

## HAMPSHIRE COUNTY COUNCIL

### Decision Report

<b>Decision Maker:</b>	Cabinet
<b>Date:</b>	24 October 2011
<b>Title:</b>	Treasury Management Monitoring Report 2011/12
<b>Reference:</b>	3255
<b>Report From:</b>	County Treasurer

**Contact name:** Anthony Dodridge

**Tel:** 01962 847407

**Email:** anthony.dodridge@hants.gov.uk

#### 1. Executive Summary

1.1. This report sets out the mid-year review of treasury management activities during 2011/12 to Members for approval.

#### 2. Contextual information

2.1. Hampshire County Council fully complies with the requirements of the revised CIPFA Code of Practice for Treasury Management in the Public Services (2009).

2.2. In the light of the Icelandic bank situation in 2008, CIPFA has amended the Treasury Management Code which introduces a new requirement for a mid-year review. This report therefore ensures this Council is embracing best practice in accordance with CIPFA's recommendations.

2.3. Treasury management in the context of this report is defined as:

“The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.” (CIPFA Code of Practice).

#### 3. Economic background

3.1. Year-on-year UK economic growth is currently only 0.7%, and the official Bank of England Base Rate is widely expected to remain unchanged at 0.5% until at least the end of 2012.

3.2. The UK economy's limited economic expansion comes as consumer spending continues to be affected by a number of factors, including higher inflation, job losses and limited wage rises.

- 3.3. Inflation in July, as measured by the Government's preferred Consumer Price Index, increased to 4.4% from 4.2% in June, which is more than double the Bank of England's 2% target rate.
- 3.4. Meanwhile, the number of people unemployed in the UK rose by 38,000 to 2.489 million in the three months to June.

#### 4. Investments

- 4.1. The Council has an investment portfolio consisting of reserves and short-term cash flows.
- 4.2. The Council is currently investing according to a low risk, high quality lending list as outlined in its Annual Investment Strategy. In compliance with this Strategy, lending is restricted to UK clearing banks, the larger UK building societies, AAA-rated money market funds, other local authorities and the Government's Debt Management Office.
- 4.3. The Council's investment holding was £325.8m as at 31 August 2011, which was placed with the following counterparties:

<b>Counterparty</b>	<b>£m</b>
Lloyds TSB	60.0
NatWest	60.0
Nationwide	60.0
Barclays	55.0
HSBC	25.0
Santander UK	13.8
Other UK local authorities	52.0
<b>Total</b>	<b>325.8</b>

- 4.4. The average interest rate earned on these investments as at 31 August 2011 was 1.5%, which should be considered within the context of an unchanged UK Base Rate of 0.5% since March 2009 and very low short-term money market rates.
- 4.5. Following the growing problems facing peripheral Europe, the Council decided to restrict new investments with UK banks and building societies (except for Santander UK up to a maximum of 3 months) to six months since 11 August 2011, although lending to other local authorities can be for periods of up to two years. Whilst maintaining a high level of capital security, this will suppress the Council's investment return which is anticipated to be around 1.2% for 2011/12.

- 4.6. The extent of cash balances will decline between now and the end of the financial year, given the ongoing capital spending being funded from borrowing and the incidence of Government grant income which is skewed towards the earlier part of the financial year.

## **5. Borrowing**

- 5.1. The Treasury Management Outturn Report for 2010/11 gave an overall outstanding Public Works Loan Board (PWLB) borrowing figure of £303m at an average interest rate of 5.2% and outstanding term remaining of 17 years at 31 March 2011.
- 5.2. Since that time, an existing loan for £5m has reached maturity and in accordance with its borrowing strategy for 2011/12 the Council has taken additional loans from the PWLB totalling £20m at an average interest rate of 2.4% and 9-year term. This medium-term funding was taken out on an Equal Instalments of Principal (EIP) basis to minimise borrowing costs.
- 5.3. As a result, the Council currently has a total of £318m PWLB loans at interest rates ranging between 2.2% and 9.9% and an average overall rate of 5.0%, and outstanding term remaining of 16 years.
- 5.4. In addition to the above PWLB loans, the Council currently has a total of £73m lender's option / borrower' option loans (LOBOs) at interest rates ranging between 3.89% and 5.00% and an average overall rate of 4.45%, and outstanding term remaining of 26 years. Given that LOBO loan rates have risen relative to PWLB rates and currently do not offer any competitive advantage due to the lack of availability of credit within the banking system, no new LOBO loan finance has been taken out since March 2008.
- 5.5. Whilst the Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31 March 2011 was £747.6m, a cautious approach has been applied in terms of take-up of new borrowing to minimise debt interest payments without compromising the long-term stability of the portfolio. Internal resources in lieu of external borrowing have been used to a limited extent in order to lower overall treasury risk by reducing both external debt and temporary investments.

