

**HAMPSHIRE COUNTY COUNCIL
Decision Report**

Decision Maker:	Cabinet
Date:	22 June 2015
Title:	2014/15 – end of year financial report
Reference:	6638
Report From:	Director of Corporate Resources – Corporate Services

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1. Executive Summary

- 1.1. This report provides a summary of the 2014/15 final accounts. The draft statement of accounts will be submitted for audit on the 30 June 2015 and reported to the Audit Committee in September, in conjunction with the External Audit report on the accounts.
- 1.2. Net service cash-limited expenditure was £6.9m lower than budgeted against an overall gross budget of £1.8bn (0.4%). This position reflects the continuing financial strategy of achieving savings early, which can then be used to meet the cost of change and invest to save or transformational projects in future years.
- 1.3. The position for each of the services is summarised in the table below.

	(Under) / Over Spend £'000
Adult Services	0
Children's Services – Non Schools	2,354
Economy, Transport and Environment	(2,472)
Policy and Resources	(6,822)
Total	<u>(6,940)</u>

- 1.4. The balanced position for Adult Services reflects significant management activity during the year to bring actual spend in line with the budget. Departmental contingencies were used to offset pressures due to increasing complexity and demography.
- 1.5. The over spend in Children Services is mainly due to continuing pressures in the Children Looked After Budget, which was reported in detail throughout the

year. This is due to an increase in the activity levels and higher average costs due to the type of care being provided.

- 1.6. The overall overspend with CLA was £10.7m. Through achieving savings in other budget areas and the use of contingencies, the Department has offset £8.3m of this. It was previously agreed by Cabinet that any balance on the overspend would be met corporately in 2014/15 with a base budget increase being put in place as part of the 2015/16 budget setting process. The overspend position on Children Services of £2.4m will therefore be funded from underspends in corporate budgets detailed below.
- 1.7. The final outturn position for Environment shows an underspend of £2.5m. This is mainly due to the early achievement of savings.
- 1.8. Policy and Resources achieved an under spend of £6.8m mainly due to on going efficiency savings and the early achievement of 2015/16 savings.
- 1.9. Service under spends within ETE and Policy & Resources have been transferred to respective cost of change reserves for use by the respective services to meet restructuring and investment costs associated with the Transformation to 2017 programme, in accordance with the financial management policy.
- 1.10. Savings on non-cash limited budgets total £4.9m mainly as a result of Treasury Management activity and higher business rates income than originally budgeted, although this has been partially offset by the need to provide for an additional doubtful debt provision in 2014/15.
- 1.11. The overall net underspend is £2.5m after allowing for the extra costs incurred within Children's Services. It is proposed to transfer the underspend to the Grant Equalisation Reserve.
- 1.12. The report contains a small section on reserves and balances highlighting that in line with the Medium Term Financial Strategy, the level of reserves has started to decline as our financial plans are delivered over the medium term. It is also recommended that following a review of reserves that £6.150m set aside to mitigate financial risks associated with changes arising from the Local Government Resource Review is transferred into the Grant Equalisation Reserve (GER).
- 1.13. This brings the level of the GER up to £50.9m in line with the financial strategy of supporting the revenue spend position during 2016/17 in order to give the County Council the time and capacity to implement the Transformation to 2017 programme for the 2017/18 financial year.
- 1.14. The report also recommends approval of
 - the annual report on the operation of the treasury management strategy, for subsequent approval by the County Council
 - the council's end of year prudential indicators
 - a revised capital financing plan for 2014/15

2. 2014/15 Final accounts

Service cash limits

- 2.1. The table below summarises the net outturn position for each Department compared to the final cash limit for the year. The figures exclude schools spending but include cost of change paid for during 2014/15 :

	(Under) / Over Spend £'000
Adult Services	0
Children's Services – Non Schools	2,354
Economy, Transport and Environment	(2,472)
Policy and Resources	(6,822)
Total	<u>(6,940)</u>

- 2.2. The ETE and Policy and Resources under spends will be transferred to earmarked reserves to meet the future cost of change in line with the existing policy.
- 2.3. The additional net spending within Children's Services in respect of increasing Children Looked After costs will be met, as agreed, from underspends in corporate budgets, which are set out in more detail below.
- 2.4. Detailed explanations of the reasons for the under spends in Departmental budgets is provided in Appendix 1.

Schools Budget

- 2.5. The Schools Budget is fully funded by Dedicated Schools Grant (DSG) and other ring-fenced grants, which have to be carried forward for school purposes. Unless an overspending arises, spending is therefore automatically in line with the cash-limit, as the cash-limit is adjusted for the carry forward of grants. In total for 2014/15 there was a net under spend of £3.4m against the schools budget and this will be carried forward to 2015/16 as part of an overall total of DSG of £31m. The final allocation of how this money will be used has already been or will be agreed by the Schools Forum later in the year.

