Appendix D

Treasury Management Mid-Year Report 2014/15

1 Purpose

1.1 This report outlines the treasury management activities during the year to date.

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). This report continues to ensure that HFRA is following best practice in accordance with CIPFA's recommendations to report on treasury management activities.

2.2 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 following paragraphs outline major macro economic themes in the domestic and global economy, which explain the background against which treasury management decisions have been made.

3.2 Growth - The recent strong performance of the UK economy has continued with output growing at a preliminary estimate of 0.8% in Q2 2014, following on from the same figure in Q1. This made the economy 0.2% larger than the pre-crisis peak of Q1 2008.

3.3 Unemployment - The labour market has continued to improve, with strong employment gains and the headline unemployment rate falling to 6.2% at the end of July 2014 (the lowest figure since late 2008). However, real earnings remain negative and employment growth trends have masked under employment, such as the large number of zero-hour contracts and people working part-time involuntarily.

3.4 Inflation: CPI inflation for August fell to 1.5% year-on-year from 1.6%. Expectations remain that inflation is likely to remain close to, but a little below, the Monetary Policy Committee's (MPC) 2% target for the next couple of years. In August the Bank of England's latest Inflation Report was published. CPI inflation projections were revised downwards over the two year horizon and expectations for wage growth, the estimate of spare capacity and equilibrium unemployment also fell.

3.5 UK Monetary Policy: The MPC made no change to the Bank Base Rate of 0.5%. However, there was a marked shift in tone from the Bank of England's Governor and other MPC members. In his Mansion House speech in June 2014 Governor Mark Carney warned that interest rates might rise sooner than financial markets were expecting. Following some mixed messages from Governor Carney later in the summer, the minutes of the August and September MPC meetings revealed a split vote on the Bank Rate, with two of the nine votes to increase the Bank Rate by 0.25%.

3.6 The MPC emphasised that when the Bank Rate did begin to rise, it was expected to do so only gradually and to remain below average historical levels for some time to come. HFRA's treasury management advisors, Arlingclose, estimate the first rise in interest rates will be in the third quarter of 2015, later than many economic commentators.

4 Investments

4.1 HFRA has an investment portfolio consisting of reserves and short-term cash flows. The authority is currently investing according to a low risk, high quality lending list as outlined in its Treasury Management Strategy.

4.2 HFRA's investment holding was £36.6m at 30 September 2014, which was placed with the following counterparties:

Counterparty	£m	£m
Barclays	3.0	
Close Brothers	3.5	
Credit Suisse	1.0	
Deutsche	3.5	
HSBC	3.5	
Lloyds TSB	3.0	
Nationwide	3.0	
Nordea	2.0	
Rabobank	3.0	
Standard Chartered	2.0	
Svenska Handlesbanken	3.5	
Banks and Building Societies sub-total (less than 1 year)		31.0
Ignis	0.2	
Federated	0.1	
Money Market Funds (overnight)		0.3
UK Local authorities (less than 1 year)		0.3
UK Local authorities (from 1 to 3 years)		3.0
CCLA Pooled Property Fund		2.0
Total		36.6

4.3 The level of cash balances has increased significantly from £25.6m at the beginning of the financial year, but is expected to return to nearer that starting amount by the end of the financial year due to the profile of the Authority's income. Most of the Authority's Central Government funding is received at the beginning of the financial year, in particular the Pension Grant of £7m, which is paid in a single instalment each July, and then paid out each month.

4.4 The average interest rate earned on these investments at 30 September 2014 was 0.82%, 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 The Guidance on Local Government Investments in England gives priority to security and liquidity and HFRA's aim is to achieve a yield commensurate with these principles. This has been maintained by following HFRA's counterparty policy as set out in its Treasury Management Strategy for 2014/15.

4.6 Counterparty credit quality is assessed and monitored with reference to a range of factors, including but not limited to, the ratings of the major ratings agencies. During the six months to September 2014 investment counterparties and the duration of new investments have been monitored and amended where necessary based on this assessment.

4.7 Following the Fire Authority transitioning to the H3 Integrated Business Centre (IBC) the Authority no longer has short term balances with Hampshire County Council and instead payments and income go through its NatWest bank account. To ensure that the Authority has sufficient liquid funds, small investment balances are held on an overnight basis with Money Market Funds.

5 Borrowing

5.1 HFRA's underlying need to borrow is measured by the Capital Financing Requirement (CFR), which at 31 March 2014 was £14.0m. Affordability and the "cost of carry" remained important influences on HFRA's borrowing strategy meaning that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.

