NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT ANNUAL REPORT 2016/17

Report of the Treasurer to the Fire Authority

Date: 22 September 2017

Purpose of Report:

To provide Members with an update on treasury management activity during the 2016/17 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 2016/17
- A review of Capital Activity during 2016/17 and the impact of this on the Authority's Capital Financing Requirement
- A review of the Investment and Cash Management Strategy during 2016/17
- Investment and Cash Activity during 2016/17.
- A review of the Year End Investments and Cash Position and Usable Reserves
- A review of the Borrowing Strategy and Borrowing Activity during 2016/17
- A summary of compliance with Treasury and Prudential Limits for 2016/17.

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

2. REPORT

ECONOMIC REVIEW

2.1 Two major events had a significant impact on financial markets during 2016/17: the UK EU referendum on 23 June 2016 and the election of President Trump in the USA on 9 November 2016. The outcome of the EU referendum immediately affected market expectations of when the first increase in the bank rate would happen, pushing it back from quarter 3 2018 to quarter 4 2018. At its meeting on 4 August the Monetary Policy Committee (MPC) cut the bank rate from 0.5% to 0.25%, and the Bank of England's Inflation Report produced forecasts warning of a major shock to economic activity in the UK which would cause economic growth to fall almost to zero in the second half of 2016. The MPC also warned that it would be considering cutting the bank rate again towards the end of 2016 in order to support growth. In addition, it restarted quantitative easing with purchases of £60bn of gilts and £10bn of corporate bonds, and also introduced the Term Funding Scheme whereby cheap financing was made available to banks in order to encourage them to pass on the cuts in the bank rate to their customers.

2.2 In the second half of 2016 the UK economy confounded the Bank of England's pessimistic forecasts. After growth in quarter 1 of just +0.2% the three subsequent quarters came in at +0.6%, +0.5% and +0.7%. Overall annual growth in 2016 was +1.8% compared with 2015, and the UK had one of the fastest growth rates amongst the G7 countries. As a result of this the MPC did not make any further cuts to the bank rate, however inflation has risen rapidly due to the effects of the sharp devaluation of sterling after the referendum.

2.3 US Treasury yields have risen sharply since the election of President Trump due to promises of fiscal stimuli which are likely to increase growth and also raise inflationary pressures in the USA. On the other hand, bond yields in the EU have been depressed due to the European Central Bank (ECB) cutting rates into negative territory and carrying out major quantitative easing during 2016/17 in order to boost growth and get inflation up from near zero towards the target of 2%. As a result of the action taken by the ECB, economic growth has improved significantly in the Eurozone to an overall figure of 1.7% for 2016. Gilt yields in the UK have been caught between US and EU influences and the result is that the gap in yields between US Treasury bonds and UK gilts has widened sharply during 2016/17 due to market perceptions that the UK is likely to be two years behind the US in starting on an upswing in rates.

REVIEW OF CAPITAL ACTIVITY IN 2016/17

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.

	2015/16 Actual	2016/17 Estimate	2016/17 Actual
	£000's	£000's	£000's
Capital Expenditure	5,282	4,505	2,048
Resourced By:			
- Capital Grants	440		7
- Capital Receipts	30		2,041
- Revenue Contributions	109		0
- Internally Financed	4,703		6
- Borrowing	0		0
Total Financed Capital Expenditure	5,282		2,048

2.6 The 2016/17 prudential indicator for Estimate of Total Capital Expenditure to be Incurred was £4,505k, and this indicator included assumed capital slippage from 2015/16 of £2,541k. The actual amount of slippage from 2015/16 was £4.2m, however the 2016/17 capital programme underspent significantly. The actual amount of capital expenditure incurred in 2016/17 (£2,048k) is well within the prudential indicator. As at 31 March 2017, the Authority's capital financing requirement was £23,885k, which was within the prudential indicator set of £29,190k. 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
- Call deposits with Banks and Building Societies
- Triple-A rated Money Market Funds
- UK Treasury Bills
- Certificates of Deposit

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

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

2.11 All aspects of the treasury management strategy outlined for 2016/17 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 2017. The bank rate was reduced from 0.5% to 0.25% in August 2016 due to reasons outlined in paragraph 2.1.

INVESTMENT AND CASH ACTIVITY IN 2016/17

2.12 As at 31 March 2017, the Authority held £9.49m of principal as short term investments. This comprised 7 separate investments with 6 different counterparties. With the exception of the overnight investment in the Barclays Business Premium Account which was £2.4m, all of the investments were for £2m or less. Five of the investments were call accounts held with three different banks and one building society, and one was a fixed term deposit with the City and County of Swansea. The fixed term deposit was for 31 days and it matured on 27th April 2017. Of the five call accounts held at the end of 2016/17, four are still in place with their balances unchanged at the time of writing this report. One call account which held £1.5m was closed on 31 May.

2.13 During the course of the year, 10 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.

2.14 The 3 Month LIBID benchmark rate for the year was 0.315%. 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 £64k, against a budgeted sum for investment income of £76k.

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

REVIEW OF INVESTMENTS / CASH POSITION AND USABLE RESERVES

2.16 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 few years has resulted in better value for money in the short term.

