

Annual Treasury Outturn Report 2012/13

1 Purpose

- 1.1 The Fire Authority adopts the key recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice, which includes an annual report on the treasury management strategy after the end of each financial year.

2 Summary

- 2.1 Treasury management in the context of this report is defined as:

“The management of the organisation’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.”

- 2.2 This annual report sets out the performance of the treasury management function during 2012/13, to include the effects of the decisions taken and the transactions executed in the past year.
- 2.3 Overall responsibility for treasury management remains with the Fire Authority. No treasury management activity is without risk; the effective identification and management of risk are integral to the Fire Authority’s treasury management objectives.
- 2.4 All treasury activity has complied with the Fire Authority’s Treasury Management Strategy Statement and Investment Strategy for 2012/13, and all relevant statute, guidance and accounting standards. In addition the Fire Authority’s treasury advisers, Arlingclose, provide support in undertaking treasury management activities.
- 2.5 The prudential and treasury management indicators which are all covered in this report are:
- actual capital financing requirement
 - actual external debt
 - authorised limit and operational boundary for external debt
 - upper limits for fixed interest rate exposure and variable interest rate exposure
 - maturity structure of fixed rate borrowing
 - total principal sums invested for periods longer than 364 days
 - ratio of financing costs to net revenue stream.

3 **Economic background**

- 3.1 The following Section outlines the key economic themes against which investment and borrowing decisions have been made in 2012/13. Despite elements of stability returning to the economy there have been periods of uncertainty, as outlined below, and there remain significant risks that have to be managed.
- 3.2 The global outlook stabilised mainly due to central banks maintaining low interest rates and expansionary monetary policy for an extended period. Equity market assets recovered sharply with the FTSE 100 registering a 9.1% increase over the year. This was despite economic growth in G-7 nations being either muted or disappointing.
- 3.3 In the UK the economy shrank in the first, second and fourth quarters of calendar 2012. It was the impressive 0.9% growth in the third quarter, aided by the summer Olympic Games, which allowed growth to register 0.2% over the calendar year 2012.
- 3.4 The expected boost to net trade from the fall in the value of sterling did not materialise, but raised the price of imports, especially low margin goods such as food and energy. Annual consumer price inflation (CPI) dipped below 3%, falling to 2.4% in June before ticking up to 2.8% in February 2013. Higher food and energy prices and higher transport costs were some of the principal contributors to inflation remaining above the Bank of England's 2% CPI target.
- 3.5 The lack of growth and the fall in inflation were persuasive enough for the Bank of England to maintain the Bank Rate at 0.5% and also sanction additional £50 billion asset purchases (QE) in July, taking total QE to £375 billion. In the March Budget the Bank's policy was revised to include the 2% CPI inflation remit alongside the flexibility to commit to intermediate targets.
- 3.6 The resilience of the labour market, with the International Labour Organisation (ILO) unemployment rate falling to 7.8%, was the main surprise given the challenging economic backdrop. Many of the gains in employment were through an increase in self-employment and part time working.
- 3.7 In March the Office for Budgetary Responsibility (OBR) halved its forecast growth in 2013 to 0.6% which then resulted in the lowering of the forecast for tax revenues and an increase in the budget deficit. The government is now expected to borrow an additional £146bn and sees gross debt rising above 100% of GDP by 2015-16. With the national debt metrics out of kilter with a triple-A rating, it was not surprising that the UK's sovereign rating was downgraded by Moody's in February and more recently by Fitch.
- 3.8 The Euro region suffered a further period of stress when Italian and Spanish government borrowing costs rose sharply and Spain was also

forced to officially seek a bailout for its domestic banks. Markets were becalmed after the ECB's declaration that it would do whatever it takes to stabilise the Eurozone and the central bank's announcement in September of its Outright Monetary Transactions (OMT) facility, buying time for the necessary fiscal adjustments required. Neither the Italian elections which resulted in political gridlock nor the poorly-managed bailout of Cyprus which necessitated 'bailing-in' non-guaranteed depositors proved sufficient for a market downturn. Growth was hindered by the rebalancing processes under way in Eurozone economies, most of which contracted in Q4 2012.

- 3.9 The government's Funding for Lending initiative commenced in August which gave banks access to cheaper funding on the basis that it would then result in them passing this advantage to the wider economy. There was an improvement in the flow of credit to mortgagees, but was still below expectation for SMEs. One direct consequence of the Funding for Lending Scheme was the sharp drop in rates at which banks borrowed from local government. 3-month, 6-month and 12-month Libid rates which were 1%, 1.33% and 1.84% at the beginning of the financial year fell to 0.44%, 0.51% and 0.75% respectively.

