NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT ANNUAL REPORT 2015/16

Report of the Treasurer to the Fire Authority

Agenda Item No:

Date: 23 September 2016

Purpose of Report:
To provide Members with an update on treasury management activity during 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 in 2011) 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 2015/16
- A review of Capital Activity during 2015/16 and the impact of this on the Authority's Capital Financing Requirement
- A review of the Investment and Cash Management Strategy during 2015/16
- Investment and Cash Activity during 2015/16.
- A review of the Year End Investments and Cash Position and Usable Reserves
- A review of the Borrowing Strategy and Borrowing Activity during 2015/16

- A summary 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 Review

2.1 The original expectation of the market was that the Bank Rate would rise in the second quarter of the 2015/16 financial year, but the forecasted rise was soon moved back to the final quarter. However, by the end of the 2015/16 financial year market expectations had changed yet again, with the expected rate rise being moved back to the first quarter of 2018/19. This change was due to a number of factors, including concerns over slowing economic growth in China, the continuation of the collapse in oil prices during 2015, and continuing Eurozone growth uncertainties. These concerns have caused sharp market volatility in equity prices during the year, with corresponding impacts on bond prices and bond yields as investors sought to move funds to safe havens. The Bank Rate therefore remained at 0.5% for the seventh successive year.

2.2 Economic growth (GDP) fell steadily from an annual rate of 2.9% in quarter 1 2015 to 2.1% in quarter 4.

2.3 The sharp volatility in equity markets during the year was reflected in sharp volatility in bond yields. However, the overall dominant trend in bond yields since July 2015 has been for yields to fall to historically low levels as forecasts for inflation have repeatedly been revised downwards and expectations of increases in central rates have been pushed back.

2.4 The European Central Bank commenced a quantitative easing (QE) programme in March 2015. This put downward pressure on Eurozone bond yields. There was a further increase in the programme of QE in December 2015.

2.5 The US economy has continued to grow as a result of consumer demand. The US central rate increased in December 2015, but concerns around the risks to world growth meant that expectations around further rate rises were pushed back.

2.6 The UK elected a majority Conservative Government in May 2015 which increased political stability in the short term, but the promise of a referendum on the UK remaining part of the European Union led to an increase in economic uncertainty. The government maintained its tight fiscal policy stance, but the more recent downturn in expectations for economic growth has made it more difficult to return the public sector net borrowing to a balanced annual position within the period of this parliament.

Review of Capital Activity in 2015/16

2.7 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.

2.8 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.

	2014/15 Actual	2015/16 Estimate	2015/16 Actual
	£000's	£000's	£000's
Capital Expenditure	4,467	6,482	5,282
Resourced By:			
- Capital Grants	1,534		440
- Capital Receipts	2,180		30
- Revenue Contributions	0		109
- Internally Financed	753		4,703
- Borrowing	0		0
Total Financed Capital Expenditure	4,467		5,282

2.9 The 2015/16 prudential indicator for Estimate of Total Capital Expenditure to be incurred was £4,869k, and this indicator excluded any capital slippage from 2014/15. The actual amount of slippage from 2014/15 was £3,075k, so the amount of capital expenditure excluding slippage was £2,207k which is within the prudential indicator. At 31 March 2016, the Authority's capital financing requirement was £25,758k, which was within the prudential indicator set of £27,981k. 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

2.10 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
- Call deposits with Banks and Building Societies
- Triple-A rated Money Market Funds
- UK Treasury Bills

During the year, all investments were made with banks, building societies (either term deposits or call deposits) and other local authority bodies.

2.11 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 Capita's weekly credit list of potential counterparties. The Capita 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 100 days

The Authority has made all investments with counterparties during the year in accordance with the maximum periods advised by Capita.

2.12 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 seem worthwhile.

2.13 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 current account balances in the Business Premium Account on a daily basis if the interest rate is favourable.

