NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT MID YEAR REVIEW 2010/11

Report of the Treasurer to the Fire Authority

Agenda Item No:

Date: 17 December 2010

Purpose of Report:

To provide Members with an update on treasury management activity during the first half of the 2010/11 financial year.

CONTACT OFFICER

Name :	Neil Timms Head of Finance and Resources
Tel :	(0115) 967 0880
Email :	neil.timms@notts-fire.gov.uk
Media Enquiries Contact :	Elisabeth Reeson (0115) 967 5889 elisabeth.reeson@notts-fire.gov.uk

1. BACKGROUND

1.1 Treasury management is defined as:

"The management of the local authority'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. "

1.2 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by the Fire Authority on 9 April 2010.

1.3 The primary requirements of the Code are as follows:

1. The creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities.

2. The creation and maintenance of Treasury Management Practices which set out the manner in which the Authority will seek to achieve those policies and objectives.

3. Receipt by the Fire Authority of an annual Treasury Management Strategy Statement for the year ahead, a mid-year review report and an annual report covering activities during the previous year.

4. Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Authority of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Authority the delegated body is the Finance and Resources Committee.

1.4 This mid year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2010/11
- A review of the Treasury Management Strategy Statement
- A review of the Authority's investment portfolio for 2010/11
- A review of the Authority's borrowing strategy for 2010/11
- A review of compliance with Treasury and Prudential Limits for 2010/11

1.5 The Authority has appointed Sector Treasury Services as its external treasury management adviser.

2. REPORT

2.1 Economic Update

Following the general election in May 2010, the coalition government put in place a plan to reduce the public sector deficit over the next five years. Growth in the UK's Gross Domestic Product (GDP) was 1.2% in the first quarter of the year, but this is likely to turn out to be a peak in the year. In terms of inflation, the Consumer Price Index (CPI) peaked at 3.7% in April and was 3.1% by August, with the Retail Price Index also high at 4.7% in August. The Bank of England's Monetary Policy Committee has set a target of 2% for inflation and expects UK inflation to fall back to a level below the target over the next two years. The bank rate has remained at 0.5% throughout the first half of the year.

2.2 Prior to the general election there were concerns in financial markets that the UK might lose its AAA sovereign credit rating. Since the Chancellor's budget on 22 June, sterling has strengthened against the US dollar and confidence that the UK will retain its rating has returned. There was an increase in demand for UK government gilts, which were seen as a safe haven for investors wanting to avoid EU government investments. The increase in demand for gilts has reduced gilt yields and consequently Public Works Loans Board (PWLB) interest rates in the first half of the year. However the Comprehensive Spending Review announcement on 20 October 2010 brought with it a policy change for borrowings. Prior to the announcement, PWLB interest rates were set daily, based on gilt yields at close of business the day before. They are now 1% above said gilt yields so the cost of borrowing for the public sector has increased, presumably as a measure to discourage authorities from borrowing because of the consequential increase in the public sector deficit.

2.3 Review of the Treasury Management Strategy

The Treasury Management Strategy approved by the Authority set out the policies for managing investments and for giving priority to the security and liquidity of those investments. The risk appetite of this Authority is low in order to give priority to security of its investments. Accordingly the following types of low risk investments may be made:

- Deposits with the Debt Management Agency (Government)
- Term deposits with Banks and Building Societies
- Term Deposits with uncapped English and Welsh local authority bodies
- Triple-A rated Money Market Funds
- UK Treasury Bills

2.4 The Authority will aim to limit its investment with any single counterparty to £2m although the strategy noted that this was sometimes difficult to achieve. No term deposits will be made for more than 1 year without the prior approval of the Treasurer and the Chair of Finance and Resources Committee. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of potential counterparties. The Authority will therefore use counterparties within the following durational bands:

- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months

2.5 The Authority will avoid locking into longer term deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

2.6 In terms of cash resources, the strategy is to maintain a bank overdraft facility of £200,000, to continue to use cash flow forecasting to predict cash surpluses and shortfalls so that these can be managed and to invest small bank account balances in the Business Premium Account on a daily basis.

2.7 In the first half of the year, there were no instances of the bank account being overdrawn and all aspects of the treasury management strategy outlined for 2010/11 remain in place as at the midpoint of the year, with no significant changes expected.

