HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Cabinet County Council
Date:	5 November 2018 29 November 2018
Title:	Treasury Management Mid-Year Monitoring Report
Report From:	Deputy Chief Executive and Director of Corporate Resources

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1. Recommendation

RECOMMENDATIONS TO CABINET

It is recommended that Cabinet recommends to County Council that:

1.1. The mid-year report on treasury management activity be noted.

RECOMMENDATIONS TO COUNCIL

Council is recommended to note:

a) The mid-year report on treasury management activity.

2. Executive Summary

2.1. In February 2010 the County Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the County Council to approve treasury management semi-annual and annual reports.

2.2. This report fulfils the County Council's legal obligation to have regard to the CIPFA Code.

2.3. The County Council's Treasury Management Strategy (TMS) for 2018/19 was approved at a meeting of the County Council in February 2018. The County Council has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the County Council's TMS.

2.4. Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter. In England the Ministry of Housing, Communities & Local Government (MHCLG) published its revised Investment Guidance which came into effect from April 2018.

2.5. The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by full council covering capital expenditure and financing, treasury management and non-treasury investments. The County Council will be producing its Capital Strategy later in 2018/19 for approval by full County Council.

2.6. 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."

2.7. 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.

2.8. All treasury activity has complied with the County Council's TMS and Investment Strategy for 2018/19, and all relevant statute, guidance and accounting standards. In addition the County Council's treasury advisers, Arlingclose, provide support in undertaking treasury management activities. The County Council has also complied with all of the prudential indicators set in its TMS.

3. External Context

3.1. The following sections outline the key economic themes currently in the UK against which investment and borrowing decisions have been made to date in 2018/19.

Economic Commentary

3.2. UK Consumer Price Inflation (CPI) index fell to 2.4% in June, a 12-month low, as the effects of sterling's large depreciation in 2016 began to fade. However CPI ticked back up marginally to 2.5% in July, mostly due to higher energy prices, and up again to 2.7% in August from cultural services, where theatre admission prices rose by more than a year ago, and games, toys and hobbies, where prices for computer games rose this year but fell a year ago. The most recent labour market data for July 2018 showed the unemployment rate at 4%; the lowest since 1975. The three month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9%. However, real wages (i.e. adjusted for inflation) grew only by 0.4%, a marginal increase unlikely to have had much effect for households.

3.3. The rebound in Gross Domestic Product (GDP) growth in Quarter 2 of 2018 to 0.4% confirmed that the weakness in economic growth in Quarter 1 was temporary and largely due to weather-related factors. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking the Bank Rate to 0.75%. No further change was made to monetary policy at the Bank of England's meeting in September.

Credit background

3.4. The big four UK banks are progressing well with ringfencing. Barclays Bank PLC and HSBC Bank PLC have created new banks (Barclays Bank UK and HSBC UK Bank) and transferred ringfenced (retail) business lines into the new companies. Lloyds Bank PLC has created Lloyds Bank Corporate Markets as a new non-ringfenced (investment) bank. RBS has renamed existing group entities and transferred accounts to leave NatWest Markets as the non-ringfenced bank and NatWest Bank, Royal Bank of Scotland and Ulster Bank as the ring-fenced banks. The County Council's day-to-day banking contract remains with NatWest Bank.

4. Local Context

4.1. On 31 March 2018, the County Council had net borrowing of £29.1m arising from financing its historical capital programme. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below:

Table 1: Balance Sheet Summary

	31/03/2018 Balance £m
CFR	(764.0)
Less: Other Debt Liabilities*	164.2
Borrowing CFR	**(599.8)**
Less: Resources for Investment	570.7
Net Borrowing	**(29.1)**

* Finance leases and PFI liabilities that form part of the County Council's debt.