Other Budgets

- 2.6. The outturn for other items contained within in the budget is shown in the following table:-

	(Under) / Over Spend £'000
Capital Financing / Interest on Balances	(4,445)
Waste Management	(192)
Contingencies	(825)
Increase in Doubtful Debt Provision	2,110
Other net variations	(1,548)
	<u>(4,900)</u>

- 2.7. The main reasons for the variances in these other budgets is detailed in the paragraphs below.

Capital financing charges and interest on balances (£4.4m under spend)

- 2.8. This under spend reflects a continuing trend in previous years of a very prudent approach to capital financing costs and interest on balances. The final outturn position reflects lower capital financing costs as a result of the use of 'internal borrowing' to fund capital expenditure rather than taking out long term loans at this point. There was also a slight improvement on interest on cash balances but this income budget was significantly increased as part of setting the 2014/15 budget and therefore has not seen the levels of variance reported in previous years. In line with the County Council decision in February, £500,000 has been transferred to a new reserve to mitigate the slight additional risk associated with the revised approved investment strategy.

Waste Management (£192,000 under spend)

- 2.9. Due to the number of variables associated with the provision of the Waste Management contract, separate central provisions are made within the budget each year and released in line with changes in waste volumes or contract terms. Any savings against the waste management contract are treated as corporate savings rather than being counted against Economy, Transport and Environment's cash limit. Whilst waste volumes have stabilised in previous years, requiring less to be drawn from contingencies, 2014/15 saw the first real increase in volumes for several years and the majority of the contingency was therefore required to meet the increased disposal costs. Close scrutiny of waste volumes will be required throughout 2015/16 to understand if this is a continuing trend.

Contingencies (£0.8m under spend)

- 2.10. The level of contingencies was reviewed as part of the February Revised Budget. The remaining contingencies have mainly been used in line with their intended purpose and a small number were not required.

Doubtful Debt Provision (£2.1m over spend)

- 2.11. The County Council's policy is to make a provision against a proportion of debts that could prove to be irrecoverable. The provision is assessed on the basis of the age profile of outstanding debts and partly on the probability of specific larger debts being irrecoverable. There is no annual budgeted amount because the provision varies significantly from year to year and only periodical 'top ups' to the provision tend to be required, the last of which was made in 2011/12. For 2014/15 a detailed review of outstanding debts has indicated that it would be prudent to make an additional provision of £2.1m for the year, which can be accommodated from underspends in other corporate budgets.

Other Variations (£1.5m under spend)

- 2.12. This relates mainly to an increase in the amount of retained business rate income received during the year. There have also been a number of smaller movements, including a net decrease in section 31 grants relating to business rates, a small overspend in the coroners service and an underspend on the past deficit pension contribution, which is now accounted for centrally.

Allocation of net under spend

- 2.13. The net under spend position is broken down in the following table and this report recommends that the £2.546m is transferred to the Grant Equalisation Reserve.

	(Under) / Over Spend £'000
Corporate Budgets	(4,900)
Children Looked After Pressure	2,354
Net underspend to GER	<u>(2,546)</u>

3. General Balances and Earmarked Reserves

- 3.1. General Balances at 31 March 2014 are £20.6m, which is in line with the current policy of carrying a general balance that is approximately 2.5% of the County Council's Budget Requirement.
- 3.2. In addition to the General Balance, the County Council maintains earmarked reserves for specific purposes and to a large extent a significant proportion of these is committed either to existing revenue or capital programmes or to mitigate risks that the County Council faces through self insurance or funding changes by Government.

- 3.3. At the time of writing this report, the actual value of earmarked reserves has not been finalised within the accounts, but in overall terms the total value of earmarked reserves will fall due to the use of them in line with their intended purpose and in line with the Medium Term Financial Strategy, in particular in funding the capital programme and supporting revenue spend whilst savings programmes are put in place. Schools balances, over which the County Council has no direct control, are expected to increase.
- 3.4. Each year, as part of the budget setting process, the Chief Financial Officer reviews the level of reserves and the purpose for which they are held. As part of this review, it was highlighted that the 'risk reserve' in respect of changes arising from the Local Government Resource Review was no longer required since volatility in the system around business rates retention and council tax support schemes (that replaced council tax benefit) have now worked through the system and the impact of these is already reflected in the budget that was set for 2015/16.
- 3.5. It is therefore recommended that the £6.150m within this reserve is transferred to the Grant Equalisation Reserve (GER) as part of the closure of the accounts. This contribution, together with the net impact of the changes in the revenue account during 2014/15 mean that the GER will stand at £50.9m, which is in line with the financial strategy of supporting the revenue spend position during 2016/17 in order to give the County Council the time and capacity to implement the Transformation to 2017 programme for the 2017/18 financial year.