2.14 All aspects of the treasury management strategy outlined for 2015/16 remained in place throughout the year. The Strategy included a forecast for the bank rate, which showed that this was expected to be at 0.75% by 31 March 2016. The bank rate has remained at 0.5% throughout the year due to reasons outlined in paragraph 2.1.

Investment and Cash Activity in 2015/16

2.15 As at 31 March 2016, the Authority held £5.485m of principal as short term investments. This comprised 5 separate investments with 3 different counterparties, all of which were £2m or less. Four of the investments were call accounts held with one bank and one building society, and one was an overnight investment in the Business Premium Account. At the time of writing this report, the amounts held in the four call accounts were unchanged.

2.16 During the course of the year, 13 investments were made, excluding the overnight sweep to the Business Premium Account. None of these exceeded £2m in value. 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. The majority of investments were held for less than 365 days, however two of the call accounts were held for more than 1 year. These two call accounts have notice periods of 1 day and 95 days respectively, and their creditworthiness was continually monitored against Capita's credit listings. Had it looked likely that the maximum recommended investment term for these institutions would have fallen below the call account notice period, then the funds would have been withdrawn.

2.17 The 3 Month LIBID benchmark rate for the year was 0.46%. The Authority's investments earned an average rate of 0.64% during the year resulting in total investment (including overnight savings interest on the current account) income earned of £50k, against a budgeted sum for investment income of £76k.

2.18 Nottinghamshire Fire and Rescue Service (Trading) Limited was set up as a subsidiary company during 2010/11 (the name of the company changed on 1 April 2016 to Nottinghamshire Fire Safety Limited). 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 the company in the form of a revolving credit facility which can be repaid at any time with one week's notice by either party. An arms-length variable interest rate was agreed at 15 basis points above the Bank of England bank rate. The loan was shown as a short term investment in the Authority's accounts and as a loan in the trading company's accounts. During 2015/16 the outstanding loan balance of £19,999 was repaid in full.

2.19 During the year, there was no requirement to use the Authority's overdraft facility.

<u>Review of Investments / Cash Position and Usable Reserves</u>

2.20 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. Following the "credit crunch" in 2008 a decision was taken 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. Furthermore, investment interest rates have been substantially lower than debt interest rates so the use of reserves rather than borrowing to finance capital expenditure over the past three years has resulted in better value for money in the short term.

2.21 At 31 March 2016 the value of the Authority's usable reserves totalled £11.243m. The balance sheet as at the same date shows that short term investments were valued at £3.415m and cash held totalled £2.101m. This means that reserves are not fully cash-backed to the tune of £5.727m which has increased from £3.477m at the end of 2014/15. This situation has arisen because no new borrowing has been taken since 2010, so capital expenditure has largely been internally financed. The Authority's treasury management advisers have indicated that borrowing should be delayed if cash flow allows for this, due to the differential between borrowing and investment interest rates mentioned in paragraph 2.20 above. This approach has generated significant savings for the Authority. The average rate for a PWLB 25 year maturity loan was 3.55% during 2015/16, whilst the average weight of return on investments was 0.64%. The Authority therefore saved around 2.91% by internally borrowing, which equates to approximately £166k on a balance of £5.727m. Members can 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, and borrowing can be arranged at short notice if required.

Review of the Borrowing Strategy and Borrowing Activity in 2015/16

2.22 The strategy recommended that a combination of capital receipts, capital grant, internal funds and borrowing would be used to finance capital expenditure during 2015/16. Capital grants totalling £440k and capital receipts of £30k were applied to finance expenditure.

2.23 No borrowing was undertaken during 2015/16 as explained in paragraph 2.21.

2.24 The treasury management limits to loan maturity were set in 2015/16 and are shown below:

Loan Maturity		
	Upper Limit	***Lower Limit***
Under 12 months	20%	0%
12 months to 5 years	30%	0%
5 years to 10 years	75%	0%
10 years to 20 years	100%	0%
Over 20 years	100%	30%

2.25 No rescheduling of debt took place, as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

2.26 The Authorised Limit is the affordable borrowing limit above which the Authority does not have the power to borrow. This was set at £30.883m for 2015/16. Total borrowing as at 31 March 2016 was £20.337m, which was well within the Authorised limit.