4.2. The County Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 30 September 2018 and the year-on-year change is shown in Table 2 overleaf:

Table 2: Treasury Management Summary

	31/03/2018 Balance £m	Movement £m	30/09/2018 Balance £m	30/09/2018 Rate %
Long-term Borrowing	(280.0)	1.6	(278.4)	(4.66)
Short-term Borrowing	(7.9)	4.8	(3.1)	(3.30)
Total Borrowing	**(287.9)**	**6.4**	**(281.5)**	**(4.65)**
Long-term Investments	289.3	15.0	304.3	2.89
Short-term Investments	240.5	(9.6)	230.9	1.34
Cash & Cash Equivalents	32.4	(2.3)	30.1	0.69
Total Investments	**562.2**	**3.1**	**565.3**	**2.14**
Net Investments	**274.3**	**9.5**	**283.8**	

Note: The figures in the table above are from the balance sheet in the County Council's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

4.3. The increase in net investments of £9.4m shown in Table 2 above reflects the combination of repayment of Public Works Loan Board (PWLB) borrowing of £6.3m, and a small increase in investment balances of £3.1m. The repayment of borrowing is in line with the County Council's policy on internal borrowing, whilst the increase in total investments since 31 March 2018 reflects the annual position of 31 March bearing the lowest investment balances, due to many government grants being front-loaded.

5. Borrowing Activity

5.1. As shown in Table 2, at 30 September 2018 the County Council held £282m of loans, a decrease of £6m to 31st March 2018, as part of its strategy for funding previous years' capital programmes. This varies from the mid-year treasury management borrowing position and movement since 31 March 2018 shown in Table 3 overleaf; as the treasury management borrowing position excludes borrowing taken out on behalf of others.

Table 3: Borrowing Position

	31/03/2018 Balance £m	Movement £m	30/09/2018 Balance £m	30/09/2018 Rate %	30/09/2018 WAM* years
PWLB	243.4	(6.2)	237.2	4.69	12.16
Banks (LOBO)	20.0		20.0	4.76	15.29
Banks (Fixed Term)	21.0		21.0	4.21	21.91
Total Borrowing	**284.4**	**(6.2)**	**278.2**	**4.66**	**13.12**

* Weighted average maturity

Note: the figures in the table above as at 31/03/2018 are from the balance sheet in the County Council's statement of accounts, but adjusted to exclude borrowing taken out on behalf of others, and accrued interest.

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. In keeping with these objectives, no new borrowing was undertaken in the period, while £6.2m of existing loans were allowed to mature without replacement. This strategy enabled the County Council to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

5.4. The benefits of internal borrowing are 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.

5.5. The County Council continues to hold £41m of market loans (£20m of which are Lender's Option Borrower's Option (LOBO) loans, and £21m of which were LOBO but have now been converted to fixed term loans by the lender). LOBO loans are 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. No banks exercised their option during the first half of 2018/19.

6. Investment Activity

6.1. The County Council holds invested funds representing income received in advance of expenditure plus balances and reserves. The County Council's investment holding was £565m at 30 September 2018, which was £8m (1.4%) lower than the same time last year. During the six month period from 1 April to 30 September 2018, the County Council's investment balance ranged between £562m and £665m due to timing differences between income and expenditure. Table 4 overleaf shows investment activity for the

County Council as at 30 September 2018 in comparison to the reported activity as at 31 March 2018:

Table 4: Investment Position (Treasury Investments)

Investments	**31/03/2018 Balance £m**	**Movement £m**	**30/09/2018 Balance £m**	**30/09/2018 Rate %**	**30/09/2018 WAM* years**
Short term Investments					
Banks and Building Societies:					
- Unsecured	11.7	8.8	20.5	0.76	0.09
- Secured	55.0	(2.6)	52.4	1.11	0.39
Money Market Funds	25.7	(4.6)	21.1	0.68	0.01
Local Authorities	160.5	(38.5)	122.0	1.36	0.45
Registered Provider	20.0		20.0	2.30	0.33
Cash Plus Funds		20.0	20.0	0.67	n/a
	272.9	**(16.9)**	**256.0**	**1.22**	**0.36**
Long term Investments					
Banks and Building Societies:					
- Secured	78.3		78.3	0.99	2.57
Local Authorities	61.0	20.0	81.0	1.29	2.43
	139.3	**20.0**	**159.3**	**1.14**	**2.50**
Long term Investments – high yielding strategy					
Local Authorities					
- Fixed deposits	20.0		20.0	3.96	15.47
- Fixed bonds	10.0		10.0	3.78	15.27
Pooled Funds					
- Pooled property**	55.0		55.0	4.35	n/a
- Pooled equity**	40.0		40.0	6.47	n/a
- Pooled multi-asset**	20.0		20.0	4.13	n/a
Registered Provider	5.0		5.0	3.40	0.58
	150.0		**150.0**	**4.76**	**13.29**
Total Investments	**562.2**	**3.1**	**565.3**	**2.14**	**2.20**