2.17 At 31 March 2017 the value of the Authority's usable reserves totalled £13.555m. The balance sheet as at the same date shows that short term investments were valued at £6.481m and cash held totalled £3.059m. This means that reserves are not fully cash-backed to the tune of £4.015m, a figure which has decreased from £5.726m at the end of 2015/16. The 2016/17 Treasury Management Strategy set out the Authority's aim to reduce the level of internal borrowing and build up cash balances to ensure that usable reserves are cash-backed to an appropriate level, however the Strategy also made it clear that the timing and rate at which cash balances increased would very much depend on the prevailing economic conditions. Opportunities have arisen during the year for the Authority to borrow from the Public Works Loan Board (PWLB) at extremely low interest rates, and this has allowed the level of internal borrowing to be reduced whilst minimising the "cost of carry" that arises due the differential between borrowing and investment rates. The average rate for a 25 year PWLB maturity loan was 2.92% during 2016/17, whilst the average rate of return on investments was 0.64%. The Authority has therefore saved around 2.28% through the use of internal borrowing. This equates to £91.5k on a balance of £4.015m. 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 enable it to do so.

REVIEW OF THE BORROWING STRATEGY AND BORROWING ACTIVITY IN 2016/17

2.18 The strategy recommended that a combination of capital receipts, internal funds and borrowing would be used to finance capital expenditure during 2016/17. Capital receipts of £2,041k and capital grant of £7k were applied to finance expenditure.

2.19 In May 2016 the Authority took a 3 month loan of £4m from Cumbia County Council at a rate of 0.48%. The total interest cost of this loan was £4.8k. It was decided that short term rather than long term borrowing should be taken at that point in the year as it would be more cost effective to delay long term borrowing until a £2m loan matured in September in order to avoid the cost of carry. At the time the short term loan was taken, the Authority held £4m in call accounts. The interest rates on these accounts ranged from 0.6% to 0.95%, so it was better to borrow at 0.48% than to recall investments.

2.20 In August 2016 PWLB rates reached historically low levels, so the Authority was able to secure a £3m 49 year maturity loan at a rate of 1.95%. This loan was partly used to refinance the £2m loan with a rate of 3.41% which matured in September, and it also enabled the Authority to reduce its level of internal borrowing.

2.21 In March 2017 the Authority took a £2m 44.5 year maturity loan from the PWLB at a rate of 2.45%. This further reduced the Authority's level of internal borrowing, and also reduced its average borrowing rate from 3.76% to 3.65% whilst lengthening the duration of the portfolio so it secures longer-term certainty.

2.22 The treasury management limits to loan maturity were set in 2016/17 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%

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

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 £30.829m for 2016/17. Total borrowing as at 31 March 2017 was £23.262m, 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 £28.026m for 2016/17, and was not exceeded at any point during the year.

SUMMARY OF COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

2.25 The following indicators were approved by Members for the 2016/17 financial year. Actual performance is shown in the final column of the table below.

2.26 The indicator for the Ratio of Financing Costs to Net Revenue Stream shows an actual result of 5.2% compared to an estimated ratio of 5.6%. This is largely due to the actual financing costs being £144k lower than estimated. This is because of a £282k underspend on interest costs due to a combination of budgeting later than planned, as well as borrowing at a lower rate than budgeted. This underspend is partially offset by an overspend on the minimum revenue provision (MRP) charge, which was due to capital expenditure for 2015/16 (on which the 2016/17 charge is based) being higher than originally anticipated due to a significant amount of capital expenditure being slipped from previous years.

2.27 The indicator for the Incremental Impact of New Capital Investment Decisions on Council Tax shows an actual result of £0.55, which is in line with the estimate.

2.28 The Authority holds a £4m Lender Option Borrower Option (LOBO) loan which was taken out in 2008. This is due to mature in 2078, however under the terms of this loan the interest rate 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. If the Loan Maturity indicators were to be calculated based on the assumption that the LOBO would mature in 2078, the proportion of loans maturing within 12 months would change from 17.2% to 0.0% and the proportion maturing in 20 years or over would change from 42.6% to 59.8%.

Treasury or Prudential Indicator or Limit	**Approved for 2016/17**	**Actual for 2016/17**
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.6%	5.2%
Estimate of the Incremental Impact of New Capital Investment Decisions on the Council Tax (Band D)	£0.55	£0.55
Estimate of Total Capital Expenditure to be Incurred	£4,505,000	£2,048,000
Estimate of Capital Financing Requirement	£29,190,000	£23,885,000
Operational Boundary	£28,026,000	Not exceeded
Authorised Limit	£30,829,000	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%	17.2%
12 months to 5 years	Upper 30% Lower 0%	27.2%
5 years to 10 years	Upper 75% Lower 0%	13.0%
10 years to 20 years	Upper 100% Lower 0%	0.0%
Over 20 years	Upper 100% Lower 30%	42.6%
Upper Limit for Principal Sums Invested for Periods Longer than 364 Days	£2,000,000	£2,000,000

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. COLLABORATION IMPLICATIONS

There are no collaboration implications arising from this report.

10. RECOMMENDATIONS

That Members note the contents of this report.

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

None.

Geoff Walker
TREASURER TO THE FIRE AUTHORITY