4 The borrowing requirement and debt management

	Balance on 31/03/2012 £m	Net new borrowing £m	Balance on 31/03/2013 £m
Capital Financing Requirement	15.879	-1.053	14.826

- 4.1 The Authority's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31/3/2013 was £14.8m. The Authority's borrowing requirement during the year identified in the capital programme was zero.

	Balance on 31/03/2012 £m	Net new borrowing £m	Balance on 31/03/2013 £m
Long Term Borrowing	8.375	-0.007	8.368
Temporary borrowing	0	0	0
Total Borrowing	8.375	-0.007	8.368
Other Long Term Liabilities (excluding provisions)	0.521	-0.269	0.252
Total External Debt	8.896	-0.276	8.620

- 4.2 The indicator for total external debt is obtained directly from the

Authority's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

- 4.3 A cautious approach has been applied in terms of take-up of new borrowing to minimise debt interest payments without compromising the long-term stability of the portfolio. No new external borrowing took place in 2012/13. Internal resources in lieu of external borrowing have been used in order to lower overall treasury risk by reducing both external debt and temporary investments.

5 Investment activity

- 5.1 The Fire Authority has invested according to a low risk, high quality lending list as outlined in the Investment Strategy for 2012/13. The total principal amounts invested (excluding accrued interest) are shown in the table below.

	Balance on 31/03/2012 £m	Balance on 31/03/2013 £m	Average Rate % / Average Life (yrs)
Instant access monies (placed with UK Banks)	4,000	1,900	0.69% (0)
Instant access monies (placed with HCC)	2,068	2,848	0.50% (0)
Short term investments	5,000	15,250	1.00% (0.33)
Long term investments	1,250	1,500	0.85% (1.28)
Total investments	12,318	21,498	0.90% (0.35)

- 5.2 Security of capital remained the Fire Authority's main investment objective. This was maintained by following the Fire Authority's counterparty policy as set out in its Treasury Management Strategy Statement for 2012/13. Investments during the year included:
- deposits in AAA-rated Money Market Funds
 - deposits with UK local authorities
 - call accounts and deposits with banks and building societies systemically important to the UK's banking system.
- 5.3 Counterparty credit quality was assessed and monitored with reference to:

- credit ratings
 - credit default swaps
 - any potential support mechanisms
 - share prices.
- 5.4 The minimum long-term counterparty credit rating determined for the 2012/13 treasury strategy was A-/A3 across rating agencies Fitch, S&P and Moody's. Based on the factors above and advice from the Treasury Management advisors, Arlingclose, the Director of Corporate Resources has varied investment duration limits for new investments according to the assessment of credit risk. At points throughout 2012/13 investment with certain counterparties has been suspended due to concerns about the credit risk that they posed.
- 5.5 The Fire Authority maintained a sufficient level of liquidity through the use of Money Market Funds and the use of call accounts. The Fire Authority sought to optimise returns commensurate with its objectives of security and liquidity. The UK base rate was maintained at 0.5% through the year and short term money market rates remained at very low levels which had a significant impact on cash investment income. The Fire Authority's average cash investment balance was £21.11m during 2012/13, and interest earned was £172,800 leading to an average yield of 0.82%.

6 **Compliance with Prudential Indicators**

- 6.1 The Fire Authority can confirm that it has complied with its Prudential Indicators for 2012/13, which were set in February 2012 as part of the Fire Authority's Treasury Management Strategy Statement. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.
- 6.2 The Fire Authority approved the adoption of the CIPFA Treasury Management Code at its meeting on 18 February 2010. In compliance with the requirements of the Code this section of the report provides Members with a summary of actual performance against each of the Prudential Indicators.

Capital Financing Requirement

- 6.3 The underlying need to borrow for capital purposes, as measured by the Capital Financing Requirement (CFR) is a core driver of treasury management activity. The estimates and actual position as at 31 March 2013 are:

	31/03/2013 Estimate £000	31/03/2013 Actual £000
Total Capital Financing Requirement	14,826	14,826
Less:		
Existing profile of long term borrowing	-8,375	-8,368
Other long term liabilities (excluding provisions)	-252	-252
Gross borrowing requirement	6,199	6,206
Less usable reserves	-23,430	-27,534
Net borrowing requirement / -investment	-17,231	-21,328