5.2 For HFRA the use of internal resources in lieu of borrowing has therefore continued to be the most cost effective means of funding capital expenditure. No new long-term borrowing has taken place in the six months to September 2014, or is planned for the remainder of the financial year. This has lowered overall treasury risk by reducing both external debt and temporary investments.

5.3 As at 30 September 2014 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 15 years. These loans were taken out between 1998 and 2010, when HFRA's cash balances were considerably lower than they are today.

5.4 There is no financial benefit to HFRA in using any of its current reserves to repay loans. The premium that is added by the PWLB to any loans that are repaid is still relatively expensive for the loans in HFRA's portfolio in comparison to the returns available from continuing to invest reserves. As a consequence no rescheduling activity has taken place. However, consideration will continue to be given to any advantageous opportunity for HFRA to reduce or restructure its debt portfolio in the future.

6 Compliance with prudential indicators

6.1 During the first six months of 2014/15, HFRA operated within the treasury management indicators set out in the Treasury Management Strategy, with the exception of the indicator for the exposure of investments to variable interest rates, which is explained in section 6.10 below.

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 agreed by the HFRA on 19 February 2014 set an authorised limit for external debt of £19.5m.

6.3 This limit is based on the estimated CFR in order to enable it to be financed entirely from external borrowing should HFRA'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 period to 30 September 2014 borrowing remained well within the authorised limit of £19.5m and no new long term borrowing has been taken out. Total external debt, including amounts owed to Hampshire County Council as part of the previous banking arrangements, was £11.6m.

Operational boundary for external debt

6.5 HFRA has set an operational boundary for external debt. This should reflect the most likely scenario and be consistent with HFRA's capital plans and Treasury Management Strategy. Temporary breaches of the operational boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. HFRA approved an operational boundary for 2014/15 of £16.0m.

6.6 As outlined above HFRA's maximum total external debt of £11.6m in the period to 30 September 2014, was within the operational boundary.

Upper limit on fixed and variable interest rate exposure

6.7 HFRA has to set an upper limit on its fixed interest rate exposure for both total investments and total external debt. HRFA approved an upper limit on fixed and variable interest rate exposure for external debt for 2014/15 of £16.0m, which is based on the operational boundary and has been set to give HFRA maximum policy flexibility. The limit enables the potential for refinancing e.g. from variable to fixed rate borrowing.

6.8 All of HFRA's long-term debt portfolio (PWLB loans) are fixed interest loans, which were £8.35m in the period to 30 September 2014, within the £16.0m limit. The maximum deficit balance of amounts owed to Hampshire County Council as part of the previous banking arrangements, for which a variable interest rate was paid, was also well within the £16.0m limit.

6.9 HFRA also has to set upper limits on its interest rate exposure for fixed and variable rate investments, which are £5.0m and £35.0m respectively. In the period from April to September 2014 HFRA had a maximum of £3m of investments at fixed rates and £41.5m at variable rates, therefore the exposure of investments to variable interest rates has exceeded the indicator that was set.

6.10 The indicator has been exceeded as a result of the overall increase in HFRA's cash balances, not any change in the investment strategy. Given the increase in HFRA's cash balances it is recommended to increase the limit for the exposure for variable rate investments to £45.0m.

Upper and lower percentage limits on the maturity structure of long-term fixed-rate borrowing outstanding in 2014/15

6.11 The Code also requires HFRA to set upper and lower percentage limits on the maturity structure of its long-term fixed rate borrowing during 2014/15. The following table shows the limits approved by HFRA. These have been set in order to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio.

Maturity Structure of Fixed Rate Borrowing	Lower Limit %	Upper Limit %	Actual Fixed Rate Borrowing	
			£m	%
under 12 months	0	50	0	0
12 months and within 24 months	0	50	0	0
24 months and within 5 years	0	50	0	0
5 years and within 10 years	0	75	2.8	33
10 years and within 20 years	0	75	2.9	35
20 years and within 30 years	0	75	2.7	32
30 years and above	0	100	0	0

Upper limits on investments with maturities longer than one year

6.12 Investments for periods in excess of a year are currently limited only to UK Local Authorities, up to a maximum of three years, with an upper limit of £5m and the maximum investment being placed with a single institution restricted to £1m.

6.13 At 30 September 2014 HFRA had £3m of investments over 364 days up to a maximum of three years with other UK local authorities.

7 Recommendation

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

7.2 To increase the prudential indicator limit for the exposure of investments variable interest rates to £45m.