

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Audit Committee
Date:	5 February 2015
Title:	Treasury Management monitoring report 2014-15
Reference:	6281
Report From:	Director of Corporate Resources – Corporate Services

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1 Purpose

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

2 Contextual information

- 2.1 Hampshire County Council 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 the County Council 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 0.7% in Quarter 3 of 2014, following on from figures of 0.7% and 0.9% in the first two quarters of the year. This made the economy 3.4% larger than the pre-crisis peak in the first quarter of 2008.

- 3.3 Unemployment - The labour market has continued to improve, with strong employment gains and the headline unemployment rate falling to 6.0% at the end of August 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 September fell to 1.2% year-on-year from 1.5% in August. 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 does begin to rise, it is expected to do so only gradually and to remain below average historical levels for some time to come. The County Council's treasury management advisors, Arlingclose, estimate the first rise in interest rates will be in the third quarter of 2015, later than some economic commentators.

4 Investments

- 4.1 The County Council 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. In compliance with this Strategy, lending is restricted to approved banks and building societies, highly rated bonds, AAA-rated money market funds and other suitable pooled investment vehicles, other local authorities and the Government's Debt Management Office.
- 4.2 The County Council's investment holding was £576.3m at 31 October 2014, which was placed with the following types of investments:

	£m	£m
Standard investments		
Bank call accounts	38.8	
Bank & building society fixed deposits	230.0	
Bank certificates of deposit	109.0	
Local authority fixed deposits (under 5 years)	158.5	
Sub-total		536.3
Investments targeting higher returns		
Local authority fixed deposits (over 5 years)	20.0	
Transport for London bonds	10.0	
Pooled property fund	10.0	
Sub-total		40.0
Total		576.3

- 4.3 The level of cash balances has increased from £521m at the beginning of the financial year, but is expected to return to nearer the starting amount by the end of the financial year due to the profile of the County Council's income. A large proportion of the County Council's Central Government funding is received at the beginning of the financial year, in particular the Revenue Support Grant, which is paid in April.
- 4.4 The average interest rate earned on these investments at 31 October 2014 was 1.29%, which should be considered within the context of an unchanged UK Base Rate of 0.5% since March 2009 and similarly low short-term money market rates.
- 4.5 The Guidance on Local Government Investments in England gives priority to security and liquidity and the County Council's aim is to achieve a yield commensurate with these principles. This has been maintained by following the County Council'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 seven months to October 2014 investment counterparties and the duration of new investments have been monitored and amended where necessary based on this assessment.
- 4.7 As part of the 2014/15 Strategy it was agreed to set aside £90m for longer term investments targeting higher returns to contribute to the County Council's revenue streams, which was in addition to the £15m of long-term investments already made in relation to the Street Lighting PFI. Some progress has been made investing £25m with other local authorities and a pooled property fund. The fall in Gilt yields in recent months has made it

difficult to find investments that can achieve the target set in the strategy of a 4% return. Further work is continuing with the County Council's advisors, Arlingclose, to identify suitable options and invest the amount that has been targeted.

5 Borrowing

- 5.1 The County Council's underlying need to borrow is measured by the Capital Financing Requirement (CFR) which was £771m at 31 March 2014. Affordability and the "cost of carry" remained important influences on the County Council'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 the County Council 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 seven months to October 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 31 October 2014 the County Council had £356.3m of outstanding long-term loans, from either the Public Works Loan Board (PWLB) or Lender Option Borrower Option (LOBO) loans from banks, at an average interest rate of 4.83% and an average outstanding term remaining of over 16 years. These loans were taken out between 1989 and 2010, when the County Council's cash balances were considerably lower than they are today.
- 5.4 There is no financial benefit to the County Council 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 the County Council'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 the County Council to reduce or restructure its debt portfolio in the future.

6 Compliance with prudential indicators

- 6.1 During the first seven months of 2014/15, the County Council 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 agreed by the County Council on 20 February 2014 set an authorised limit for external debt of £870m.

- 6.3 This limit is based on the estimated CFR in order to enable it to be financed entirely from external borrowing should the County 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 period to 31 October 2014 borrowing remained well within the authorised limit of £870m and no new long term borrowing has been taken out. Total external debt in the financial year to date peaked in June 2014 at £576m, which is below the limit that has been set.

Operational boundary for external debt

- 6.5 The County Council has set an operational boundary for external debt. This should reflect the most likely scenario and be consistent with the County Council'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. The County Council approved an operational boundary for 2014/15 of £810m.
- 6.6 As outlined above the County Council's maximum total external debt of £576m in the period to 31 October 2014, was within the operational boundary.

Upper limit on fixed and variable interest rate exposure

- 6.7 The County Council has to set an upper limit on its fixed interest rate exposure for both total investments and total external debt. The County Council approved an upper limit on fixed and variable interest rate exposure for external debt for 2014/15 of £810m, which is based on the operational boundary and has been set to give the County Council maximum policy flexibility. The limit enables the potential for refinancing e.g. from variable to fixed rate borrowing.
- 6.8 In the period to 31 October 2014 the maximum value of the County Council's borrowing at fixed rates was £454m, which is made up of PWLB loans and the County Council's PFI liabilities. The maximum exposure to variable rate debt was £122m in the same period, which was made up mostly of LOBO loans. Both of these amounts are within the limit for fixed and variable interest rate exposure.
- 6.9 The County Council also has to set upper limits on its interest rate exposure for fixed and variable rate investments, which are £250m and £750m respectively. In the period from April to October 2014 The County Council had a maximum of £178m of investments at fixed rates (investments fixed for more than one year) and £570m at variable rates, both within the limits that were set.

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

6.10 The Code also requires the County Council to set upper and lower percentage limits on the maturity structure of its long-term borrowing during 2014/15. The following table shows the limits approved by the County Council. 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 Long Term Borrowing at 31/10/2014		Compliance with Set Limits?
			£m	%	
under 12 months	0	50	3.5	1.0	Yes
12 months and within 24 months	0	50	11.6	3.2	Yes
24 months and within 5 years	0	50	33.1	9.3	Yes
5 years and within 10 years	0	75	45.1	12.7	Yes
10 years and within 20 years	0	75	144.0	40.4	Yes
20 years and within 30 years	0	75	103.0	28.9	Yes
30 years and within 40 years	0	100	10.0	2.8	Yes
40 years and above	0	100	6.0	1.7	Yes

Upper limits on investments with maturities longer than one year

6.11 Investments for periods in excess of a year are limited to £250m. At 31 October 2014 the County Council had £178m of investments over 364 days.

7 Recommendation

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

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

This proposal does not link to the Corporate Strategy but, nevertheless, the Audit Committee are required to note the report in compliance with best practice from CIPFA's Code of Practice for Treasury Management
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Other Significant Links

Links to previous Member decisions:		
<u>Title</u>	<u>Reference</u>	<u>Date</u>
Direct links to specific legislation or Government Directives		
<u>Title</u>	<u>Date</u>	

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.)

<u>Document</u>	<u>Location</u>
None	

IMPACT ASSESSMENTS:

1. Equality Duty

1.1. The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited under the Act;
- Advance equality of opportunity between persons who share a relevant protected characteristic (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, gender and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- a) The need to remove or minimise disadvantages suffered by persons sharing a relevant characteristic connected to that characteristic;
- b) Take steps to meet the needs of persons sharing a relevant protected characteristic different from the needs of persons who do not share it;
- c) Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity which participation by such persons is disproportionately low.

1.2. Equalities Impact Assessment:

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.