

## HAMPSHIRE COUNTY COUNCIL

### Decision Report

<b>Decision Maker:</b>	Cabinet
<b>Date:</b>	25 October 2010
<b>Title:</b>	Treasury Management Monitoring Report 2010/11
<b>Reference:</b>	2066
<b>Report From:</b>	County Treasurer

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#### 1. Executive Summary

1.1. This report sets out the mid-year review of treasury management activities during 2010/11 and the proposed approach to developing the 2011/12 Treasury Strategy.

#### 2. Contextual information

2.1. Hampshire County Council 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.

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. Investments

3.1. The Council has an investment portfolio consisting of reserves and short-term cash flows.

3.2. The Council’s investment holding was £218.5m as at 31 August 2010.

- 3.3. The extent of cash balances will decline between now and the end of the financial year, given the ongoing capital spending being funded from borrowing and the incidence of Government grant income which is skewed towards the earlier part of the financial year.
- 3.4. The Council 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.
- 3.5. The interest rate earned on investments to 31 August 2010 averaged 0.91%, which is significantly higher than the seven-day notice rate of 0.30% (which is a widely used benchmark) and the Bank of England's base rate which has remained unchanged at 0.5% since March 2009.
- 3.6. The annual strategy report presented to Cabinet on 4 February 2010 suggested that a weak economic recovery would limit the requirement for the base rate to increase from 0.5%, with market forecasts at the time indicating a base rate level of 1.0%, 2.0% and 3.0% by the ends of 2010, 2011 and 2012 respectively.
- 3.7. A slowing global economy and a weaker outlook for UK economic growth due to Government spending cuts and higher taxes means that despite inflation being above the Bank of England's 2.0% target (3.1% for the year ended August 2010) and forecasted to remain around 2.7% in 2011, the market forecasts have become rather more subdued indicating a base rate level of 0.5%, 1.5% and 2.5% by the ends of 2010, 2011 and 2012 respectively.

#### **4. Borrowing**

- 4.1. The Treasury Management Outturn Report for 2009/10 gave an overall outstanding Public Works Loan Board (PWLB) borrowing figure of £276m at an average interest rate of 5.33% and outstanding term remaining of 18 years at 31 March 2010.
- 4.2. Since that time, an existing loan for £2m has reached maturity and in accordance with its borrowing strategy for 2010/11 the Council has taken additional loans from the PWLB totalling £16m at an average interest rate of 4.44% and 24-year term. This rate is slightly more favourable than the target rate of 4.50% outlined in the annual strategy.
- 4.3. As a result, the Council currently has a total of £290m PWLB loans at interest rates ranging between 3.39% and 9.875% and an average overall rate of 5.29%, and outstanding term remaining of 18 years.
- 4.4. In addition to the above PWLB loans, the Council currently has a total of £73m lender's option / borrower' option loans (LOBOs) at interest rates ranging between 3.89% and 5.00% and an average overall rate of 4.45%, and outstanding term remaining of 28 years. Given that LOBO loan rates have risen relative to PWLB rates and currently do not offer any competitive advantage due to the lack of availability of credit within the banking system, no new LOBO loan finance has been taken out since March 2008.

## **5. Compliance with treasury management indicators**

5.1. During the first five months of 2010/11, the Council operated within the treasury management indicators set out in the Council's Treasury Management Strategy.

### **Authorised limit for external debt**

5.2. 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 Cabinet on 4 February 2010 set an authorised limit of £690m. Further to the re-classification of a Waste Management contract as a finance lease, the authorised limit was subsequently increased to £780m as outlined in the Treasury Management Outturn Report for 2009/10.

5.3. 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 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.

5.4. During the 5-month period to 31 August 2010, the gross borrowing reached a maximum of £564m which is within the authorised limit of £780m.

### **Operational boundary for external debt**

5.5. The Council also needs to set an operational boundary for external debt. This should reflect the most likely scenario and be consistent with the Council's capital plans and Treasury Management Strategy. Temporary breaches of the 2010/11 operational boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. The Council approved an operational boundary for 2010/11 of £570m, which was similarly increased by £90m following the re-classification of the Waste Management contract as a finance lease to £660m as outlined in the Treasury Management Outturn Report for 2009/10.

5.6. During the 5-month period to 31 August 2010, the gross borrowing reached a maximum of £564m which is within the operational boundary of £660m.

### **Actual external debt**

5.7. Actual external debt at 31 March 2010 was £512m, which comprised £276m PWLB loans, £73m LOBO bank loans, £85m finance lease associated with Waste Management contract, and £78m temporary loans from the Hampshire Pension Fund and Hampshire Police Authority.