* Weighted average maturity

** The rates provided for pooled fund investments are reflective of the average of the most recent dividend return as at 30 September 2018.

Note: the figures in the table above are from the balance sheet in the County Council's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

6.2. Both the CIPFA Code and government guidance require the County Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The County Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6.3. During the first half of 2018/19, £38.5m of short-term local authority investments have matured, and opportunities were taken to reinvest £20m into longer term local authority investments, and £20m into cash plus funds. Cash plus funds provide a further avenue of diversification of investment instruments to the County Council and are expected to provide higher returns over the medium term.

6.4. 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 2018/19.

6.5. Counterparty credit quality was assessed and monitored with reference to credit ratings, for financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

6.6. The County Council will also consider the use of secured investments products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.

6.7. 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 increased by 0.25% to 0.75% in August 2018 and short-term money market rates have remained at relatively low levels which has continued to have a significant impact on cash investment income.

6.8. The progression of credit risk and return metrics for the County Council's investments managed in-house (excluding external pooled funds) are shown in the extracts from Arlingclose's investment benchmarking in Table 5 overleaf:

Table 5: Investment Benchmarking (Investments Managed In-house)

	Credit Rating	Bail-in Exposure	WAM* (days)	Rate of Return
Hampshire performance:				
- 31/03/2018	AA	8%	735	1.36%
- 30/09/2018	AA	9%	810	1.41%
Similar Local Authorities	AA-	48%	1,026	1.00%
All Local Authorities	AA-	66%	37	0.55%

* Weighted average maturity

6.9. As part of the Investment Strategy the County Council agreed an amount targeted towards high yielding investments of £200m. 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.

6.10. Of the £200m available £150m has been invested, and an additional £10m has been committed but not called.

6.11. The County Council's £115m portfolio of externally managed pooled multi-asset, equity and property funds generated an average total return of 7.81%, comprising a 4.79% income return which is used to support services in year, and 3.03% of capital growth. As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the County Council's investment objectives are regularly reviewed.

6.12. The investments in pooled funds allow the County Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. The funds, which are operated on a variable net asset value (NAV) basis, offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short term. All of the County Council's pooled fund investments are in the respective fund's distributing share class which pay out the income generated. The County Council's intention is to hold them for at least the medium term.

6.13. MHCLG released a consultation on statutory overrides relating to the introduction of IFRS 9 Financial Instruments accounting standard from 2018/19. The consultation recognises that the requirement in IFRS 9 for certain investments to be accounted for a fair value through profit and loss may introduce "more income statement volatility" which may impact on budget calculations. The consultation proposes a time-limited statutory override and has sought views whether it should be applied only to pooled property funds. The County Council has responded to the consultation which closed on 30 September. The County Council's response stated that the County Council agrees that there should be a statutory override, but that it should not be time limited, as the circumstances meaning an override is appropriate now will still apply in April 2021 and beyond. The statutory override should apply to all pooled investment funds, as the County Council sees no reason for the Government to incentivise property funds over other pooled funds. Good treasury risk management requires long-term investments to be diversified over a range of asset classes, and the government should support this by extending the proposed override to all types of collective investment scheme.