4. Treasury management and prudential indicators

- 4.1. The County Council's treasury management policy requires an annual report to the Cabinet on the exercise of the treasury management function, details of which are set out in Appendix 2. Under the Treasury Management Code of Practice, the end of year report has to be submitted to the County Council.
- 4.2. The Prudential Code for Capital Finance in Local Authorities requires that the County Council reports its actual performance against the Prudential Indicators that were set in its Treasury Management Strategy. Appendix 2 summarises the relevant indicators for the 2014/15 outturn which are in accordance with the figures approved by the County Council.

5. Capital spending and financing 2014/15

- 5.1. £274.7m of capital schemes were committed during the year, leaving £61.2m to be carried forward to 2015/16, subject to Cabinet's approval.
- 5.2. Capital expenditure of £244.6m was incurred, which can all be financed within available resources, this includes £27.1m of spending on the street lighting PFI scheme which will be funded by means of a finance lease funded by Government.

- 5.3. Prudential borrowing of £14.1m will be taken out to support the programme, although there will also be a further repayment of prudential borrowing from capital receipts and other funding sources of £5.1m. Further details of the outturn position for capital are provided in Appendix 3.

6. Assurance statement

- 6.1. The code of Practice on Local Authority Accounting in the UK requires the County Council within its Statement of Accounts to publish an annual governance statement signed by the Leader and Chief Executive. As part of this process, the Chief Internal Auditor provides an independent opinion on the adequacy and effectiveness of the system of internal control operating in the County Council as a whole. The Chief Internal Auditor's Annual Report and Opinion is approved by the Audit Committee.

- 6.2. The Chief Internal Auditor has concluded that:

"In my opinion, Hampshire County Council's framework of governance, risk management and management control is 'Adequate' and audit testing has demonstrated controls to be working in practice.

Where weaknesses have been identified through internal audit review, we have worked with management to agree appropriate corrective actions and a timescale for improvement."

7. Pension Fund

- 7.1. The separate accounts for the Hampshire Pension Fund will also be incorporated in the County Council's Statement of Accounts. The accounts for 2014/15 record that the value of the fund's assets has increased to £5.1bn during the year. The Chief Internal Auditor has provided a separate assurance opinion for the Pension Fund and has concluded that :

"In my opinion, based on internal audit work completed 'Substantial Assurance' can be placed on Hampshire County Council (Pension Services) framework of governance, risk management and management control and audit testing has demonstrated controls to be working in practice.

Where weaknesses have been identified through internal audit review, we have worked with management to agree appropriate corrective actions and a timescale for improvement."

8. Final Accounts

- 8.1. The final accounts must be submitted for audit by 30 June each year. The purpose of this report is to outline the key issues arising from the outturn position for 2014/15, although given the much earlier report publication times for this Cabinet meeting, it is possible that there will be minor changes within the accounts that will have to be reflected in the version that is submitted for audit.

- 8.2. Delegated Authority has therefore been requested for the Director of Corporate Resources to make any necessary amendments to the figures presented in this report for final publication in the annual accounts to be submitted for audit. Any major changes or issues will be reported back to Cabinet either verbally, at the meeting or in due course.

9. Recommendations

- 9.1. That the outturn position set out in Section 2 be approved and that it is recommended to County Council that the overall net under spend be transferred to the Grant Equalisation Reserve.
- 9.2. That the risk reserve in respect of the Local Government Resource Review be transferred to the Grant Equalisation Reserve.
- 9.3. That delegated authority be given to the Director of Corporate Resources to make any final changes to the outturn position presented in this report prior to the accounts being submitted for audit by 30th June.
- 9.4. That the report on the County Council's treasury management activities and prudential indicators as set out in Appendix 2 be approved for submission to the County Council.
- 9.5. That service capital programme cash limits for 2015/16 be increased to reflect the carry forward of capital programme schemes and shares of capital receipts, as set out in Appendix 3.

Adult Services**Revenue Expenditure 2014/15**

Major variations in cash limited expenditure – Nil variance against the adjusted cash limit.

