

1 Purpose

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

2 Contextual information

- 2.1 The Hampshire Fire & Rescue Authority 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 Authority 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 August, as measured by the Government's preferred Consumer Price Index, increased to 4.5% from 4.4% in July, 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 80,000 to 2.51 million in the three months to July. That is the largest increase in nearly two years.

4 Investments

- 4.1 The Authority has an investment portfolio consisting of reserves and short-term cash flows.

- 4.2 The Authority 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 Authority's investment holding was £10.3m as at 30 September 2011, which was placed with the following counterparties:

Counterparty	£m
NatWest	1.0
Lloyds TSB	1.0
Nationwide	1.0
Santander UK	1.0
Doncaster Metropolitan Borough Council	0.5
Hampshire County Council	5.8
Total	10.3

- 4.4 The average interest rate earned on fixed-interest term deposit investments with the above counterparties (excluding Hampshire County Council) as at 30 September 2011 was 1.3%, 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 Any residual balance is invested with the County Council, earning interest based on the Bank of England's base rate of 0.5%. This is available on an instant-access basis to meet the Authority's short-term cashflow requirements, which can be subject to considerable fluctuation.
- 4.6 Following the growing problems facing peripheral Europe, the Authority 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 Authority's overall investment return which is anticipated to be around 1.0% for 2011/12.
- 4.7 The extent of cash balances is expected to diminish between now and the end of the financial year, due to an annual pensions grant of over £5m received in July 2011 which is being drawn down on a monthly basis.

5 Borrowing

- 5.1 The Treasury Management Outturn Report for 2010/11 gave an overall outstanding Public Works Loan Board (PWLB) borrowing figure of £8.35m at an average interest rate of 4.71% and outstanding term remaining of 19 years at 31 March 2011.
- 5.2 Since that time, the Authority has not taken any additional loans from the PWLB as the current difference between long term borrowing costs and short term investment returns is high. The difference associated with medium- and long-term borrowing compared to temporary investment returns means that new fixed rate borrowing would entail additional short-term costs. New borrowing would also increase the Authority's cash balance which, in turn, would increase the level of counterparty risk exposure.
- 5.3 Whilst the Authority's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31 March 2011 was £16.9m, 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 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 six months of 2011/12, the Authority operated within the treasury management indicators set out in the Authority'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 the Finance & General Purposes Committee on 14 January 2011 and the Hampshire Fire & Rescue Authority on 9 February 2011 set an authorised limit of £27.9m.
- 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 Authority'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 6-month period to 30 September 2011, the gross borrowing reached a maximum of £8.35m which is within the authorised limit of £60.0m.

Operational boundary for external debt

- 6.5 The Authority also needs to set an operational boundary for external debt. This should reflect the most likely scenario and be consistent with the Authority'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 Authority approved an operational boundary for 2011/12 of £22.7m.
- 6.6 During the 6-month period to 30 September 2011, the gross borrowing reached a maximum of £8.35m which is within the operational boundary of £22.7m.

Upper limit on fixed interest rate borrowing

- 6.7 The Authority has to set an upper limit on its fixed interest rate exposure, 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 Authority approved an upper limit on fixed interest rate exposure for 2011/12 of £22.7m, which is based on the operational boundary and has been set to give the Authority maximum policy flexibility. The limit enables the potential for a refinancing from, e.g., variable to fixed rate borrowing.
- 6.8 During the 6-month period to 30 September 2011, the long-term fixed-rate principal sums outstanding reached a maximum of £8.35m which is within the upper limit on fixed interest rate exposure of £22.7m.

Upper limit on variable interest rate borrowing

- 6.9 The Authority also has to set an upper limit on its variable interest rate exposure. The Authority approved an upper limit on variable interest rate exposure for 2011/12 of £22.7m, which is based on the operational boundary and has been set to give the Authority maximum policy flexibility. The limit enables the potential for a refinancing from, e.g., fixed to variable rate borrowing.
- 6.10 During the 6-month period to 30 September 2011, there was no variable interest rate exposure which is within the upper limit of £22.7m.

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 Authority 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 the Authority. These have been set in order to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio.

	Upper limit (%)	Lower limit (%)	Actual (%)
Under 12 months	50	0	0
12 to 24 months	50	0	0
24 months to 5 years	50	0	0
5 years to 10 years	75	0	15
10 years and within 20 years	75	0	30
20 years and within 30 years	75	0	55
30 years and above	100	0	0

Upper limits on investments with maturities longer than one year

- 6.12 For 2011/12, the Authority set an upper limit of £2m on investments for periods over 364 days up to a maximum of two years, although the maximum investment being placed with one institution is restricted to £1m.
- 6.13 During the 6-month period to 30 September 2011 the Authority adhered to this prudential limit, and at this date had investments with maturities longer than one year of £0.5m.

7 Recommendation

- 7.1 That the mid-year review of treasury management activities be noted.