



NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

REVISION TO TREASURY MANAGEMENT STRATEGY 2009/10

Report of the Treasurer to the Fire Authority

Agenda Item No:

Date: 18 December 2009

Purpose of Report:

To seek approval from Members for the revision of the Treasury Management Strategy 2009/10.

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 The Local Government Act 2003 requires the Authority to set out its treasury strategy for borrowing and to prepare an annual investment strategy; this sets out the Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- 1.2 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992 for the Authority to produce a balanced budget. Section 32 requires the Authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to the extent whereby resulting increases in charges to revenue are limited to a level which is affordable within the projected income of the Authority for the foreseeable future.
- 1.3 A report on the Prudential Code for Capital Accounting was approved by Members at the Authority's meeting on 20 February 2009. That report set out the prudential indicators for 2009/10, which are designed to ensure that the Authority's capital investment plans are affordable, prudent and sustainable. This Treasury Management Strategy report is complementary to that Prudential Code report.
- 1.4 The Authority has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management.
- 1.5 The Authority has appointed Sector Treasury Services as treasury adviser. Sector has provided the Authority with its view on anticipated interest rates for the forthcoming year.

2. REPORT

- 2.1 Over the past year or so, the world has seen the sub prime lending crisis in the United States, followed by the banking crisis in the autumn of 2008. The global banking system came near to collapse and governments around the world were forced to recapitalise and rescue their major banks. The resulting withdrawal of lending from banks anxious to preserve capital led to economic forecasts being sharply reduced. This in turn led to falls in oil and other commodity prices with the result that previously rising inflation, which in the UK was running at over 5%, was replaced by fears of recession and global cuts in interest rates.
- 2.2 This position affected the Authority in two ways:
 - i) Interest receipts from lending fell to an all time low, so low in fact that there was little point in lending at all.
 - ii) Available and approved counterparties dwindled to the extent that fewer and fewer institutions meet the lending criteria of the Authority.

- 2.3 A number of Local Authorities had made investments in foreign banks, which began to look increasingly risky and this culminated in the collapse of the banking system in Iceland which left a number of Authorities with huge debts.
- 2.4 The Fire Authority has always followed a very prudent strategy and agreed a Treasury Management Strategy in March 2008. However following the major disturbances in the market, this strategy was tightened to avoid both borrowing and lending by utilising its own internal resources to finance capital spending, thus reducing the levels of actual cash balances. This strategy was perfectly reasonable for the short term but ran the risk of having very low liquidity.
- 2.5 The Head of Finance and Resources has recently reviewed this position and is of the view that it is time to begin to return to more normal levels of borrowing and lending. This is for a number of reasons, but is primarily linked to the recent improvements in financial markets.
- 2.6 Currently the Authority has balances and reserves approaching £6m, although in reality virtually none of this is held as cash or liquid funds. This would therefore fail one of the criteria in the CIPFA code that investments should be liquid.
- 2.7 It is also necessary to consider the possible effect of any squeeze on public sector borrowing which might follow the next general election. If government were to take the view that there should be a freeze on public sector borrowing or a return to previous capital controls the Authority would be placed at significant risk as all of its balances and reserves are currently being used to finance the capital programme rather than being invested. This might mean that the Authority is left with no actual useable balances.
- 2.8 In addition to this the Authority has taken a view on the use of maturity loans instead of annuity loans because they are far more efficient and therefore cheaper.
- 2.9 A maturity loan, as its name suggests, becomes due in full on the date of its maturity, whereas an annuity loan is paid off in annual instalments. There is an assumption therefore that when a loan matures it will either be replaced with another loan or paid off from accumulated cash reserves.
- 2.10 Both of these assumptions are fine providing that there is either continued access to capital by way of loans or actual cash balances.
- 2.11 In order to support the existing capital programme the Authority needs to borrow approximately £6m in 2009/10, however this will only finance the capital programme and will not restore any balances or reserves to cash.
- 2.12 The best indicator of the level of debt that the Authority could have is given by the Capital Financing Requirement which is published annually as part of the prudential code requirements. Currently this stands at £27,419,000 although the operational boundary for prudential purposes has been set at

£25m. This operational boundary included an assumption that £4.2m would be received via a capital receipt for Dunkirk Fire Station so in effect the actual ceiling for debt would have been of the order of £29m without this receipt. Members will be aware that this receipt has not yet been realised.

- 2.13 Currently the Authority's external debt stands at £17m with a further £6m required before March 2010, making a total of £23m. Adding the £6m of balances and reserves which are currently being used to finance some elements of the capital programme to this figure balances back to the £29m figure given above.
- 2.14 Of the balances and reserves, £2.3m is held as earmarked sums. This means that the expenditure on these items is certain, and therefore the Authority really ought to have this "backed" by either liquid funds or cash.
- 2.15 The total debt requirement for 2010/2011 is built up as follows:

	£m
Existing debt 2009/10 (August)	17
Borrowing to finance 2009/10 programme	6
Borrowing to "cash back" reserves	<u>6</u>
	29

- 2.16 If the Authority was to borrow now to cash back all reserves and balances there would probably be a requirement to invest something approaching £6m, with the possibility that £4.2m from the sale of Dunkirk will also be paid in 2010/2011 which would then also require to be invested. It is suggested therefore that the Authority take a more measured approach and seek to "cash back" only the earmarked reserves initially with further borrowing taking place next year.
- 2.17 Essentially what is being proposed is a return to the normal practice of treasury management using the same counterparties as already agreed and still adopting a highly cautious approach.
- 2.18 This differs markedly from the "battered down" approach which has been adopted during 2009/2010 to date, but this is due to changes in market conditions and concerns for future borrowing requirements.
- 2.19 No element of this proposal changes anything within the existing overall strategy as agreed in March 2008.

3. FINANCIAL IMPLICATIONS

There is always a differential between borrowing rates and lending rates which the Authority has been able to take advantage of in recent years. The high credit rating of the Authority makes borrowing very cheap, whereas lending is always at market rates. If this differential continues to work in the Authority's favour then there will be a slight budget gain from this action. This could equally be the other way around but

margins are quite narrow in the market at present so any impacts would be expected to be low

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.

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.

8. RISK MANAGEMENT IMPLICATIONS

There are two areas of risk associated with this proposal, the first being the risk of bad investment. The investment of local authority funds cannot be achieved without some element of risk however, careful choice of borrowers using established and respected indices will minimise this risk. There is also a risk of the Authority not having sufficient liquid funds available when these are required. Under normal circumstances it is usually possible to borrow money fairly quickly from other Local Authorities or the Authority's own bankers, however if borrowing other than for short term cashflows is not allowed then this becomes a significant risk.

9. RECOMMENDATIONS

That Members approve the return to the Treasury Management Strategy originally agreed for 2009/2010 to allow normal prudent borrowing and lending to occur.

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

None.

Peter Hurford
TREASURER TO THE FIRE AUTHORITY