5.8. A full breakdown of PWLB and LOBO loans as at 30 September 2010 is provided in the exempt appendix - Agenda Item 12.

### **Upper limit on fixed interest rate exposure**

- 5.9. The Council has to set an upper limit on its fixed interest rate exposure (which includes the Street Lighting PFI liability), 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 Council approved an upper limit on fixed interest rate exposure for 2010/11 of £330m, which has similarly been increased by £90m following the re-classification of the Waste Management contract as a finance lease to £420m.
- 5.10. During the 5-month period to 31 August 2010, the long-term fixed-rate principal sums outstanding reached a maximum of £372m which is within the upper limit on fixed interest rate exposure of £420m.

### **Upper limit on variable interest rate exposure**

- 5.11. The Council also has to set an upper limit on its variable interest rate exposure. This is calculated simply as the difference between the approved authorised borrowing limit and the fixed-rate borrowing outstanding at the end of each year if no further such borrowing is undertaken. The Council approved an upper limit on variable interest rate exposure for 2010/11 of £420m.
- 5.12. During the 5-month period to 31 August 2010, the variable interest rate exposure reached a maximum of £194m which is within the upper limit of £420m.

### **Upper and lower percentage limits on the maturity structure of long-term fixed-rate borrowing outstanding in 2010/11**

- 5.13. The Code also requires the Council to set upper and lower percentage limits on the maturity structure of its long-term fixed-rate borrowing during 2010/11. The following table shows the limits approved by Council. These have been set in order to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio.

	<b>Upper limit (%)</b>	<b>Lower limit (%)</b>	<b>Actual (%)</b>
Under 12 months	10	0	3
12 to 24 months	10	0	2
24 months to 5 years	20	0	9
5 years to 10 years	30	10	14
10 years and beyond	90	70	72

### **Upper limits on investments with maturities longer than one year**

- 5.14. For 2010/11, the Council sets an upper limit of nil on investments for periods longer than one year. During the 5-month period to 31 August 2010, the Council has not made any investments for periods exceeding a year and has therefore adhered to this limit.

## **6. Development of the 2011/12 Treasury Management Strategy**

- 6.1. Preparatory work is due to commence in early course to produce the 2011/12 Treasury Management Strategy which is due to be approved in February 2011, in line with CIPFA Guidance.
- 6.2. The preparation of a robust Treasury Management Strategy which allows a risk aware approach to be taken in managing the Council's debt and investment portfolio's requires a high level of professional expertise coupled with a specialist knowledge of the markets in which the Council operates. It is normal practice for Councils to seek the services of Treasury Advisers and it is therefore proposed to invite tenders for a two-year appointment. This approach will enable the Council to explore the potential for achieving long term interest savings, without any significant change in the County Council's risk exposure, taking full account of professional, expert and specialist knowledge in this field.
- 6.3. This is a very specialised market and whilst an appropriate level of expertise exists within the Council to operationally manage the portfolio, it would not be appropriate to look to attract individuals with the level of expert knowledge required to support the strategy development, as this would be an extremely expensive approach. The Council would be unlikely to attract such individuals and/or retain them and indeed the specialist knowledge they have would immediately decline when they were no longer operating within their field.
- 6.4. It is planned to award the advisory contract to provide services ahead of the treasury management strategy for 2011/12 being prepared in early January 2011.
- 6.5. Subject to a successful outcome, consideration would be given to re-tendering the contract in the autumn of 2012.

## **7. Recommendations**

- 7.1. That the mid-year review of treasury management activities be approved for submission to the County Council along with the approach to developing the Treasury Strategy for 2011/12 utilising Treasury Advisers.

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

<b>Hampshire safer and more secure for all:</b>	yes/no
Corporate Improvement plan link number (if appropriate):	
<b>Maximising well-being:</b>	yes/no
Corporate Improvement plan link number (if appropriate):	
<b>Enhancing our quality of place:</b>	yes/no
Corporate Improvement plan link number (if appropriate):	
<b>OR</b>	
<b>This proposal does not link to the Corporate Strategy but, nevertheless, requires a decision for Cabinet to note the mid-year review of treasury management activities for submission to the County Council and approve the commissioning of external treasury management consultancy to provide support to the in-house function.</b>	

**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.)**

DocumentLocation

None

## **IMPACT ASSESSMENTS:**

### **1. Equalities Impact Assessment:**

- 1.1. 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