2.8 <u>Review of the Investment Portfolio</u>

During the first half of the year, a total of 24 investments were made (excluding the overnight sweep to the Business Premium Account). The maximum value placed in any single investment was £2m, apart from investments made with the Authority's own bank (Barclays Bank) and the longest duration was 7 months. Three investments were placed with other local authorities and the remainder were placed with banks and building societies meeting the credit rating criteria shown above. An analysis of investments as at 30 September 2010 revealed that the Authority had £12m invested with 5 different institutions (more than £2m was invested with Barclays Bank at this point) at an average interest rate of 0.82%. All of these counterparties were AAA rated - £10m was placed with UK institutions and £2m was placed with a Singapore bank. It is not anticipated that the Authority will maintain this level of investments throughout the year, as some of this has arisen from the firefighter pension top-up grant received in July 2010. This grant will be used throughout the year.

2.9 Investment income earned up to 30 September 2010 totalled £26k. This is set against a budget for the year of £50k and it is expected at this stage that the annual budget will be exceeded. This is largely because the Authority has had more surplus cash to invest, rather than due to favourable interest rates.

2.10 Review of the Borrowing Strategy

The strategy recommended borrowing from the PWLB earlier in the year or when the 25 year rates fell back to or below the central forecast rate of 4.75%. The existing debt maturity profile meant that loans would need to be for a period of more than 10 years to keep within prudential limits. It was anticipated that approximately £6m would be borrowed to finance the capital programme and up to £2m to cash back reserves.

2.11 As the capital programme is currently underspending to date, it was considered prudent to hold back on borrowing the whole £6m at an early stage. The capital programme shows an estimated outturn which is in excess of the £6m, but this excess will be financed by capital grant or revenue contributions. Borrowing took place at the end of September from the PWLB with the sum of £3m being taken for a period of 14 years at a fixed rate of 3.69%. Borrowings are still well within the Authority's capital financing requirement.

2.12 No rescheduling of debt has taken place to date, as the interest rate climate has not resulted in an advantageous environment for rescheduling.

2.13 As outlined in the section above on the economy PWLB interest rates increased by 1% across all maturities on 20 October and this will lead to an increase in borrowing costs for the Authority. However, it is unlikely to impact significantly on this year's budget and the effect of the rate changes will be built into future years' budgets.

2.14 Review of compliance with treasury and prudential limits

The following indicators were approved by Members for the 2010/11 financial year. As at 30 September, the actual performance was as shown in the final column of the table below.

Treasury or Prudential Indicator or Limit	Approved for 2010/11	Actual as at 30/09/10
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.9%	Not available until year end
Estimate of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D)	£2.67	Not available until year end
Estimate of Total Capital Expenditure to be Incurred	£6,689,000	£7,679,000
Estimate of Capital Financing Requirement	£33,326,000	Not exceeded
Operational Boundary	£32,746,000	Not exceeded
Authorised Limit	£36,021,000	Not exceeded
Upper limit for fixed rate interest exposures	100%	100%

Upper limit for variable rate interest exposures	30%	0%
Loan Maturity:	Limits:	
Under 12 months	Upper 20% Lower 0%	0%
12 months to 5 years	Upper 30% Lower 0%	26%
5 years to 10 years	Upper 75% Lower 0%	25%
10 years to 20 years	Upper 100% Lower 20%	17%
Over 20 years	Upper 100% Lower 20%	32%
Upper Limit for Principal Sums Invested for Periods Longer than 364 Days	£2,000,000	Not applicable

3. FINANCIAL IMPLICATIONS

The financial implications of this report are set out in full within the body of the report.

4. HUMAN RESOURCES AND LEARNING AND DEVELOPMENT IMPLICATIONS

There are no human resources or learning and development implications arising directly from this report.

5. EQUALITY IMPACT ASSESSMENT

There are no equalities issues arising directly from this report, as it is a review of activities rather than a new policy.

6. CRIME AND DISORDER IMPLICATIONS

There are no crime and disorder implications arising directly from this report.

7. LEGAL IMPLICATIONS

There are no legal implications arising directly from this report, other than the requirement to act within the Authority's powers when undertaking treasury management borrowings and investments.

8. RISK MANAGEMENT IMPLICATIONS

The investment of local authority funds cannot be achieved without some element of risk. Careful choice of borrowers using creditworthiness indices will minimise this risk. This prudent approach will undoubtedly result in some interest rate loss but the principles of security and liquidity are paramount.

9. RECOMMENDATIONS

It is recommended that Members note the contents of this report.

10. BACKGROUND PAPERS FOR INSPECTION (OTHER THAN PUBLISHED DOCUMENTS)

None.

PETER HURFORD
TREASURER TO THE FIRE AUTHORITY