Service Area	(Under) / Over spend £000	Adjusted Cash Limit £000	Reason for Variation
Director	114	1,846	The pressure mainly relates to the part year effect of the new senior management restructure.
Policy and Strategic Development	(1,724)	32,945	The net underspend relates largely to the prevention and early intervention service, elements of which have been partially funded from the public health grant.
Older Persons and Physical Disabilities	1,192	143,121	There are significant pressures on both purchased residential and direct payments due to higher than budgeted client numbers and above budgeted weekly costs. There are further pressures on the transport and equipment and adaptation budgets. These pressures have been partially offset by an underspend in domiciliary care which relates to lower expenditure and higher income.
Learning Disabilities and Mental Health	(439)	125,613	The underspend relates to greater levels of income achieved than budgeted within the safeguarding and quality service and underspends within non operational areas due to a review of mental health contracts. These underspends have been partially offset by pressures within mental health purchased residential and LD direct payments relating to above budgeted activity and above budgeted weekly costs.

Service Area	(Under) / Over spend £000	Adjusted Cash Limit £000	Reason for Variation
In house services	3,129	31,521	The main area of pressures within in-house is staffing due to pressures relating to the use of agency staff in order to meet statutory requirements whilst vacant posts are filled.
Contingencies	(2,272)	(4,321)	This relates to the management of departmental contingencies which have been used to off-set the departments overall pressure.
Total	0	330,725	

Children's Services

Revenue Expenditure 2014/15

Major variations in cash limited expenditure – Net overspending of £2.354m against the adjusted cash limit.

Service Area	(Under) / Over spend £000	Adjusted Cash Limit £000	Reason for Variation
Schools Budget			
Pupil Growth/Infant Class Sizes	(475)	5,497	Lower than estimated costs relating to pupil growth funding (£980,000 of £3.8m budget). This is offset by increased spend on infant class size funding (£128,000) and temporary class rooms (£338,000), due to demand for more basic need places mainly at primary school age.
Two Year Old Free Entitlement	(2,355)	8,578	Following the introduction of the two year old entitlement in 2013/14 and eligibility extension in September 2014, the take-up of places has continued to be lower than the place funding allocation, although take-up is just above the national average. From 2015/16 the funding is based on actual take-up.
Three and Four Year Old Free Entitlement	(1,175)	49,254	This primarily relates to take-up being lower than estimated and additional Dedicated Schools Grant based on the census change from January 2013 to January 2014.
Special/resource/statemented top-up Funding	(425)	31,128	An underspend on the post-16 budget due to lower learner numbers and control of costs. This is offset by pressures on special discretionary grants, top-up funding for special schools, resourced provision budgets and statemented pupils in mainstream, due mainly to growth in pupil numbers.

Independent and Non-maintained Special Schools	1,605	10,922	Higher than expected pupil numbers and related costs, with an increasing number of tribunal cases.
Various Other (net)	(606)	616,733	Other minor variances
Carry Forward of Dedicated Schools Grant	3,431	(3,431)	The Department for Education (DfE) allows any unspent DSG funds to be carried forward each year and ring-fenced for schools purposes. The sum is the part of the total DSG to be carried forward of £31.363m. Of this, £22.524m has been committed as agreed with Schools Forum, with £8.839m currently unallocated.
Sub-total Schools Budget	-	718,681	
Non-Schools Budget			
Other Education & Community - Learner Support	1,044	31,927	Mainly pressure on the costs of the home to school transport contract (£1.35m), although this is partly mitigated by lower costs of post 16 transport (£130,000) and additional income (£150,000).
Services for Young People	(1,240)	6,337	Shared service outcomes with Public Health have contributed towards savings in youth support work.
Central Budgets	(2,069)	2,069	Contingency not allocated but used to offset the department's other pressures.
Isle of Wight Partnership	(393)	0	Net contribution to overheads, incorporated into the Transformation to 2015 programme.
Strategic Management	(954)	6,834	Primarily the early achievement of identified 2015/16 efficiency savings.

Adult & Community	(1,156)	106	One-off grant income as a result of change in accounting treatment from academic year to financial year.
Services for Young Children	(3,980)	15,916	Mainly the early achievement of 2015/16 efficiency savings targets, including joint working with Public Health, as well as planned reductions in the children's centres contract values and continued challenges in recruiting to children's centre teacher posts due to the temporary nature of the posts.
Virtual School	(260)	725	Vacancy management and temporary reduced capacity within Hampshire Inspection and Advisory Service to provide additional advisers.
Special Education Other	(1,832)	4,394	Planned underspends against the SEN reform and implementation grants, which is phased over two years and has been used to offset the department's other pressures
Assessment & Care Management	267	15,973	Mainly the costs of voluntary redundancies as part of the Council's transformation to 2017/18 programme.
Children Looked After (CLA)	10,659	43,844	An increase of 5.8% in CLA activity between March 2014 (1,265) and March 2015 (1,339). Although this is lower than the anticipated increase of 11.5%, based on growth in the previous financial year, the type of care being provided and related costs are higher, leading to the estimated £8.5m pressure being exceeded.
Family Support Services	(481)	14,607	Reduced demand in day care and joint working with Public Health for teenage pregnancy support work. This is offset by increased direct payment activity.