7. Non-Treasury Investments

7.1. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the County Council as well as other non-financial assets which the County Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

7.2. Although not classed as treasury management activities the County Council may also make loans and investments for service purposes, for example loans to Hampshire based businesses or the direct purchase of land or property. Such loans and investments will be subject to the County Council's normal approval processes for revenue and capital expenditure and need not comply with the treasury management strategy. The County Council's existing non-treasury investments are listed in Table 6 below:

Table 6: Non-Treasury Investments

	30/09/2018 Asset value £m	30/09/2018 Rate %
Loans to Hampshire Based Business	9.5	4.00
Total	**9.5**	**4.00**

8. Compliance Report

8.1. The County Council confirms compliance of all treasury management activities undertaken during the period with the CIPFA Code of Practice and the County Council's approved TMS. Compliance with specific investment limits, as well as the authorised limit and operational boundary for external debt, are demonstrated in Tables 7 and 8 overleaf:

Table 7: Debt Limits

	2018/19 Maximum £m	30/09/2018 Actual £m	2018/19 Operational Boundary £m	2018/19 Authorised Limit £m	Complied
Borrowing	290	282	700	760	✓
Other Long-term Liabilities	164	164	170	210	✓
Total Debt	**454**	**446**	**870**	**970**	✓

Table 8: Investment Limits

	2018/19 Maximum	30/09/2018 Actual	2018/19 Limit	Complied
Any Single Organisation, except the UK Central Government	£30m	£30m	£70m	✓
Any Group of Organisations under the same ownership	£30m	£30m	£70m	✓
Any Group of Pooled Funds under the same management	£30m	£30m	£70m	✓
Registered Providers	£25m	£25m	£70m	✓
Money Market Funds	15%	2%	50%	✓

9. Treasury Management Indicators

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

Interest Rate Exposures

9.2. 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 9 – Interest Rate Exposures

	30/09/2018 Actual	2018/19 Limit	Complied
Upper limit on fixed interest rate investment exposure	£119m	£375m	✓
Upper limit on variable interest rate investment exposure	£447m	£700m	✓
Upper limit on fixed interest rate borrowing exposure	£278m	£970m	✓
Upper limit on variable interest rate borrowing exposure	£3m	£970m	✓

9.3. 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

9.4. 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 10 – Maturity Structure of Borrowing

	30/09/2018 Actual	Upper Limit	Lower Limit	Complied
Under 12 Months	0%	50%	0%	✓
12 Months and Within 24 Months	3%	50%	0%	✓
24 Months and Within 5 Years	11%	50%	0%	✓
5 Years and Within 10 Years	20%	75%	0%	✓
10 Years and Within 20 Years	55%	75%	0%	✓
20 Years and Within 30 Years	11%	75%	0%	✓
30 Years and Above	0%	100%	0%	✓

Principal Sums Invested for Periods Longer than 364 days

9.5. 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 11 – Principal Sums Invested for Periods Longer than 364 days

	2018/19	2019/20	2020/21
Actual principal invested beyond year end	£304m	£231m	£206m
Limit on principal invested beyond year end	£375m	£300m	£300m
Complied	✓	✓	✓

CORPORATE OR LEGAL INFORMATION:

Links to the Strategic Plan

Hampshire maintains strong and sustainable economic growth and prosperity:	Yes/~~No~~
People in Hampshire live safe, healthy and independent lives:	Yes/~~No~~
People in Hampshire enjoy a rich and diverse environment:	Yes/~~No~~
People in Hampshire enjoy being part of strong, inclusive communities:	Yes/~~No~~

Other Significant Links

Links to previous Member decisions:	
<u>Title</u> Revenue Budget and Precept 2018/19 and Capital Programme 2018/19 – 2020/21 http://democracy.hants.gov.uk/ieDecisionDetails.aspx?AIId=6228	<u>Date</u> Cabinet – 5 February 2018 County Council – 22 February 2018

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

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

IMPACT ASSESSMENTS:

1. Equality Duty

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

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

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

a) The need to remove or minimise disadvantages suffered by persons sharing a relevant characteristic connected to that characteristic;

b) Take steps to meet the needs of persons sharing a relevant protected characteristic different from the needs of persons who do not share it;

c) Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity which participation by such persons is disproportionally low.

1.2. **Equalities Impact Assessment:**

Equalities objectives are not considered to be adversely affected by the proposals in this report.

2. Impact on Crime and Disorder:

2.1. This 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.