

Treasury Management Strategy 2010/11

1 Summary

- 1.1 The Hampshire Fire & Rescue Authority adopts the key recommendations of CIPFA's *Treasury Management in the Public Services: Code of Practice* (the Treasury Management Code), which includes an annual report on the treasury management strategy and plan before the start of the year, and an annual report after its close.
- 1.2 The recently revised 2009 Treasury Management Code also introduces a new requirement for a mid-year review, and a need to ensure that members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.
- 1.3 It places a number of responsibilities on the Authority, including the following:
 - Approving an annual borrowing strategy at its annual budget meeting, to cover the raising of capital finance and the management of the Authority's long-term debt portfolio, focusing on the minimisation of risk.
 - Considering at the same time the Authority's Annual Investment Strategy.
- 1.4 **This strategy recommends that:**
 - **long-term fixed-rate borrowing of up to £1.2m during 2010/11 should be taken out from the Public Works Loan Board (PWLB), whilst maintaining the target variable/fixed rate ratio of 50% / 50%. If circumstances are appropriate to do so, then this limit can be exceeded.**
 - **the Annual Investment Strategy described in section 5 be approved.**

2 Capital finance and debt

- 2.1 Total capital expenditure for 2010/11 is estimated to be £6.186m, of which £0.171m is to be financed from the proceeds of asset sales during the year, £1.735m from capital grants, and £0.73m from revenue contributions. The balance of £3.55m will be financed from borrowing.

- 2.2 Since the Fire & Rescue Authority was established in April 1997, a number of long-term fixed-rate loans totaling £7.45m have been taken from the Public Works Loan Board (PWLB) in line with the strategy previously agreed.

Date	Amount £	Rate %	Year of maturity
March 1998	350,000	5.875	2023/24
October 2000	350,000	5.0	2020/21
August 2001	750,000	4.875	2022/23
November 2001	650,000	4.875	2020/21
November 2001	450,000	4.5	2021/22
July 2002	350,000	5.0	2024/25
August 2002	100,000	4.875	2019/20
August 2002	100,000	4.75	2026/27
September 2002	150,000	4.625	2020/21
July 2004	500,000	4.95	2031/32
August 2004	500,000	4.85	2032/33
September 2004	500,000	4.75	2033/34
November 2004	350,000	4.65	2033/34
December 2006	350,000	4.2	2036/37
July 2007	500,000	5.0	2037/38
March 2009	600,000	3.97	2032/33
August 2009	300,000	4.40	2034/35
October 2009	300,000	4.10	2035/36
January 2010	300,000	4.50	2035/36

- 2.3 Whilst PWLB rates have risen over recent months, long-term fixed rates continue to remain at relatively low and stable levels in the context of historical rates (around 4.5% for 25-year money). The strategy of taking new long-term fixed-rate loans in line with the 2010/11 identified borrowing requirement will be applied. This would finance the planned capital assets at low rates against the risk of future long-term fixed interest rate rises.
- 2.4 However, a balance needs to be drawn in the debt portfolio between long-term debt at fixed interest rates from the PWLB and other sources and debt where interest is payable at variable rates. Fixed-rate long-term debt means that interest costs are more stable and less vulnerable to changes in interest rates. Short-term debt is sensitive to changes in interest rates and enables savings to be made when interest rates fall but means higher costs when they rise.
- 2.5 If no further fixed-rate long-term borrowing takes place between now and the end of March 2010, £7.45m or 52% of HFRA's estimated capital financing requirement as at 31 March 2010 of £14.3m will be held at fixed interest rates.

- 2.6 An estimated capital financing requirement as at 31 March 2011 of £17.3m would allow the taking up of a further £1.2m new fixed-rate long-term borrowing to March 2011 in order to adhere to the target variable/fixed rate ratio of 50% / 50%. This limit can be exceeded if circumstances are appropriate.

3 Interest rates and borrowing strategy

- 3.1 The Base Rate had remained unchanged at 0.5% since it was last reduced in March 2009, its lowest level since the Bank of England was formed in 1694.
- 3.2 Whilst inflation as measured by the Consumer Price Index (CPI) for December 2009 rose sharply to 2.9% from its November 2009 figure of 1.9%, a number of market forecasters (not least the Bank of England itself) expect this surge in inflation to be temporary and slow in coming months as inevitable fiscal tightening acts as a dampener on prices.
- 3.3 Based on 25-year term fixed-rate maturity PWLB loans, long-term borrowing rates have fluctuated considerably over the past year although have averaged around 4.5%. Initially rising from 4.0% in early January 2009, they peaked at around 4.8% in June 2009 before falling back to 4.1% in October 2009, before rising again to their current rate of around 4.5%.
- 3.4 It is envisaged that longer-term interest rates will remain on a stable path over the next year at around 4.5%, although recent concern over the UK Government's indebtedness threatening its AAA sovereign rating status may lead to an increase in such long-term borrowing costs over time.
- 3.5 The Authority's £7.45m fixed-rate debt has been secured at an average of 4.73% (see paragraph 2.2). This may prove to be a good legacy on an historic basis with the prospect of higher inflation and yields from 2011 onwards.
- 3.6 From a short-term investment interest rate perspective, a weak economic recovery limits the requirement for the Base Rate to increase from its current level of 0.5%. Nonetheless, market forecasts would seem to indicate a Base Rate level of 1.0%, 2.0% and 3.0% by the ends of 2010, 2011 and 2012 respectively.
- 3.7 The strategy will be to take out long-term fixed-rate borrowing from the PWLB of up to £1.2m in the period to March 2011 at a rate of 4.5% or less, or prevailing rates if this target rate were to prove unattainable.

