net Position			(16.8)	

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

The Council had a funding gap of £16.8 million representing the difference between gross debt and total investments. This position is expected to continue over the next few years as the Council has to manage its finances with significantly less government funding. This could impact further in the form of increased borrowing and reductions to reserves, with the result that the net borrowing position of the Council is expected to widen (increase) in future years.

Prudential Indicators – 2014/2015

- 4.7 All external borrowing and investments undertaken in 2014/2015 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 originally set by the Council for 2014/2015 in total at £440.123m which was detailed as follows:

	£m
Borrowing	410.945
Other Long Term Liabilities	29.178
Total	<u>440.123</u>

The Operational Boundary for External Debt for 2014/2015 was set at £331.753m as follows:

	£m
Borrowing	302.575
Other Long Term Liabilities	29.178
Total	<u>331.753</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 Council's Balance Sheet in compliance with International Financial Reporting Standards (IFRS).

The Council's maximum level in 2014/2015 was £338.202 million and is well within the borrowing limit set for the Authorised Borrowing Limit for External Debt.

However the Operational Boundary for External Debt was exceeded due to the fact that the accounting treatment in respect of the Council's share in the Joint Waste Disposal arrangement with Gateshead and South Tyneside councils has changed for 2014/15. The result is that this arrangement is now considered to be a PFI contract and as such must be included on the Council's Balance Sheet for 2014/15. This means that the 'Other Long Term Liabilities' value in the Debt measures has increased to recognise this late and significant accounting adjustment. There is no requirement to amend the Operational Boundary for 2014/15 but the previously agreed 2015/16 limits will need to be increased to take into account this latest accounting development.

- 4.8 The table below shows that all other Treasury Management Prudential Indicators have also been complied with during 2014/2015.

Prudential Indicators		2014/2015	
		Limit £'000	Actual £'000
P10	Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	250,000	90,181
P11	Upper limit for variable rate exposure Net principal re variable rate borrowing / investments	60,000	15,655
P12	Maturity Pattern 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%	19.57% 0.66% 5.69% 83.75%
P13	Upper limit for total principal sums invested for over 364 days	75,000	0

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

5 Investment Strategy and Performance - 2014/2015

The Investment Strategy for 2014/2015 was approved by Council on 5th March 2014. 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 2014/2015.

- 5.1 At 31st March 2015, the Council had outstanding investments of £229.7 million. The following table shows the return made on the Council's total investments for 2014/2015 as compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Council uses to assess its performance.

	2014/2015 Return %	2014/2015 Benchmark %
In-house Managed Funds	0.76	0.35

This return far exceeded the benchmark set for 2014/2015 and represents a very good achievement especially when short-term investment rates continue to remain very low.

- 5.2 All investments placed in 2014/2015 have been made in accordance with the approved Investment Strategy and comply with the Criteria and the Approved Lending List set by Council on 5th March 2014 and also taking into account subsequent revisions reported 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 very low levels compared to previous years.

Investment rates available in the market have continued at very 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 all financial institutions to shorter term periods.

- 5.3 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 2014/2015 have been reported to members previously and the latest Lending List and Criteria are included in the Treasury Management First Quarterly Review 2015/2016 report appearing elsewhere on today's agenda, for information.

6 Reason for Decision

6.1 To note the performance for 2014/2015.

7 Alternative Options

7.1 No alternatives are submitted for consideration

