NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT ANNUAL REPORT 2010/11

Report of the Treasurer to the Fire Authority

Agenda Item No:

Date: 16 September 2011

Purpose of Report:

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

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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 annual report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic review of 2010/11;
- A review of Capital Activity during 2010/11 and the impact of this on the Authority's Capital Financing Requirement;
- A review of the Investment and Cash Management Strategy during 2010/11;
- Investment and Cash Activity during 2010/11;
- A review of the Year End Investments and Cash Position and Usable Reserves;
- A review of the Borrowing Strategy and Borrowing Activity during 2010/11;
- A summary 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

Economic Review

2.1 In the UK, growth outperformed expectations in the first half of the year, but the severe winter changed this to a negative position in the second half. Outside of the UK, some major issues impacted on the world economy: during the course of the year, the Euro zone sovereign debt crisis developed with first Greece, then Ireland, being forced to accept assistance from an EU rescue package. Towards the end of the year, Portugal's sovereign debt position also worsened. Additionally the so-called "Arab Spring" caused an increase in world oil prices and these factors combined to dampen international growth prospects.

2.2 The new coalition Government announced significant spending cuts in the October Comprehensive Spending Review and gave away little in the March 2011 budget. The aim of government policy is to reduce the national debt burden but the measures may affect economic growth to some extent in the short term. The increase in demand for gilts reduced gilt yields in the first half of the year, but rising inflation in the second half of the year reversed this. 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. There has not been an associated increase in early redemption rates, so the early repayment of loans is now less attractive.

2.3 Investment rates picked up a little in the second half of the year, linked to strong first half growth and rising inflation. However, poor growth performance in the latter half of the year resulted in the timing of an expected bank rate rise moving back to mid 2011. Investors are generally cautious about longer term commitment.

Review of Capital Activity in 2010/11

2.4 The Authority undertakes capital expenditure on long term assets. These activities may either be:

- Financed immediately by way of capital or revenue resources (capital receipts, capital grants, revenue contributions), which does not give rise to a requirement to borrow; or

- If insufficient financing is available, or if a decision is taken not to apply resources, the capital expenditure will need to be financed by borrowing.

2.5 Actual capital expenditure forms one of the required prudential indicators. The table below shows actual capital expenditure in the year and how this was financed.

	2009/10 Actual	2010/11 Estimate	2010/11 Actual
	£000's	£000's	£000's
Capital Expenditure	6,031	7,652	5,932
Resourced By:			
- Capital Grants	738		946
- Capital Receipts	10		0
- Revenue Contributions	335		2,608
- Internally Financed up to level of MRP	0		1,449
- Borrowing	4,948		929
Total Financed Capital Expenditure	6,031	7,652	5,932

2.6 Actual capital expenditure was within the prudential indicator set of £6,689k. At 31 March 2011, the Authority's capital financing requirement was £28,981k, which was within the prudential indicator set of £33,326k. The Capital Financing Requirement (CFR) figure represents the Authority's underlying need to borrow to fund capital expenditure and equates to un-financed capital expenditure which has not yet been paid for by revenue funding or other resources such as capital grants or receipts. The CFR is reduced over time by way of a statutory Minimum Revenue Provision charge to revenue which effectively charges the revenue budget for the use of capital assets over their asset lives.

Review of the Investment and Cash Management Strategy

2.7 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 specified 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.

During the year, all investments were made with banks and other local authority bodies.

2.8 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 reference to Sector's weekly credit list of potential counterparties. The Sector weekly credit list shows potential investment counterparties, which are colour-coded to indicate the maximum period it is recommended that investments are made for. The Authority will therefore use counterparties with the following durational colour codes:

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

2.9 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.

2.10 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.

2.11 All aspects of the treasury management strategy outlined for 2010/11 remained in place throughout the year. The Strategy included a forecast for the bank rate, which showed that this was expected to be at 1% by 31 March 2011. However the bank rate has remained at 0.5% throughout the year and beyond.

<u>Investment and Cash Activity in 2010/11</u>

2.12 As at 31 March 2011, the Authority held £7m of principal as short term investments. This comprised 5 separate investments with 5 counterparties, none of which was more than £2m. Two of the investments were with Local Authorities and three were with banks. At the time of writing this report, all of these investments had matured and been repaid.

2.13 During the course of the year, 38 investments were made, excluding the overnight sweep to the Business Premium Account. None of these exceeded £2m in value. The longest term investment placed was for 7 months and all investments were made in accordance with the Authority's credit rating criteria policy. There were occasions when the amount invested with the Authority's own bank (Barclays Bank) exceeded £2m due to difficulties at those times in placing funds with counterparties meeting our credit rating criteria.

2.14 The three month LIBID benchmark rate for the year was 0.615%. The Authority's investments earned an average rate of 0.673% during the year resulting in total investment income earned of £70k. This was in excess of the budgeted sum for investment income of £50k and was mainly due to surplus cash being higher than expected as a result of the revenue budget underspend.

