Agenda item:

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Audit Committee
Date:	5 December 2013
Title:	Treasury management mid-year monitoring report 2013-14
Reference:	5317
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 for noting.

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 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 UK economy showed some improvement, with consumer spending boosting growth. Gross Domestic Product (GDP) for the first quarter of 2013 was +0.3% and for the second quarter was +0.7%. Recent data suggests a similar rate in quarter three. Some positive signs for household spending emerged. The deterioration in real earnings growth (i.e. earnings less inflation) slowed, which implied a slower erosion of purchasing power. Consumer confidence improved. Household savings rates remained high, which is unsurprising given the uncertain economic outlook, but appear to be on a downward track, suggesting spending was being driven by borrowing or lower savings. This raises questions about the sustainability of the recovery at these rates of growth.

3.3 Inflation - annual CPI for August was 2.7% and is expected to remain close to this level throughout the autumn. Further out, inflation should fall back towards the 2% target as external price pressures fade and a revival in productivity growth curbs domestic cost pressures.

3.4 Monetary Policy - there was no change to UK monetary policy with official interest rates and asset purchases maintained at 0.5% and £375bn respectively. The main development for UK monetary policy was the start of Mark Carney's tenure as Governor of the Bank of England and the implementation of forward guidance. Within the September Inflation Report, the Bank stated its forward guidance, the main element of which is to defer monetary tightening (an increase in interest rates) until the International Labour Organisation (ILO) Unemployment Rate falls below 7% (among a raft of caveats). The Bank projected that the probability of this happening would remain below 50% until 2016.

3.5 Global Economy - Whilst the outlook for the global economy appeared to have improved over the first half of calendar 2013/14, significant economic risks remain, particularly in China and the Eurozone. The Chinese banking system is facing tighter liquidity conditions as officials seek to slow down rampant credit growth, and, despite the time gained by the ECB to allow individual members and the Eurozone as a whole to reform their economies, the Eurozone debt crisis has not gone away. The region appears to be dragging itself out of recession and September's German general election passed with little incident but political uncertainties, particularly in Italy, could derail any progress towards a more balanced and stable regional economy.

3.6 The US recovery appeared to be in train, but a lack of agreement on the federal budget by the end of September caused a partial government shutdown at the start of October, which could have an effect on GDP growth. Political risks also remain regarding the debt ceiling.

4 Investments

4.1 The County Council has an investment portfolio consisting of reserves and short-term cash flows. The County Council 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, AAA-rated money market funds, other local authorities and the

Government's Debt Management Office.

4.2 The County Council's investment holding was £587.4m at 30 September 2013, which was placed with the following counterparties:

Counterparty	£m	£m
Banks & Building Societies (less than 1 year)		420.9
UK Local authorities (less than 1 year)	108.0	
UK Local authorities (from 1 to 3 years)	43.5	
UK Local authorities (+3 years for street lighting PFI)	15.0	
UK Local authorities sub total		166.5
Total		587.4

4.3 The timing of when the County Council received its funding from Government related to Formula Grant and Business Rates in 2013/14 has changed. Revenue Support Grant of £158m was all received in April and May and will be gradually paid out throughout the year to deliver the County Council's services, the funding was previously spread more evenly throughout the year. This explains the increased level of cash balances at the beginning of the financial year from £447.4m to £587m.

4.4 The average interest rate earned on these investments at 30 September 2013 was 0.87%, 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 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 2013/14.

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 the end of September 2013 investment counterparties and the duration of new investments have been monitored and amended where necessary based on this assessment. For example based on the assessment that a 'good bank' and 'bad bank' split for RBS was being favoured by the Chancellor as a potential plan for the government to sell its stake in RBS, the credit ratings agency Moody's placed RBS's rating on review for downgrade on 5 July 2013. Although the probability of losses remains low as a precautionary measure the County Council has reduced its maximum duration on RBS (including NatWest) investments to overnight.

4.7 In the County Council's annual Investment Strategy the following non-specified investment instruments were agreed. Investments are categorised as 'specified' or 'non-specified' within the investment guidance issued by the CLG. Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the "high credit quality" as determined by the County Council and are not deemed capital expenditure investments under Statute. Non specified investments are, effectively, everything else. The highlighted duration and percentage limits have been added to the instruments below for completeness.

