

Treasury Management – mid-year review

1 Purpose

- 1.1 This report sets out the mid-year review of treasury management activities during 2012/13 for noting.

2 Contextual information

- 2.1 Hampshire Fire & Rescue Authority (HFRA) fully complies with the requirements of the revised Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in the Public Services (2009).

- 2.2 In 2008 following the Icelandic banking crisis CIPFA amended the Treasury Management Code introducing a requirement for a mid-year review. This report continues to ensure that HFRA is following 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 The overall economic outlook for the UK is flat as indicated by the following headlines. This shows that the climate of uncertainty is continuing, with investment yields continuing to be very low and the Authority needing to maintain a very cautious approach to manage the security of its investments.

- Year-on-year UK economic growth was -0.4% at the end of Quarter 2 of 2012, which includes reductions in growth in the last three quarters of the year.
- The official Bank of England Base Rate currently 0.5% is not expected to rise for the foreseeable future and some analysts are forecasting a further cut.
- Inflation in August 2012, as measured by the Government's preferred Consumer Price Index, fell by 0.1% from the previous month to 2.5%. Inflation remains above the Bank of England's 2% target rate, as it has done since the end of 2009.
- The number of people unemployed in the UK fell by 13,000 to 2.564 million in June, continuing a gradual downward trend that began in December 2011.

4 Investments

4.1 HFRA has an investment portfolio consisting of reserves and cash held on a temporary basis.

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, other local authorities and the Government's Debt Management Office

4.3 The Authority's investment holding was £23.1m as at 30 September 2012, which was placed with the following counterparties:

Counterparty	£m	£m
NatWest	2.00	
Lloyds TSB	2.00	
Nationwide	2.00	
Barclays	2.00	
HSBC	2.00	
Banks/Building Societies sub-total		10.00
Doncaster Metropolitan Borough Council	0.50	
Fife Council	0.25	
Lancashire County Council	0.50	
Middlesborough Council	0.50	
Newcastle-upon-Tyne City Council	0.25	
Local Authorities sub-total		2.00
Hampshire County Council		11.10
Total		23.10

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 2012 was 0.9%, 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 Cash balances are expected to increase further between now and the end of the financial year due to the Authority's planned underspending and additional contributions being made to reserves.

- 4.7 Following the ongoing financial problems in the Eurozone that have affected the UK banking sector the duration of new investments with UK banks and building societies has been kept under review. At times based on current information, temporary limits below the maximum 364 days allowed for investments in the Treasury Management Strategy, have been set and new investments with some counterparties suspended. These policies are in place to maintain a high level of capital security but this will suppress HFRA's investment return which is anticipated to remain below 1% for 2012/13.
- 4.8 HFRA's Treasury Management Strategy for 2012/13 set a maximum investment limit of £2m per counterparty for UK banks and building societies. The effect of suspending investing with some counterparties combined with the current high cash balances has resulted in the Authority being at the maximum of its investment limits for the remaining banks and building societies and having a large proportion of its cash invested with Hampshire County Council.
- 4.9 In order to maintain HFRA's capacity to invest its cash balances whilst reviewing the security of investments with all counterparties, the Treasurer has increased the maximum investment limit per counterparty for UK banks and building societies from £2m to £4m, under the scheme of delegation for Treasury Management. The Treasurer will continue to monitor the security offered by the various counterparties and ensure that investments are spread between a suitable number of counterparties to minimise the risks to the security of capital.

5 Borrowing

- 5.1 As at 30 September 2012 HFRA had £8.35m of outstanding Public Works Loan Board (PWLB) borrowing at an average interest rate of 4.71% and an average outstanding term remaining of 17 years.
- 5.2 Although the average interest rate payable is above rates currently being offered for a similar timescale, when viewed against historic interest rates the debt portfolio represents good mitigation against the long-term risk of exposure to interest rate fluctuations, which could increase the cost of borrowing. However, consideration continues to be given to any advantageous opportunity for the Authority to reduce or restructure its debt portfolio.
- 5.3 No new borrowing has been taken out since May 2010 and there are no plans to take out any new borrowing in the remainder of the current financial year.

6 Compliance with treasury management indicators

- 6.1 During the first six months of 2012/13, the Authority operated within the treasury management indicators set out in the 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 and General Purposes Committee on 13 January 2012 and Hampshire Fire and Rescue Authority on 9 February set an authorised limit of £21m.
- 6.3 During the 6-month period to 30 September 2012, gross borrowing reached a maximum of £9.26m which is within the authorised limit of £21m. This amount is made up of loans from the Public Works Loan Board (PWLB) and finance leases.

Operational boundary for external debt

- 6.4 HFRA 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 2012/13 operational boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. HFRA approved an operational boundary for 2012/13 of £18.4m.
- 6.5 The maximum gross borrowing of £9.26m in the six month period to the end of September 2012 is within the operational boundary of £18.4m.

Upper limit on fixed and variable interest rate exposure

- 6.6 HFRA has to set an upper limit on its fixed and variable interest rate exposure, which is expressed in terms of the maximum long-term principal sums which can be outstanding on any day in each year. The Authority approved the same upper limit for fixed and variable interest rate exposure for 2012/13 of £18.4m each. This is based on the operational boundary and has been set to give the Authority maximum policy flexibility, with the potential to refinance and switch from fixed to variable interest rate exposure or vice versa.
- 6.7 All of the Authority's debt is held at fixed interest rates. During the 6-month period to 30 September 2012, the principal sums outstanding reached a maximum of £9.26m, which is within the upper limit for fixed interest rate exposure of £18.4m. None of the Authority's debt is held at variable interest rates.

Upper and lower percentage limits on the maturity structure of long-term fixed-rate borrowing outstanding in 2012/13

- 6.8 The Code also requires HFRA to set upper and lower percentage limits on the maturity structure of its long-term fixed-rate borrowing during 2012/13. 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 – as at 30 Sep 2012 (%)
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	20
10 years to 20 years	75	0	25
20 years to 30 years	75	0	55
30 years to 40 years	100	0	0
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

- 6.9 For 2012/13, HFRA set an upper limit of £2m on investments for periods longer than one year. Investments for periods of greater than one year are restricted to investments with other local authorities, not banks or building societies. The Authority adhered to this prudential limit throughout the 6-month period to 30 September 2012, and at this date had investments with maturities longer than one year of £1.5m.

7 Recommendation

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