Youth Justice	1,205	1,981	Lower income at Swanwick Lodge Secure Unit as a result of temporary bed closures and Hampshire children being placed in the welfare beds during the year, thereby reducing income from other local authorities.
Other Children & Family Services	1,387	8,342	Pressure on the leaving care service as a result of increased supported lodgings and support activity, and higher inter-agency spend on adoption services.
Management & Support	295	5,228	Mainly the costs of voluntary redundancies as part of the Council's transformation to 2017/18 programme.
Various Other (net)	(138)	8,534	Other minor variances
Sub-total Non-Schools Budget	2,354	166,817	
Total	2,354	885,498	

Environment, Transport & Economy

Revenue Expenditure 2014/15

Major variations in cash limited expenditure – underspend of £2.472m against the adjusted cash limit.

Main variations

Service Area	(Under) / Over spend £000	Adjusted Cash Limit £000	Reason for Variation
Highways, Traffic and Transport	(1,878)	69,089	The net underspend relates to the early achievement of 2015/16 savings, offset by the costs of enhanced voluntary redundancy together with higher costs associated with bidding for capital funding, which previously would have been transferred to the authority as capital grant.
Waste, Planning and Environment	(230)	44,776	The early achievement of the 2015/16 savings has resulted in a net underspend after absorbing the costs of enhanced voluntary redundancy but this position is masking an underlying pressure in waste due to waste volume growth and a reduction in income in relation to the fall in market prices for some recyclable materials.
Economic Development	18	1,167	The pressure relates to costs of enhanced voluntary redundancy, partially offset by the early achievement of 2015/16 savings.
Research and Resources	(382)	3,575	The net underspend relates to the early achievement of 2015/16 savings, offset by the costs of enhanced voluntary redundancy.
Total	(2,472)	118,607	

Policy & Resources

Revenue Expenditure 2014/15

Major variations in cash limited expenditure – underspend of £6.822m against the adjusted cash limit.

Main variations

Service Area	(Under) / Over spend £000	Adjusted Cash Limit £000	Reason for Variation
Corporate Services	(2,845)	49,114	Corporate Services continues to implement a strategy of strong budgetary control, managing expenditure through joint working and generating income, for example for legal, internal audit and other services. This has enabled the costs relating to the recent voluntary redundancy programme to be absorbed and also ensured achievement of the planned early achievement of savings and further in-year savings to contribute to the Cost of Change reserve to be used for future investment in transformation work.
Public Health	0	37,428	For Public Health, the outturn position is £3.1m below the ring fenced grant. The cash limit has been adjusted by the unspent portion of the 2014/15 grant which has been transferred to the Revenue Grants Unapplied Reserve and will be available in future years for spend which meets Public Health grant conditions, consequently there is no variance against the adjusted cash limit. The main reason for the spend being less than the grant is that strong financial management and the achievement of value for money has enabled lower expenditure in the areas of Sexual Health , Nutrition, Obesity & Physical Activity, Tobacco and Health Checks. This was partially offset by intentional additional expenditure in Miscellaneous Health Improvements & Wellbeing.

Service Area	(Under) / Over spend £000	Adjusted Cash Limit £000	Reason for Variation
Culture, Community and Business Services	(3,044)	43,991	Strong financial management throughout the year ensured that both the planned early achievement of the 2015/16 savings and further reductions in expenditure (for example in Libraries) and additional income (mainly in Culture and Heritage Services) were achieved. This more than offset the department's costs arising from the recent voluntary redundancy exercise. The balance will be added to the Cost of Change reserve and used for future investment in transformation work.
Other P & R	(933)	9,560	The variance is a result of savings across a number of budgets in addition to the planned early achievement of 2015/16 savings. This includes lower expenditure during the year in a number of areas, such as the external audit fee and Members expenses. Unused budget within Members devolved budgets, Have Your Say and Rural Affairs fund will be carried forward to match future expenditure.
Total	(6,822)	140,093	

Annual Treasury Outturn Report 2014/15

1. Purpose

- 1.1. The County Council adopts the key recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice, which includes an annual report on the treasury management strategy after the end of each financial year.

2. Summary

- 2.1. 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.”
- 2.2. This annual report sets out the performance of the treasury management function during 2014/15, to include the effects of the decisions taken and the transactions executed in the past year.
- 2.3. Overall responsibility for treasury management remains with the County Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the County Council’s treasury management objectives.
- 2.4. All treasury activity has complied with the County Council’s Treasury Management Strategy and Investment Strategy for 2014/15, and all relevant statute, guidance and accounting standards. In addition the County Council’s treasury advisers, Arlingclose, provide support in undertaking treasury management activities.
- 2.5. The County Council has complied with all of the prudential indicators set in its Treasury Management Strategy; these are detailed fully in Appendix 1.