Instrument	Maximum maturity	Max % of the portfolio
Term deposits with banks, building societies which meet the specified investment criteria (on advice from TM Adviser)	2 years	100
Term deposits with local authorities	5 years	100
Certificates of Deposit and other negotiable instruments with banks and building societies which meet the specified investment criteria	2 years	100
Deposits with registered providers (former Housing Associations)	5 years	10
Gilts	5 years	25
Bonds issued by supra-national banks (e.g. European Inverstment Bank, World Bank)	5 years	25
Sterling denominated bonds by non-UK sovereign governments	5 years	10
Money Market Funds and Collective Investment Schemes	2 years	50
Corporate and debt instruments issued by corporate bodies	2 years	10

4.8 It is recommended to extend the maximum investment duration to 5 years for investments with governments or public sector organisations, such as other local authorities and registered providers (former housing associations where any investment can be secured against the organisation's assets). This will enable the County Council in the current very low interest rate environment to access higher yielding investments with relatively secure institutions. In addition it would give additional flexibility to better respond to extreme financial circumstances such as another banking crisis, when normal investments were not considered appropriate. The overall limit for investments with a duration of more than a year remains at £150m, which will ensure that the County Council has sufficient liquidity to meet its day to day obligations.

5 Borrowing

5.1 The County Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) at 31 March 2013 was £705m. Affordability and the "cost of carry" (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) remained important influences on the County Council's borrowing strategy.

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 six months to September 2013, 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 2013 the County Council had £373m of loans outstanding, made up of £300m of loans from the Public Works Loan Board (PWLB) and £73m of market loans. The average interest rate is 4.93% and average outstanding term remaining is 16.7 years. These loans were taken out between 1989 and 2011, when the County Council's cash balances were considerably lower than they are today.

5.4 There is currently 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 six months of 2013/14 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 14 February 2013 set an authorised limit for external debt of £850m.

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 six month period to 30 September 2013 external debt, which includes long-term borrowing, the liability for the Street Lighting PFI contract and Waste Management contract, plus funds held for other organisations such as trusts, reached a maximum of £555m, well within the authorised limit of £850m.

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 2013/14 of £810m.

6.6 As outlined above the County Council's maximum total external debt of £555m in the period from April to September 2013, 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. An upper limit on fixed and variable interest rate exposure for external debt for 2013/14 of £810m was approved by the County Council, which is based on the operational boundary and has been set to give maximum policy flexibility. The limit enables the potential for refinancing e.g. from variable to fixed rate borrowing.

6.8 The majority of the County Council's long-term debt portfolio (PWLB loans and PFI and Waste Management contracts) are fixed interest loans, which reached a maximum of £437m in the six month period to 30 September 2013. There is a smaller amount of variable rate borrowing (market loans and funds held on behalf of other organisations), which reached £120m. The levels of borrowing at both fixed and variable interest rates are within the £810m limits.

6.9 The County Council also has to set upper limits on its interest rate exposure for fixed and variable rate investments, which are £600m and £510m respectively. In the period from April to September 2013 the County Council had a maximum of £348m of investments at fixed rates and £339m at variable rates, both within the agreed limits.

Upper and lower percentage limits on the maturity structure of long-term fixed-rate borrowing outstanding in 2013/14

6.10 The Code also requires the County Council to set upper and lower percentage limits on the maturity structure of its long-term fixed rate borrowing during 2013/14. The following table shows the limits approved by the County Council in its Treasury Management Strategy. 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 (%)
Under 12 months	50	0	4
12 to 24 months	50	0	1
24 months to 5 years	50	0	11
5 years to 10 years	75	0	10
10 years and within 20 years	75	0	32
20 years and within 30 years	75	0	36
30 years and above	100	0	6

Upper limits on investments with maturities longer than one year

6.11 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 £150m and the maximum investment being placed with a single institution restricted to £40m.

6.12 At 30 September 2013 County Council had £43.5m of investments over 364 days up to a maximum of three years with other UK local authorities, with a further £14m of investments agreed with local authority counterparties but due to begin in the coming months.

6.13 The limit set and the above figures exclude three amounts of £5m lent to other local authorities for up to 22 years, to match the savings achieved by the Street Lighting PFI contract.

7 Recommendation

7.1 That the mid-year review of treasury management activities, including the updated investment limits for ‘non-specified’ investments in section 4.7, be noted.

CORPORATE OR LEGAL INFORMATION:

Links to the Corporate Strategy

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.

Other Significant Links

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

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. 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.