

HERTFORDSHIRE COUNTY COUNCIL

CABINET

MONDAY 18 NOVEMBER 2002 AT 2.00 P.M.

COUNTY COUNCIL

TUESDAY 19 NOVEMBER 2002 AT 10.30 A.M.

agenda item no.

Cabinet

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County Council

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BORROWING STRATEGY - revision

Report of the Finance Director

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Executive Member: David Beatty

1. Purpose of the Report

- 1.1 To recommend a revised set of criteria for the County Council's lending list for investments to incorporate recent changes to regulations.
- 1.2 To recommend that long term borrowing up to the County Council's quota is taken to fund in advance the Baldock Bypass Scheme.
- 1.3 Approval of the full County Council is required as the Borrowing Strategy forms part of the policy framework

2. Summary

- 2.1 The Local Authorities (Capital Finance and Approved Instruments (Amendment) Regulations 2002 added Money Market Funds to the list of approved instruments for local authorities.
- 2.2 The current lending list allows fixed term cash deposits or cash to be placed on call with institutions with a certain level of credit rating.
- 2.3 Long term borrowing rates are at historically low levels and the County Council's Treasury Management advisers are advising that the Council take advantage of the rates in anticipation of the expenditure on the Baldock Bypass Scheme.
- 2.4 The quota available to borrow from the Public Works Loan Board is £39.6m for 2002/03 and it is anticipated that holding the cash for the remainder of the financial year will cost around £15k.

3. Conclusion

- 3.1 Money Market Funds would be an advantageous addition to the HCC list as they offer security (they have the highest possible rating, AAA), liquidity and yield for short term cash.
- 3.2 A revised policy for setting lending limits is set out in Appendix A. This policy does not change the current criteria in place for cash deposits. However Money Market Funds are added to the list.
- 3.3 Borrowing up to the quota of £39.6m to fund the Baldock Bypass Scheme in advance will allow the County Council to take advantage of historically low interest rates.
- 3.4 Cabinet is invited to consider the proposed revisions to the Borrowing Strategy and make an appropriate proposal to County Council.

4. Background

- 4.1 County Council approved the Borrowing and Treasury Management Strategy for 2002/03 on 14 February 2002.
- 4.2 In April 2002 The Local Authorities (Capital Finance and Approved Instruments) (Amendment) Regulations 2002 came into force. These regulations added Money Market Funds to the list of approved instruments in which local authorities can invest their short term cash.
- 4.3 At the 14 February 2002 meeting the County Council approved a maximum borrowing limit of £150m within the budget report. The strategy anticipated borrowing to be in the range of £100m to £120m.

5. Current Lending List Criteria

- 5.1 The current lending list criteria were approved by Policy Committee in January 1996. The Finance Director approves any additions or deletions of institutions from the list within these criteria.
- 5.2 The current criteria only allow fixed term cash deposits through the London money market or cash to be placed in call accounts with one of the institutions on the list. The criteria for the lending list are based on credit ratings issued by Fitch-IBCA and are set to a high standard.
- 5.3 Each institution on the list has a credit limit which restricts the amount that can be invested with them at any one time. As a local authority with a long term borrowing portfolio, Hertfordshire County Council is only permitted to invest cash for a maximum of 364 days. In addition, each institution on the list has a maturity limit which reflects their credit rating.

6. Money Market Funds

- 61 Money Market Funds have been used by private sector institutions for the investment of short-term cash in the UK since the early 1990's. These funds operate by a number of investors depositing cash in a fund and the fund manager using that cash to buy a wide range of money market instruments. These instruments generate a return in the form of interest, which is paid to the investors. However the investors retain the right to withdraw their cash at any time without any notice. These Funds are run by the large UK banks and investment houses.
- 6.2 The Local Authorities (Capital Finance and Approved Instruments) (Amendment) Regulations 2002 set out strict criteria governing which Money Market funds local authorities can invest in. They are:
- Denominated in sterling
 - Domiciled in the EU (most are based in Luxembourg or Dublin)
 - Have the "highest possible rating" (referred to as AAA).
- 6.3 There are several advantages to having money market funds on Hertfordshire County Council's lending list:
- Security
The diversification achieved by the funds by using a range of money market instruments and time periods reduce the risk of investing in the funds. This is reflected in the AAA credit rating, which is higher than most institutions currently on the HCC lending list.
 - Liquidity
Money market funds allow investors to withdraw their funds on the same day up to a set deadline (generally around 12 noon). This means that cash can be available in a case of an unexpected shortfall and would also be available to take advantage of attractive rates on fixed term deposits whenever they arise.
 - Yield
Money market funds have a target yield of either 7 day LIBID or 1 month LIBID, both of which are very attractive returns for such a highly credit-rated and liquid investment.
- 6.4 Adding Money Market Funds to the lending list is not intended to replace the use of fixed term deposits. However they would be a useful addition to the list for the placing of cash required within a month at stable rates with low risk.