3. Economic Background

Growth and Inflation

- 3.1. The robust pace of GDP growth of 3% in 2014 was underpinned by a buoyant services sector, supplemented by positive contributions from the production and construction sectors. Resurgent house prices, improved consumer confidence and healthy retail sales added to the positive outlook for the UK economy given the important role of the consumer in economic activity.
- 3.2. Annual CPI inflation fell to zero for the year to March 2015, down from 1.6% a year earlier. The key driver was the fall in oil prices (which fell to \$44.35 a barrel; a level not seen since March 2009) and a steep drop in wholesale energy prices with extra downward momentum coming from supermarket competition resulting in lower food prices. Bank of England Governor, Mark Carney, wrote an open letter to the Chancellor in February, explaining that the Bank expected CPI to temporarily turn negative, but rebound around the end of 2015 as the lower prices dropped out of the annual rate calculation.

Labour Market

- 3.3. The UK labour market continued to improve and remains resilient across a broad base of measures including real rates of wage growth. January 2015 showed a headline employment rate of 73.3%, while the rate of unemployment fell to 5.7% from 7.2% a year earlier. Comparing the three months to January 2015 with a year earlier, employee pay increased by 1.8% including bonuses and by 1.6% excluding bonuses.

UK Monetary Policy

- 3.4. The Bank of England's Monetary Policy Committee (MPC) maintained interest rates at 0.5% and asset purchases (QE) at £375bn. Its members held a wide range of views on the response to zero CPI inflation, but just as the MPC was prepared to look past the temporary spikes in inflation to nearly 5% a few years ago, they felt it appropriate not to get panicked into a response to the current low rate of inflation. The minutes of the MPC meetings reiterated the Committee's stance that the economic headwinds for the UK economy and the legacy of the financial crisis meant that increases in the Bank Rate would be gradual and limited, and below average historical levels.
- 3.5. Arlingclose's expectation for the first rise in official interest rates remains Quarter 2 of 2016. The risks to this forecast remain weighted to the downside; in particular, signs of more widespread deflation or political uncertainty could prompt a further downward revision to the forecast. The pace of interest rate rises will be gradual and the extent of rises limited.
- 3.6. A continuation of Base Rates being held at record lows has limited the return that can be made on investment balances. Also, despite positive economic indicators there remain risks for investors due to 'bail-in' legislation. The credit risk associated with making unsecured bank deposits has increased relative to the risk of other investment options available to the County Council. Whilst the likelihood of suffering a loss from the default of a bank remains relatively unchanged, the 'bail-in' regime has significantly increased the impact a default would have in terms of the scale of loss the County Council could be exposed to.

4. Local Context

- 4.1. At 31/03/2015 the County Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £761.6m, while usable reserves and working capital, which are the underlying resources available for investment, were £498.1m.
- 4.2. At 31/03/2015, the County Council had £361m of borrowing and £491m of principal invested. The County Council's current strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing.
- 4.3. The County Council's CFR is forecast to remain constant in 2015/16. The County Council's reserves are forecast to remain stable and therefore the current internally borrowed position can be maintained if this continues to be advantageous.

5. Borrowing Strategy

- 5.1. At 31/03/2015 the County Council held £361m of loans, (a decrease of £12m since 31/03/2014) as part of its strategy for funding previous years' capital programmes.
- 5.2. The County Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the County Council's long-term plans change being a secondary objective.
- 5.3. Affordability and the "cost of carry" remained important influences on the County Council's borrowing strategy alongside the consideration 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. As short-term interest rates have remained, and are likely to remain at least for the next two years, lower than long-term rates, the County Council determined it was more cost effective in the short-term to use internal resources instead of taking out new borrowing.
- 5.4. The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose assists the County Council with the monitoring of internal and external borrowing.

Table 1: Borrowing Activity in 2014/15

	Balance on 31/03/2014 £m	Net new borrowing £m	Balance on 31/03/2015 £m
CFR	758.6		761.6
Short Term Borrowing ¹	14.6	(3.1)	11.5
Long Term Borrowing	358.6	(8.8)	349.8
TOTAL BORROWING	373.2	(11.9)	361.3
Other Long Term Liabilities	160.0	20.2	180.2
TOTAL EXTERNAL DEBT	533.2	8.3	541.5
Increase/ (Decrease) in Borrowing £m			(11.9)

- 5.5. During 2014/15 the County Council repaid £14.54m of maturing PWLB debt, and did not replace this borrowing. This will reduce the future cost of interest payments on the County Council's external debt.