2.15 Nottinghamshire Fire and Rescue Service (Trading) Limited was set up as a subsidiary company during the year and started trading 1 September 2010. A bank account for the company was opened with Barclays Bank, who required funding to be paid into the account to cover possible working capital shortfalls. To accommodate this, a loan of £54,999 was made to NFRS(T) Ltd in the form of a revolving credit facility which can be repaid at any time with one week's notice. An arms-length variable interest rate was agreed at 15 basis points above the Bank of England bank rate. As at 31 March, none of the loan had been repaid, and it is shown as a short term investment in the Authority's accounts and as a loan in the trading company's accounts.

2.16 During the year, the Authority's overdraft facility was not used.

Review of Investments / Cash Position and Usable Reserves

2.17 Members will be aware that the Authority's "usable" reserves i.e. the General Fund and Earmarked Reserves have not been fully cash backed in the past due to the internal financing of capital expenditure in previous years. This was a particular issue during the "credit crunch" period in 2008 when Members approved an interim treasury strategy to delay borrowing, thereby avoiding an increase in cash balances whilst the money markets were suffering a degree of turmoil and credit ratings were volatile.

2.18 Since then the position has improved: at 31 March 2011, the value of the Authority's usable reserves totalled £9,717k. The balance sheet as at the same date shows that short term investments totalled £7,055k and cash held totalled £1,199k. Members can therefore be assured that if the Authority needs to spend some of its usable reserves, there is sufficient liquidity in its financial position to be able to do so.

Review of the Borrowing Strategy and Borrowing Activity in 2010/11

2.19 The strategy recommended borrowing from the Public Works Loans Board (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.

2.20 Borrowing took place at the end of September from the PWLB with a maturity loan of £3m being taken for a period of 14 years at a fixed rate of 3.69%. This was in the context of an underspending capital programme at that time, and it was considered prudent to limit the amount borrowed to £3m.

2.21 During the budget process, a proposal was put forward to finance capital expenditure in 2011/12 from revenue reserves in order to reduce future years' capital financing costs. Subsequently on 1 April 2011, Members of the

Finance and Resources Committee accepted a proposal to bring forward revenue financing of the capital programme to 2010/11, which would utilise the 2010/11 revenue underspend and bring forward by one year the achievement of savings in capital financing charges within the revenue budget. The table in paragraph 2.5 shows that after taking account of revenue contributions to finance capital expenditure, only £929k of the £3m borrowed has been used to finance the capital programme in 2010/11. The Treasury Management Strategy allows the Authority to borrow in advance of need providing that borrowing is only undertaken to finance the capital programme approved for the medium term. The remaining £2,071m of borrowing taken in 2010/11 will be used to finance the capital programme in 2011/12 and 2012/13 and, as PWLB interest rates for new loans have generally increased since last September, the Authority will benefit from the early borrowing with lower interest charges over the term of the loan.

2.22 The prudential indicator which sets a lower limit for loans maturing in 10 to 20 years is 20% and this indicator has not been met, with only 11% of debt maturing in this period. It was originally envisaged that a further loan would be taken in the 2010/11 financial year to fund the capital programme, and this would have been for a duration falling into the 10 to 20 year band, however the subsequent approval of a revenue contribution to finance 2010/11 capital expenditure means that we will continue to fail to meet the lower limit until such time as a further loan is taken. This should not be seen as a situation which exposes the Authority to too high a risk – the purpose of the indicator is to ensure that not all debt is due to mature in the very short term, which would expose the Authority to the risk of interest rate increases in the near future. The proportion of debt due to mature in over 20 years is currently 32%, which is well above the 20% minimum limit and the total amount due to mature in the two bands together i.e. over 10 years, is 43%. This was reported to Members of the Finance and Resources Committee during the year as part of Prudential Code monitoring.

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

2.24 The Authorised Limit is the affordable borrowing limit above which the Authority does not have the power to borrow. This was set at £36,021k for 2010/11. Total borrowing as at 31 March 2011 was £27,658k, which was well within the Authorised limit.

2.25 The Operational Boundary is the expected borrowing position of the Authority within the year. This was set at £32,746k for 2010/11, and was not exceeded at any point during the year.

2.26 As outlined in the section above on the economy, PWLB interest rates increased by 1% across all maturities on 20 October 2010 and this will lead to an increase in borrowing costs for the Authority which will be built into future years' budgets.

<u>Summary of compliance with treasury and prudential limits</u>

2.27 The following indicators were approved by Members for the 2010/11 financial year. Actual performance is shown in the final column of the table below. One prudential indicator has been breached during the year, and this was explained further in paragraph 2.21 above.

Treasury or Prudential Indicator or Limit	**Approved for 2010/11**	**Actual for 2010/11**
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.9%	5.6%
Estimate of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D)	£2.67	£1.83
Estimate of Total Capital Expenditure to be Incurred	£6,689,000	£5,932,000
Estimate of Capital Financing Requirement	£33,326,000	£28,981,000 (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:	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%	30%
10 years to 20 years	Upper 100% Lower 20%	11%
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

Risk management is a key aspect of treasury management, and the Treasury Management Strategy sets out the parameters within which activities will be carried out with a view to managing credit risk, liquidity risk, re-financing risk and market risk. The Authority has approved a prudent approach to treasury management and this report allows Members to review how well risks have been managed during the year.

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