4 Policy on borrowing in advance of need

- 4.1 The Authority will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds.
- 4.2 In determining whether borrowing will be undertaken in advance of need, the Authority will:
- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
 - ensure the ongoing revenue liabilities created, and the implications for future plans and budgets have been considered;
 - evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.

5 Investment of surplus funds – Annual Investment Strategy

- 5.1 This proposed Annual Investment Strategy has been prepared in accordance with guidance issued under section 15(1)(a) of the Local Government Act 2003.
- 5.2 When investing its surplus funds, the Authority's investment priority is to continue to maintain the security of capital and maintain policy flexibility through liquidity of its investments. The Authority will aim to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity.
- 5.3 Accordingly, only 'specified investments' will be used in 2010/11. Specified investments are defined in the Government's guidance as offering both high security and liquidity. All such investments should be in sterling and with a maturity of no more than a year. Such short-term investments made with the UK Government or a local authority will automatically count as specified investments. In addition, short-term sterling investments with banks and building societies with high credit ratings will count as specified investments.
- 5.4 During the year, cash flow requirements will mean that there is no scope for any direct long-term investment on the money markets. Therefore, the Authority will invest all its surplus funds with the County Council, earning interest based on the local authority seven-day notice rate.

5.5 Whilst the Authority is not expected to hold any surplus funds during 2010/11, in the unlikely event that the Authority has surplus funds available these will either be invested in:

- Fixed-term deposits for periods of up to 364 days with local authorities, the Government's Debt Management Office, or banks and building societies rated at least A2 by Moody's (a Government-recognised credit rating agency) that are included on Hampshire County Council's lending list;
- Call deposits in four managed AAA-rated money market funds included on the Authority's lending list, which are given as follows:
 - Standard Life Sterling Fund
 - RBS Global Treasury Sterling Fund
 - JP Morgan Sterling Fund; and
 - Prime Rate Sterling Fund;
- Call deposits with the County Council.

5.6 Such 'call deposits' could be recalled by the Hampshire Fire & Rescue Authority at any time.

5.7 The banks and building societies included on the Authority's current lending list are given as follows:

	Moody's long-term rating	Maximum lending term
• Lloyds	Aa3	364 days
• NatWest	Aa3	364 days
• Barclays	Aa3	364 days
• HSBC	Aa2	364 days
• Nationwide Building Society	Aa3	364 days
• Northern Rock	A2	6 months
• Leeds Building Society	A2	3 months
• Abbey	Aa3	Overnight

- 5.8 The Authority obtains credit rating information from Moody's, which is one of only three Government-recognised credit rating agencies. Credit ratings are reviewed on at least a monthly basis to identify any changes.
- 5.9 The lending list is closely monitored and reviewed by the Treasurer, taking into account each institution's credit ratings, asset base, market capitalization, press reports, etc. Institutions will be removed immediately from the list if any doubt is cast on their creditworthiness. The credit rating agencies have been largely discredited by Iceland and their role in the credit crisis. Credit ratings are just one of the various tools used in making a considered assessment of credit risk.
- 5.10 Limits are placed on levels of total deposits made with individual institutions, based on their relative strength as a counterparty. Whilst the Annual Investment Strategy sets a maximum lending term of 364 days, this will be shortened in respect of those institutions with a relatively lower credit rating.
- 5.11 Changes to the lending list and the limits on investments will be subject to the approval of the Treasurer.
- 5.12 Other, or 'non-specified', investments will not be used, given the greater potential risk.
- 5.13 The Authority delegates responsibility for the execution and administration of treasury management decisions to the Treasurer, who will act in accordance with this Treasury Management Strategy.
- 5.14 The Treasurer's treasury management staff operate within detailed parameters set out in an internal code of practice, which takes account of CIPFA's *Treasury Management in the Public Services: Code of Practice* and other guidance issued by the Chartered Institute of Public Finance and Accountancy.
- 5.15 In-house expertise is considered sufficient not to warrant the use of external treasury management advisors.

6 Prudential and other treasury indicators

6.1 The interest budget to finance the Council's capital financing requirement for 2010/11 to 2012/13 is summarized as follows:

	2010/11 Estimate £'000	2011/12 Estimate £'000	2012/13 Estimate £'000
Interest on:			
Public Works Loan Board loans	445	537	581
Temporary loans from Hampshire County Council	30	30	30
Total	475	567	611

6.2 A summary of the prudential and other treasury indicators is attached as Appendix 10.