¹ Loans with maturities less than 1 year.

LOBOs

- 5.6. The County Council holds £73m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the County Council has the option to either accept the new rate or to repay the loan at no additional cost. None of the LOBO loan options were exercised by the lender in 2014/15.

Debt Rescheduling

- 5.7. The premium charged for early repayment of PWLB debt remained relatively expensive for the loans in the County Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

Abolition of the PWLB

- 5.8. In January 2015 the Department of Communities and Local Government (CLG) confirmed that HM Treasury (HMT) would be taking the necessary steps to abolish the Public Works Loans Board. HMT has confirmed however that its lending function will continue unaffected and local authorities will retain access to borrowing rates which offer good value for money. The County Council intends to use the PWLB's replacement as a potential source of borrowing if required.

6. Investment Activity

- 6.1. The European Parliament approved the EU Bank Recovery and Resolution Directive (BRRD) on April 15, 2014. The combined effect of the BRRD and the UK's Deposit Guarantee Scheme Directive (DGSD) is to promote deposits of individuals and SMEs above those of public authorities, large corporates and financial institutions. Other EU countries, and eventually all other developed countries, are expected to adopt similar approaches in due course.
- 6.2. The outlawing of bail-outs, the introduction of bail-ins, and the preference being given to large numbers of depositors other than local authorities, means that the risks of making unsecured deposits rose relative to other investment options. The County Council therefore increasingly favoured secured investment options or diversified alternatives such as covered bonds, non-bank investments and pooled funds over unsecured bank and building society deposits.
- 6.3. The County Council has held invested funds representing income received in advance of expenditure plus balances and reserves held. During 2014/15 the County Council's investment balances have ranged between £491 and £700 million.
- 6.4. 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.

Table 2: Investment Activity in 2014/15

Investments	Balance on 31/03/2014 £m	Balance on 31/03/2015 £m	Average Rate/Yield on 31/03/2015 %	Average Life on 31/03/2015 Years
Short term Investments				
- Banks & Building Societies:				
- Unsecured	305.0	207.1	0.85%	0.17
- Secured	0.0	15.0	0.74%	0.98
- Money Market Funds	26.0	47.8	0.46%	0.00
- Local Authorities	95.0	28.0	0.69%	0.64
- Corporate Fixed Bonds	0.0	15.9	0.75%	0.73
Long term Investments				
- Local Authorities	80.5	137.5	1.89%	2.80
Long terms Investments – high yielding strategy				
- Local Authorities				
- Fixed deposits	15.0	20.0	3.96%	19.03
- Fixed bonds	0.0	10.0	3.74%	19.55
- Pooled Funds	0.0	10.0	10.14% ²	n/a
TOTAL INVESTMENTS	521.5	491.3	1.46%	3.13
Increase/ (Decrease) in Investments £m		(30.2)		

- 6.5. During 2014/15 the County Council diversified its range of investments in order to reduce the risk of loss of funds. Over the year the County Council made new investments in short term secured bank instruments and corporate fixed bonds. In the longer term the County Council has achieved a greater amount of investments with Local Authorities, which increases the security of the County Council's funds. The County Council has also invested more of the allocation to the high yield strategy through further investing with Local Authority fixed deposits, as well as new Local Authority fixed bonds, and an investment in a pooled property fund.
- 6.6. As part of the 2014/15 Investment Strategy it was agreed to target £90m for higher yielding investments such as long-term investments with other Local Authorities, or equity, bond or property investments. This amount is in addition to £15m that was identified for long term investments associated with the Street Lighting PFI. Investments yielding higher returns will contribute additional income to the County Council, although some come with the risk that they may suffer falls in the value of the principal invested.
- 6.7. The fall in long term interest rates in the current financial year has limited the opportunities that have been available for advantageous long term investments. Of the £105m available £40m has been invested, and in addition £15m has been committed to a second long-term pooled property fund.

² Rate of return based on 11 months of monthly returns.

- 6.8. Security of capital has remained the County Council's main investment objective. This has been maintained by following the County Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2014/15.
- 6.9. Counterparty credit quality was assessed and monitored with reference to credit ratings, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.
- 6.10. The County Council maintained a sufficient level of liquidity through the use of call accounts and money market funds. The County Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate has been maintained at 0.5% since March 2009 and short-term money market rates have remained at relatively low levels which continued to have a significant impact on cash investment income.
- 6.11. The County Council's average cash balances were £612m during the year and interest earned for the year was £7.1m, giving a yield of 1.17%.

7. Compliance with Prudential Indicators

- 7.1. The County Council confirms compliance with its Prudential Indicators for 2014/15, which were set in February 2014 as part of the County Council's Treasury Management Strategy Statement.

