NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT MID YEAR REVIEW 2015/16

Report of the Treasurer to the Fire Authority

Date: 18 December 2015

Purpose of Report:

To provide Members with an update on treasury management activity during the first half of the 2015/16 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. The Code was updated in 2011.

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 2015/16;
- A review of the Treasury Management Strategy Statement ;
- A review of the Authority's investment portfolio for 2015/16;
- A review of the Authority's borrowing strategy for 2015/16;
- A review of compliance with Treasury and Prudential Limits for 2015/16.

1.5 The Authority has appointed Capita Asset Services as its external treasury management adviser.

2. REPORT

ECONOMIC UPDATE

2.1 The 2014 UK GDP growth rate of 2.9% was the strongest since 2006, and the 2015 growth rate is likely to be a leading rate amongst G7 countries. Growth is expected to weaken in quarter 3 of 2015 as the appreciation of Sterling against the Euro and weak growth in the EU, China and emerging markets impacts on UK exports. The Government's austerity programme may also have a dampening effect, although the pace of reductions was eased in the May Budget. Despite this, the Bank of England August Inflation Report included a forecast for growth to remain around 2.4%-2.8% over the next three years. However, falls in business and consumer confidence in September due to an increase in concern for the economic outlook could contribute to a dampening of growth through weakening investment and consumer expenditure. This may lead to the Bank of England cutting its growth forecasts in future Inflation Reports. For the recovery to become more sustainable in the longer term there needs to be a move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure.

2.2 The strong growth in 2012 has resulted in unemployment falling quickly over the last few years. It was recognised that wage inflation needed to rise faster than general inflation in order to make the recovery sustainable, so it is encouraging that wage inflation has risen significantly above CPI inflation during 2015. This reversal of the squeeze on disposable incomes has led to stronger consumer demand, which in turn has supported growth.

2.3 The August Bank of England Inflation Report was subdued in respect of inflation, which was forecast to barely get back up to the 2%. With the current decrease in oil prices and the depression of world commodity prices due to the Chinese economic downturn there could be several more months of low inflation still to come. There are therefore considerable risks around whether inflation will rise in the near future as strongly as had previously been expected. This will make it more difficult for the Bank of England to raise UK interest rates as soon as was being forecast, especially as there are also fears that the volatility seen in equity and bond markets so far in 2015 could potentially spill over to impact on real economies rather than just financial markets.

REVIEW OF THE TREASURY MANAGEMENT STRATEGY

2.4 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;
- Call deposits with Banks and Building Societies.

2.5 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 Capita’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 100 days

2.6 The methodology used by Capita to create creditworthiness ratings has been amended to reflect changes in the methodologies used by the main rating agencies (Fitch, Moody’s and Standard & Poor’s). All three agencies have begun removing the ratings “uplift” that had been provided to some institutions due to implied levels of sovereign support. This is in response to the evolving regulatory regime. In addition to the removal of implied sovereign support, the rating agencies are also taking into account additional factors, such as regulatory capital levels. In keeping with these new methodologies, the credit element of Capita’s credit assessment process now focusses solely on the short and long term ratings of an institution. Other key elements in the process remain unchanged.

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 if the interest rate is favourable.

2.9 In the first half of the year, there were no instances of the bank account being overdrawn.

REVIEW OF THE INVESTMENT PORTFOLIO

2.10 During the first half of the year, a total of 6 investments were made (excluding the overnight sweep to the Business Premium Account). The maximum value placed in any single investment was £2m and the longest duration of 242 days was for a single investment of £900k. The investments were placed with banks and building societies meeting the credit rating criteria shown above. An analysis of investments as at 30 September 2015 revealed that the Authority had £9.9m invested with 5 different institutions at an average interest rate of 0.59%. Of the £9.9m, £7.9m was placed with UK institutions (as defined by the Bank of England Prudential Regulation Authority) and £2m was placed with banks incorporated outside the European Economic Area (EEA) which are authorised to accept deposits through a branch in the UK.

2.11 Investment income earned up to 30 September 2015 totalled £18k. The budgeted target of £76k therefore seems unlikely to be achieved at this stage. This variance is due to lower cash balances than assumed when the budget was set and this is because no new borrowing has yet been taken.

REVIEW OF THE BORROWING STRATEGY

2.12 The strategy for 2015/16 is to use a combination of capital receipts, borrowing and internal funds to finance capital expenditure. Two PWLB loans will mature in the medium term (£2m in 2016/17 and £2m in 2017/18). These will need to be replaced with new borrowing and it is estimated that new borrowing in the period 2015/16 to 2017/18 will be in the region of £13m.

2.13 PWLB interest rate forecasts have fallen during the year, with the forecasted rate for a 25 year loan taken out in March 2016 reducing from 4.00% in February 2015 to 3.70% in November 2015. It is uncertain how long this downward trend will continue, therefore it is likely that the Authority will borrow before the end of the financial year. However, as borrowing rates are higher than current investment rates it is important that the Authority avoids unnecessary carrying costs by not borrowing too far advance of expenditure. It is also possible that rates may continue to fall beyond March 2016. For this reason, borrowing in latter half of 2015/16 is likely to be restricted to between £2m and £4m of the £13m required in the medium term.

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

2.15 All other aspects of the borrowing strategy remain in place at this mid-point in the year.

REVIEW OF COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

2.16 The following indicators were approved by Members for the 2015/16 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 2015/16	Actual as at 30/09/15
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.3%	Not available until year end
Estimate of the Incremental Impact of the New Capital Investment Decisions on the Council Tax (Band D)	£0.18	Not available until year end
Estimate of Total Capital Expenditure to be Incurred (including slippage)	£6,482,000	£5,882,000
Estimate of Capital Financing Requirement	£27,981,000	Not exceeded
Operational Boundary	£28,076,000	Not exceeded
Authorised Limit	£30,883,000	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%	9.80%
12 months to 5 years	Upper 30% Lower 0%	30.31%
5 years to 10 years	Upper 75% Lower 0%	16.28%
10 years to 20 years	Upper 100% Lower 0%	0.00%
Over 20 years	Upper 100% Lower 30%	43.61%
Upper Limit for Principal Sums Invested for Periods Longer than 364 Days	£2,000,000	Not applicable

The table above shows that a slight breach of the 12 months to 5 years limit has occurred in the first half of the year. This is because no new borrowing has taken place following the maturing of a PWLB loan in September 2014, so Officers have not had an opportunity to re-balance the maturity profile. The breach will be addressed when a new loan is next taken.

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.

Neil Timms
TREASURER TO THE FIRE AUTHORITY