2.27 The Operational Boundary is the expected borrowing position of the Authority within the year. This was set at £28.076m for 2015/16, and was not exceeded at any point during the year.

Summary of compliance with treasury and prudential limits

2.28 The following indicators were approved by Members for the 2015/16 financial year. Actual performance is shown in the final column of the table below.

2.29 The indicator for the Ratio of Financing Costs to Net Revenue Stream shows an actual result of 4.6% compared to an estimated ratio of 5.3%.

2.30 The indicator for the Incremental Impact of New Capital Investment Decisions on Council Tax shows an actual result of -£0.29 (i.e. a reduction in impact) compared to an estimate of £0.18. The result for this indicator was affected by underspending capital financing budgets in 2015/16. The minimum revenue provision charges were lower than anticipated due to an underspent capital programme in 2014/15. The budget for interest charges underspent because a decision was made to delay the replacement of a loan which matured in 2014/15 and to delay further borrowing until economic circumstances become more favourable.

2.31 The table below shows that the limit for 12 months to 5 years loan maturity has once again been breached, with the proportion of debt within this maturity band being 49.9%. This is due to two reasons, the first of which being that no new borrowing has taken place since 2010 which has meant that the opportunity to re-balance the debt maturity profile could not be taken. The second reason is that the interest rate of the £4m Lender Option Borrower Option loan held by the Authority can be revised by the lender at five year intervals, with the next opportunity for revision being in March 2018. If the lender chooses to exercise this option then the Authority could choose to repay the loan if the newly offered interest rate is not advantageous. This loan is therefore categorised as maturing in March 2018 for the purposes of calculating the loan maturity prudential indicator, even though it is extremely unlikely that the lender will exercise their option and so the loan agreement will almost certainly continue beyond this period. This same issue has resulted in a breach of the indicator for debt with a loan maturity of over 20 years (24.1% against a lower limit of 30%). Members can be assured that neither of these issues poses a risk for the Authority.

Treasury or Prudential Indicator or Limit	**Approved for 2015/16**	**Actual for 2015/16**
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.3%	4.6%
Estimate of the Incremental Impact of New Capital Investment Decisions on the Council Tax (Band D)	£0.18	-£0.29
Estimate of Total Capital Expenditure to be Incurred	£4,869,000	£5,282,000
Estimate of Capital Financing Requirement	£27,981,000	£25,758,000
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:	Limits:
Under 12 months	Upper 20% Lower 0%	9.8%
12 months to 5 years	Upper 30% Lower 0%	49.9%
5 years to 10 years	Upper 75% Lower 0%	16.1%
10 years to 20 years	Upper 100% Lower 0%	0%
Over 20 years	Upper 100% Lower 30%	24.1%
Upper Limit for Principal Sums Invested for Periods Longer than 364 Days	£2,000,000	£2,000,000

Update on the Sovereign Credit Rating for Investments

2.32 When approving the Treasury Management Strategy for 2016/17, The Authority determined that it would only use approved counterparties for investments from countries with a minimum sovereign credit rating of AA from Fitch Ratings. This provided an opportunity to invest with banks and institutions from a number of countries, including the U.K. which was rated AA+ by Fitch at the time the strategy was approved.

2.33 Following the outcome of the EU Referendum in June 2016 and the resulting economic and political uncertainty, Fitch downgraded the sovereign rating of the UK by one notch on 28th June 2016 to AA, the minimum approved rating within the Authority's current investment strategy as highlighted above. The ratings agency also placed the UK on "negative outlook" which raises the potential for the agency to downgrade the UK further within the next eighteen months, if the economic outlook for the UK deteriorates. This issue will be considered at the next meeting of the Finance and Resources Committee.

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

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.

NEIL TIMMS
TREASURER TO THE FIRE AUTHORITY