7. Long Term Borrowing

- 7.1 At the moment the County Council's level of long term borrowing is £118.9m, and this is sufficient for covering cash flow needs.
- 7.2 The Department of Transport have approved the Baldock Bypass Scheme at over £40m. Much of this will need to be funded through long term borrowing.
- 7.3 Long term borrowing rates are lower than they have been for many years, with rates as low as 4%. These rates are very attractive compared to the average interest rate of the current loan portfolio of 5.92%.
- 7.4 Butlers, the County Council's Treasury Management advisers, have suggested it would be prudent to consider borrowing the funds we will need in the future for the Baldock scheme now to take advantage of the low fixed rates currently available.
- 7.5 The County Council has a quota totalling £39.6m which it is able to borrow from the Public Works Loan Board (PWLB) during the financial year 2002/03. Therefore it would be possible to borrow up to this amount at the current low rates.
- 7.6 Any surplus cash not immediately required for capital or revenue expenditure is invested on a short term basis until it is required. The rates that can be achieved from lending money are between $3\frac{7}{8}\%$ and 4% depending on the period. Therefore this strategy is expected to cost around $\frac{1}{8}\%$ in the short term.

8. Financial Implications

- 8.1 Borrowing up to the PWLB quota of £39.6m would cost around £1.7m per annum. Under the current financial support system we would expect this to be reflected in the capital Standard Spending Assessment in subsequent years.
- 8.2 The difference between the cost of borrowing and the interest which would be earned during the remainder of the financial year until it is required is estimated to be around £15k. It is anticipated that this cost can be contained within the Capital Financing budget.

**HERTFORDSHIRE COUNTY COUNCIL
POLICY FOR SETTING LENDING LIMITS**

The policy sets a high standard of credit criteria. These are applied to a wide range of financial institutions, so that the Authority can maximise its ability to earn the best interest rates whilst minimising the risk of loss.

MONEY MARKET DEPOSITS & CASH ON CALL

All lending is done in sterling and overseas banks on the list must have branches or incorporated subsidiaries in the UK.

Legal Requirements

- ◇ Bank of England authorisation for each institution
- ◇ Maximum 364 day maturity limit for investments

Minimum Credit Rating Requirements

All approved banking institutions must have a Fitch-IBCA short term rating of F1 or F1+ and a minimum long term rating of A. Many Building Societies do not need a credit rating. Their maturity and credit limits are therefore based on their asset value.

The maturity and credit limits (i.e. the maximum period and value of a loan to that institution) depend on the “individual” and “support” ratings as set out below.

If Fitch IBCA do not undertake a credit rating review of an institution, consideration will be given to ratings of an equivalent level issued by other credit rating agencies.

NB Due to ongoing problems in the Japanese banking sector NO Japanese banks are currently on the approved lending list.

Maturity and Credit Limits

Rating/Type of institution	Maturity Limit	Credit Limit £m
Main UK Banks	364 days	20
Local authorities and other public bodies	364 days	10
Individual rating B/C or above Support rating 3 or above	364 days	10
Individual rating C or D Support rating 3 or above	364 days	5
Individual rating C or D Support rating 4 or below	3/6 months (depends on circumstances)	5
Italian/Norwegian/Spanish/ Swedish/Portuguese banks	3/6 months	5/10 (depends on circumstances)
Building societies: Assets \$900+	364 days	10
\$250-899	364 days	5
\$150-249	364 days	2.5

These criteria form the basis for the maturity and credit limits.

The credit ratings and status of institutions are regularly monitored and lower maturity and credit limits may be imposed where there are specific concerns not yet reflected in the ratings.

MONEY MARKET FUNDS

All lending is done in sterling and all institutions must be regulated by an officially recognised EU Body.

All approved funds must have at least one of the following credit ratings:

- Moody's Investor Service Ltd Aaa MR1+
- Standard and Poor's Ltd AAAm
- Fitch - IBCA AAA V1+.

The limit for lending to any one Money Market Fund is £20m.

Group Limits

Where a number of banks are part of the same group, there is a total credit limit for the group which is equal to that of the parent bank.

Main UK Banks total group limit £30m.

Group limits for other institutions vary according to their credit rating.

Transaction Limit

No one transaction can exceed £10m except for roll over of interest on renewal of an existing loan.

Breaches of Lending Limits

Breaches of lending limits up to £1m for periods of up to 1 month are permitted in exceptional circumstances where a deal at the maximum credit limit would leave a small, uneconomical sum to place.

Changes to the Lending List

The Finance Director can authorise changes to the limits on individuals institutions or add institutions within the terms of this Policy. Any changes to the criteria in this Policy must be approved by County Council.