NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT ANNUAL REPORT 2011/12

Report of the Treasurer to the Fire Authority

Agenda Item No:

Date: 21 September 2012

Purpose of Report:

To provide Members with an update on treasury management activity during 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 annual report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic review of 2011/12
- A review of Capital Activity during 2011/12 and the impact of this on the Authority's Capital Financing Requirement
- A review of the Investment and Cash Management Strategy during 2011/12.
- Investment and Cash Activity during 2011/12.
- A review of the Year End Investments and Cash Position and Usable Reserves
- A review of the Borrowing Strategy and Borrowing Activity during 2011/12

- A summary 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

Economic Review

2.1 In the UK, growth proved mixed over the year. In quarter 2 GDP growth was 0% but then in quarter 3 growth of 0.6% was seen followed by a return to negative growth in quarter 4. The year finished with prospects for the UK economy looking particularly bleak, due to negative growth in the EU in quarter 4 and a sharp increase in oil prices caused by Middle East concerns. However there were signs of economic growth for some countries outside the EU.

2.2 The UK coalition Government maintained its fiscal stance against the warnings from two credit rating agencies that the UK could lose its AAA credit rating. A key to keeping this credit rating is ensuring strong economic growth in order to reduce the national debt burden to a sustainable level within an austerity plan timeframe. The USA and France lost their AAA ratings from one rating agency during the year. Gilt yields fell until February due to concerns over the EU debt crisis. This resulted in UK Gilts being seen as a safe investment and this, combined with quantatitive easing, combined to depress Public Works Loans Board borrowing rates to historically low levels.

2.3 Investment rates remained low for shorter term deposits during 2011/12 following on from the 2008 financial crisis. However, one month and longer rates improved slightly during the year.

Review of Capital Activity in 2011/12

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.

	2010/11 Actual	2011/12 Estimate	2011/12 Actual
	£000's	£000's	£000's
Capital Expenditure	5,932	4,349	2,879
Resourced By:			
- Capital Grants	946		1,486
- Capital Receipts	0		25
- Revenue Contributions	2,608		1,368
- Internally Financed up to level of MRP	1,449		0
- Borrowing	929		0
Total Financed Capital Expenditure	5,932	4,349	2,879

2.6 Actual capital expenditure was within the prudential indicator set of £4,349k. At 31 March 2012, the Authority's capital financing requirement was £27,372k, which was within the prudential indicator set of £28,078k. 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, building societies 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

During the year Sector advised clients to limit the duration of investments with Eurozone counterparties to 3 months due to the financial crisis affecting Greece and Spain, which had the potential to impact on other Eurozone countries. The Authority immediately followed this advice and continued to follow it for the remainder of the year and beyond.

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 2012. However the bank rate has remained at 0.5% throughout the year and beyond.

<u>Investment and Cash Activity in 2011/12</u>

2.12 As at 31 March 2012, the Authority held £10.5m of principal as short term investments. This comprised 8 separate investments with 7 counterparties, none of which was more than £2m. Two of the investments were with Local Authorities, four were with banks and one held with a building society. At the time of writing this report, six 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 12 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 3 Month LIBID benchmark rate for the year was 0.817%. The Authority's investments earned an average rate of 0.848% during the year resulting in total investment income earned of £112k. 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 2010/11. 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. The loan is shown as a short term investment in the Authority's accounts and as a loan in the trading company's accounts. During 2011/12 £5,000 of the loan was repaid to the Authority.

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 2012, the value of the Authority's usable reserves totalled £10,880k. The balance sheet as at the same date shows that short term investments were valued at £10,582k and cash held totalled £3,218k. 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 2011/12

2.19 The strategy recommended that capital grant and a capital receipt from the sale of Dunkirk Fire Station would be used to finance capital expenditure during 2011/12. Due to the delay in the sale of Dunkirk Fire Station and a revenue budget underspend, further funding was obtained by way of direct revenue contributions.

2.20 No borrowing was undertaken during 2011/12 as £3,000k of borrowing was undertaken in September 2010 for the financing of the capital programme in 2010/11 and 2011/12. Subsequently on 1 April 2011, Members of the Finance & Resources Committee accepted a proposal to bring forward revenue financing of the capital programme for 2010/11 and 2011/12. This meant that £2,000k of the £3,000k loan was not used to finance the capital programme. In September 2012, a £2,000k PWLB will be repaid and this surplus borrowing will be used to fund the repayment.

2.22 The prudential indicator which sets a lower limit for loans maturing in 10 to 20 years is 20% and this indicator has been breached, 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 meant that the lower limit continued to be breached until the end of the financial year. 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 breach was reported to Members of the Finance and Resources Committee during the year as part of Prudential Code monitoring. The indicator has been amended for 2012/13.

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 £33,838k for 2011/12. Total borrowing as at 31 March 2012 was £27,600k, 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 £30,762k for 2011/12, and was not exceeded at any point during the year.

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

2.27 The following indicators were approved by Members for the 2011/12 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 in paragraph 2.22 above.

Treasury or Prudential Indicator or Limit	**Approved for 2011/12**	**Actual for 2011/12**
Estimate of Ratio of Financing Costs to Net Revenue Stream	6.4%	6.3%
Estimate of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D)	£1.57	£0.26
Estimate of Total Capital Expenditure to be Incurred	£4,349,000	£2,879,000
Estimate of Capital Financing Requirement	£28,078,000	£27,372,000 (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:	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. EQUALITIES IMPLICATIONS

An equality impact assessment has not been done because this report gives a review of activities rather than introducing 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