## **6. Compliance with treasury management indicators**

- 6.1. During the first five months of 2011/12, the Council operated within the treasury management indicators set out in the Council's Treasury Management Strategy.

### **Authorised limit for external debt**

- 6.2. CIPFA's Code of Practice requires authorities to set an authorised limit for external debt, defined as the sum of external borrowing and other long-term liabilities. The annual strategy report presented to Cabinet on 11 February 2011 set an authorised limit of £860m.
- 6.3. This limit is based on the estimated Capital Financing Requirement (CFR) in order to enable it to be financed entirely from external borrowing should the

Council's internal reserves become depleted. The limit also includes an allowance for temporary borrowing to cover normal revenue cash flow requirements and unexpected outflows or delays in receiving cash.

- 6.4. During the 5-month period to 31 August 2011, the gross borrowing reached a maximum of £504m which is within the authorised limit of £860m.

**Operational boundary for external debt**

- 6.5. The Council also needs to set an operational boundary for external debt. This should reflect the most likely scenario and be consistent with the Council's capital plans and Treasury Management Strategy. Temporary breaches of the 2011/12 operational boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. The Council approved an operational boundary for 2011/12 of £780m.
- 6.6. During the 5-month period to 31 August 2011, the gross borrowing reached a maximum of £504m which is within the operational boundary of £780m.

**Upper limit on fixed interest rate exposure**

- 6.7. The Council has to set an upper limit on its fixed interest rate exposure (which includes a Waste Management contract finance lease and Street Lighting PFI liability), which is expressed in terms of the maximum long-term fixed-rate principal sums which can be outstanding on any day in each year. The Council approved an upper limit on fixed interest rate exposure for 2011/12 of £780m, which is based on the operational boundary and has been set to give the Council maximum policy flexibility. The limit enables the potential for a refinancing from, e.g., variable to fixed rate borrowing.
- 6.8. During the 5-month period to 31 August 2011, the long-term fixed-rate principal sums outstanding reached a maximum of £406m which is within the upper limit on fixed interest rate exposure of £780m.

**Upper limit on variable interest rate exposure**

- 6.9. The Council also has to set an upper limit on its variable interest rate exposure. The Council approved an upper limit on variable interest rate exposure for 2010/11 of £780m, which is based on the operational boundary and has been set to give the Council maximum policy flexibility. The limit enables the potential for a refinancing from, e.g., fixed to variable rate borrowing.
- 6.10. During the 5-month period to 31 August 2011, the variable interest rate exposure reached a maximum of £100m which is within the upper limit of £780m.

**Upper and lower percentage limits on the maturity structure of long-term fixed-rate borrowing outstanding in 2011/12**

- 6.11. The Code also requires the Council to set upper and lower percentage limits on the maturity structure of its long-term fixed-rate borrowing during 2011/12. The following table shows the limits approved by Council. These have been set in order to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio.

	<b>Upper limit (%)</b>	<b>Lower limit (%)</b>	<b>Actual (%)</b>
Under 12 months	50	0	1
12 to 24 months	50	0	2
24 months to 5 years	50	0	9
5 years to 10 years	75	0	20
10 years to 20 years	75	0	27
20 years to 30 years	75	0	37
30 years to 40 years	100	0	4
40 years to 50 years	100	0	0
50 years and above	100	0	0

#### **Upper limits on investments with maturities longer than one year**

6.12. For 2011/12, the Council sets an upper limit of £60m on investments for periods longer than one year. The Council adhered to this prudential limit throughout the 5-month period to 31 August 2011, and at this date had investments with maturities longer than one year of £27m.

#### **7. Recommendation**

7.1. That the mid-year review of treasury management activities be approved for submission to the County Council.

**CORPORATE OR LEGAL INFORMATION:****Links to the Corporate Strategy**

<b>Hampshire safer and more secure for all:</b>	yes/no
Corporate Improvement plan link number (if appropriate):	
<b>Maximising well-being:</b>	yes/no
Corporate Improvement plan link number (if appropriate):	
<b>Enhancing our quality of place:</b>	yes/no
Corporate Improvement plan link number (if appropriate):	
<b>OR</b>	
<b>This proposal does not link to the Corporate Strategy but, nevertheless, requires a decision for Cabinet to note the mid-year review of treasury management activities for submission to the County Council.</b>	

**Section 100 D - Local Government Act 1972 - background documents**

**The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)**

DocumentLocation

None

## **IMPACT ASSESSMENTS:**

### **1. Equalities Impact Assessment:**

- 1.1. Equality objectives are not considered to be adversely affected by the proposals in this report.

### **2. Impact on Crime and Disorder:**

- 2.1. The proposals in this report are not considered to have any direct impact on the prevention of crime.

### **3. Climate Change:**

- a) How does what is being proposed impact on our carbon footprint / energy consumption?

No specific impact.

- b) How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

No specific impact.