8. Treasury Management Indicators

- 8.1. The County Council measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures

- 8.2. This indicator is set to control the County Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed will be:

Table 4 – Interest Rate Exposures

	Approved Limits for 2014/15	Maximum during 2014/15	Compliance with Limits:
Upper limit on fixed interest rate investment exposure	£250m	£175m	Yes
Upper limit on variable interest rate investment exposure	£750m	£570m	Yes
Upper limit on fixed interest rate borrowing exposure	£810m	£463m	Yes
Upper limit on variable interest rate borrowing exposure	£810m	£122m	Yes

- 8.3. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing

- 8.4. This indicator is set to control the County Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 5 – Maturity Structure of Borrowing

	Upper	Lower	Actual
Under 12 months	50%	0%	25%
12 months and within 24 months	50%	0%	4%
24 months and within 5 years	50%	0%	8%
5 years and within 10 years	75%	0%	12%
10 years and within 20 years	75%	0%	34%
20 years and within 30 years	75%	0%	17%
30 years and above	100%	0%	0%

Principal Sums Invested for Periods Longer than 364 days

- 8.5. The purpose of this indicator is to control the County Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

Table 6 – Principal Sums Invested for Periods Longer than 364 days

	2014/15	2015/16	2016/17
Limit on principal invested beyond year end	£250m	£285m	£250m
Actual	£178m		

Prudential Indicators 2014/15

The Local Government Act 2003 requires the County Council to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the County Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The County Council's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	2014/15 Approved £m	2014/15 Revised £m	2014/15 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m
Total expenditure	284	257	245	236	168
Capital receipts	8	11	13	16	5
Grants and other income	145	147	161	120	114
Revenue contributions	29	29	29	68	35
Contributions from reserves	60	26	6	6	1
Total financing	242	213	209	210	155
Supported borrowing	4	0	0	0	0
Prudential borrowing	9	17	14	31	24
Less repayments from capital receipts etc	0	(5)	(5)	(5)	(11)
Finance lease	29	32	27	0	0
Total funding	42	44	36	26	13
Total financing and funding	284	257	245	236	168

Estimates of Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the County Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.15 Approved £m	31.03.15 Revised £m	31.03.15 Actual £m	31.03.16 Estimate £m	31.03.17 Estimate £m
General Fund	761	771	762	765	741

The CFR is forecast to fall by £30m over the next three years as capital expenditure financed by debt is outweighed by resources put aside for debt repayment.

Gross Debt and the Capital Financing Requirement

In order to ensure that over the medium term debt will only be for a capital purpose, the County Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	31.03.15 Approved £m	31.03.15 Revised £m	31.03.15 Actual £m	31.03.16 Estimate £m	31.03.17 Estimate £m
Borrowing	351	354	361	343	330
PFI liabilities	184	185	180	176	168
Total Debt	535	539	541	519	498

Total debt is expected to remain below the CFR during the forecast period.

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt, below.

Operational Boundary for External Debt

The operational boundary is based on the County Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Operational Boundary	2014/15 Approved £m	2014/15 Revised £m	2014/15 Actual £m	2015/16 Boundary £m	2016/17 Boundary £m
Borrowing	620	620	366	620	610
Other long-term liabilities	190	190	180	180	170
Total Debt	810	810	546	800	780

Authorised Limit for External Debt

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the County

Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2014/15 Approved £m	2014/15 Revised £m	2014/15 Actual £m	2015/16 Limit £m	2016/17 Limit £m
Borrowing	640	640	366	650	630
Other long-term liabilities	230	240	180	220	210
Total Debt	870	880	546	870	840

Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2014/15 Approved %	2014/15 Revised %	2014/15 Actual %	2015/16 Estimate %	2016/17 Estimate %
General Fund	7.53%	7.14%	7.07%	6.99%	6.92%

Adoption of the CIPFA Treasury Management Code

The County Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in February 2010.

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

Hampshire safer and more secure for all:	Yes
Corporate Improvement plan link number (if appropriate):	
Maximising well-being:	Yes
Corporate Improvement plan link number (if appropriate):	
Enhancing our quality of place:	Yes
Corporate Improvement plan link number (if appropriate):	

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.)

Document

Location

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:

- (a) Equality objectives are not considered to be adversely impacted 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, but the County Council through the services that it provides through the revenue budget and capital programme ensures that prevention of crime and disorder is a key factor in shaping the delivery of a service / project.

3. Climate Change:

3.1. How does what is being proposed impact on our carbon footprint / energy consumption?

The revenue budget and capital programme contain measures that will assist in reducing our carbon footprint.

3.2. How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts

The County Council in designing its services will ensure that climate change issues are taken into account.