Sunderland City Council

Item No. 8

AUDIT AND GOVERNANCE COMMITTEE **20 July 2018**

TREASURY MANAGEMENT – REVIEW OF PERFORMANCE 2017/2018

Report of the Head of Financial Management

1 Purpose of the Report

1.1 To report on the Treasury Management borrowing and investment performance for 2017/2018.

2 Description of Decision (Recommendation)

2.1 The Committee is requested to note the positive Treasury Management performance for 2017/2018.

3 Introduction

3.1 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 Council on 1st March 2017. 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.

4 Review of Performance 2017/2018

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 2.87% is low and the Council's treasury management advisor reports this compares favourably with their other local authority clients as does the 0.62% rate of return achieved on investments.

Borrowing Strategy and Performance – 2017/2018

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 2017 and was updated where necessary to reflect changing circumstances. The Borrowing Strategy for 2017/2018 was based upon the views of the Executive Director of Corporate Services, supplemented with market data, market information and leading economic forecasts provided by the Council's treasury management adviser, Link Asset Services.

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 market 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%.

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 2018.

4.4 The table below shows the average PWLB 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 Council. 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 uncertainty around the final Brexit deal, worsening relations with Russia and increased protectionist policies from the USA.. 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 bond yields.

In line with discussions with the Council's economic advisors, the Council has taken advantage of low borrowing rate troughs that have occurred and has taken out £50m of new borrowing during the financial year to support the agreed capital programme. These rates were considered opportune and will benefit the 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 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 2017/2018 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 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 managed In-House		**153.6**	**0.62**
Net Position			**(163.4)**	

* 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 funding gap of £163.4 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 is likely to 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 – 2017/2018

4.7 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 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 2017/2018 in total at £577.553m which is detailed as follows:

	£m
Borrowing	493.192
Other Long Term Liabilities	84.361
Total	**577.553**

The Operational Boundary for External Debt for 2017/2018 was set at £498.960m as follows:

	£m
Borrowing	414.599
Other Long Term Liabilities	84.361
Total	**498.960**

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 2017/2018 was £397.575 million (which includes borrowing in respect of other organisations such as Tyne and Wear Fire and Rescue Authority) and is well 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 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**	Upper Limit	
	Under 12 months	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 Council is currently within the limits set for all of its Treasury Management Prudential Indicators.

5 Investment Strategy and Performance - 2017/2018

The Investment Strategy for 2017/2018 was approved by Council on 1st March 2017. 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 2017/2018.

5.1 At 31st March 2018, the Council had outstanding investments of £153.61 million. The following table shows the return made on the Council's total investments for 2017/2018 as compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Council uses to assess its performance.

	2017/2018 Return %	2017/2018 Benchmark %
In-house Managed Funds	**0.62**	**0.21**

This return far exceeded the benchmark set for 2017/2018 and represents a very good achievement especially when short-term investment rates continue to remain very low.

5.2 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 Council on 1st March 2017 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 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 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 2017/2018 have been reported to members previously and the latest Lending List and Criteria are included in the Treasury Management First Quarterly Review 2018/2019 report appearing elsewhere on today's agenda for information.

6 Reason for Decision

6.1 To note the performance for 2017/2018.

7 Alternative Options

7.1 No alternatives are submitted for consideration