NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT MID YEAR REVIEW 2011/12

Report of the Treasurer to the Fire Authority

Agenda Item No:

Date: 16 December 2011

Purpose of Report:

To provide Members with an update on treasury management activity during the first half of the 2011/12 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 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 2011/12
- A review of the Treasury Management Strategy Statement
- A review of the Authority's investment portfolio for 2011/12
- A review of the Authority's borrowing strategy for 2011/12
- A review of compliance with Treasury and Prudential Limits for 2011/12

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

2. REPORT

2.1 Economic Update

The Euro zone sovereign debt crisis continued with renewed market concerns that Italy and Spain would be joining Greece, Ireland and Portugal in needing assistance. The response to the crisis appeared to be weak earlier in the year, but culminated in September in the approval of a £440bn bail out fund, which has brought a temporary relief to financial markets. However the situation in Greece is still of significant concern because the scale of the problem is so great.

2.2 In the United States there have been political difficulties over plans to address the budget deficit, and the AAA sovereign credit rating has been downgraded by the Standard and Poors credit rating agency. This has had a negative impact on the outlook for the world economy and growth prospects in the US, UK and Euro zone have been lower than expected. World stock market values fell in the second quarter of 2011/12.

2.3 The UK economy grew by a weaker than expected 0.2% in the first quarter of 2011/12. UK consumer sentiment is subdued – disposable income is falling, VAT has increased, unemployment is rising and inflation is running high. The Bank of England's Monetary Policy Committee has retained the bank rate at 0.5% and is likely to continue with this policy for some time because an increase would have a negative effect on the economy. There has been an indication that the quantitative easing programme may be expanded.

2.4 International investors continue to view UK government gilts as a safe haven from the Euro zone crisis and the consequent increase in demand for gilts has reduced yields and therefore PWLB borrowing rates.

2.5 Review of the Treasury Management Strategy

The Treasury Management Strategy approved by the Authority sets 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

2.6 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

On 8 September 2011 Sector advised the Authority that due to the heightened uncertainty in financial markets because of the Euro zone difficulties, they were advising that all investments should be for a duration of no more than 3 months with the exception of investments with the UK government, other local authorities, money market funds and UK semi-nationalised banks. This is a temporary revision to the Treasury Management Strategy, which is still in place at the time of writing this report.

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

2.8 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.

2.9 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 2011/12 remain in place as at the midpoint of the year, with the exception of the duration of investments outlined in paragraph 2.6.

2.10 Review of the Investment Portfolio

During the first half of the year, a total of 25 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 364 days. Four investments were placed with other local authorities and the remainder were placed with banks and building societies meeting the credit rating criteria shown above. On one occasion during the 6 months, there was one investment exceeding the £2m limit – this was a £3.4m investment placed overnight with Barclays Bank. An analysis of investments as at 30 September 2011 revealed that the Authority had £14m invested with 8 different institutions at an average interest rate of 1.056%.

£11m was placed with UK institutions and £3m was placed with overseas banks.

2.9 Investment income earned up to 30 September 2011 totalled £65k. This is set against a budget for the year of £50k so the annual budget has already been 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 for 2011/12 is to finance the majority of capital expenditure from revenue contributions and capital grant. Also, in 2010/11 £3m was borrowed from the PWLB and only £984k of this was used to fund capital expenditure last year, leaving £2,016k available to fund the 2011/12 and 2012/13 capital programmes.

2.11 The strategy also states that up to £2m could be borrowed in the current year if it is felt that interest rates are likely to increase – the aim of this strategy would be to avoid higher interest costs over the term of the loan. As at 30 September 2011, no new borrowing has been taken but any opportunities to do this will still be explored before the year end.

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 The strategy included a forecast of interest rates: the bank rate was forecast to increase to 0.75% in September 2011, but has actually remained at 0.5% and is now not forecast to increase to 0.75% until September 2013. The PWLB 10 year fixed loan rate was forecast to be 4.9% for the whole of this year, and is now forecast to be 3.3% by the end of the year (at the time of writing this report, the rate is 3.36%). This is due to the impact of the economic situation as outlined in paragraph 2.4.

2.14 Review of compliance with treasury and prudential limits

The following indicators were approved by Members for the 2011/12 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 2011/12**	**Actual as at 30/09/11**
Estimate of Ratio of Financing Costs to Net Revenue Stream	6.4%	Not available until year end
Estimate of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D)	£1.57	Not available until year end
Estimate of Total Capital Expenditure to be Incurred	£2,804,000	£3,935,000
Estimate of Capital Financing Requirement	£28,078,000	Not exceeded

Operational Boundary	£30,762,000	Not exceeded
Authorised Limit	£33,838,000	Not exceeded
Upper limit for fixed rate interest exposures	100%	100%
Upper limit for variable rate interest exposures	30%	0%
Loan Maturity:	<u>Limits:</u>	
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%	12%
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

2.15 The estimate of total capital expenditure to be incurred is higher than that forecast in the strategy because £1,545k of the 2010/11 capital programme budget was slipped into the current year.

2.16 The lower limit for loans maturing in 10 to 20 years is 20% and this indicator has been breached, with only 12% of debt maturing in this period. This was reported to Members of the Finance and Resources Committee at the meetings on 28 February 2011 and 7 October 2011. The reason for the breach is that it was 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 a revenue contribution of £2.608m was used to finance capital expenditure for 2010/11. This means that the lower limit will continue to be breached until such time as a further loan will be taken. Corrective action should not be taken to resolve the breach, unless such action fits in with other aspects of the treasury management strategy. However, 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 44%.

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. EQUALITIES IMPLICATIONS

An equality impact assessment has not been undertaken because this report details 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.

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TREASURER TO THE FIRE AUTHORITY