Authorised Limit and Operational Boundary for external debt

- 6.4 CIPFA's Code of Practice requires authorities to set an Authorised Limit for external debt, defined as the sum of external borrowing and other long-term liabilities. This is a statutory limit which should not be breached. The Fire Authority's Authorised Limit was set at £21m for 2012/13.
- 6.5 This limit is based on the estimated Capital Financing Requirement (CFR) in order to enable it to be financed entirely from external borrowing should the Fire Authority's internal reserves become depleted. The limit also includes an allowance for temporary borrowing to cover normal revenue cash flow requirements and unexpected outflows or delays in receiving cash.
- 6.6 During 2012/13, the gross borrowing reached a maximum of £8.9m which is within the Authorised Limit of £21m.
- 6.7 The Fire Authority also needs to set an Operational Boundary for external debt. This should reflect the most likely scenario and be consistent with the Fire Authority's capital plans and Treasury Management Strategy. Temporary breaches of the 2012/13 Operational Boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. The Fire Authority approved an Operational Boundary for 2012/13 of £18.4m.
- 6.8 During 2012/13, the gross borrowing reached a maximum of £8.9m which is within the Operational Boundary of £18.4m.

Upper limits for fixed interest rate exposure and variable interest rate exposure

- 6.9 These indicators allow the Fire Authority to manage the extent to which it is exposed to changes in interest rates.
- 6.10 The Fire Authority has to set an upper limit on its fixed interest rate exposure, which is expressed in terms of the maximum long-term fixed-rate principal sums which can be outstanding on any day in each year. The Fire Authority approved an upper limit on fixed interest rate exposure for 2012/13 of £18.4m.
- 6.11 During 2012/13, the long-term fixed-rate principal sums outstanding reached a maximum of £8.9m which is within the upper limit on fixed interest rate exposure of £18.4m.
- 6.12 The Fire Authority also has to set an upper limit on its variable interest rate exposure. The Fire Authority approved an upper limit on variable interest rate exposure for 2012/13 of £18.4m, which is based on the Operational Boundary and has been set to give the Fire Authority maximum policy flexibility. The limit enables the potential for a refinancing from, e.g. fixed to variable rate borrowing.
- 6.13 During 2012/13, the variable interest rate temporary borrowing from Hampshire County Council reached a maximum of £265,000 which is within the upper limit on variable interest rate exposure of £18.4m.

Maturity structure of fixed rate borrowing

- 6.14 The Code also requires the Fire Authority to set upper and lower percentage limits on the maturity structure of its long-term fixed rate borrowing during 2012/13. The following table shows the limits approved by the Fire Authority. These have been set in order to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio.

	Upper limit (%)	Lower limit (%)	Actual (%)
Under 12 months	50	0	0
12 to 24 months	50	0	0
24 months to 5 years	50	0	0
5 years to 10 years	75	0	29
10 years to 20 years	75	0	29
20 years to 30 years	75	0	42
30 years to 40 years	100	0	0
40 years and above	100	0	0

- 6.15 The Fire Authority's long-term fixed rate borrowing during 2012/13 has not breached these set limits.

Total principal sums invested for periods longer than 364 days

- 6.16 For 2012/13, the Fire Authority originally set an upper limit of £2m on investments for periods longer than one year in February 2012. On setting the Treasury Management Strategy Statement for 2013/14 in February 2013, the opportunity was taken to revise the upper limit for 2012/13 to £5m.
- 6.17 This indicator allows the Fire Authority to manage the risk inherent with longer term investments, and lending for longer than 364 days and up to a maximum of two years is currently restricted to UK local authorities only (including police and fire authorities).
- 6.18 The Fire Authority's long-term investments during 2012/13 have not breached the limit in place.

Capital Expenditure

- 6.19 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and in particular to consider the impact on Council tax.

	2012/13 Approved	2012/13 Actual	31/03/14 Estimate	31/03/15 Estimate
	£m	£m	£m	£m
Capital Expenditure	4,156	2,668	5,160	6,606

- 6.20 Capital expenditure has been and will be financed or funded as follows:

Capital Financing	2012/13 Approved	2012/13 Actual	31/03/14 Estimate	31/03/15 Estimate
	£000	£000	£000	£000
Capital receipts	0	0	1,054	1,970
Government Grants	2,131	1,402	2,179	1,450
Capital payments reserve	358	0	229	2,486
Revenue contributions	1,664	1,266	1,698	700
Capital contributions	3	0	0	0
Total Financing	4,156	2,668	5,160	6,606

Capital Financing	2012/13 Approved	2012/13 Actual	31/03/14 Estimate	31/03/15 Estimate
	£000	£000	£000	£000
Supported borrowing	0	0	0	0
Unsupported borrowing	0	0	0	0
Total Funding	0	0	0	0
Total Financing and Funding	4,156	2,668	5,160	6,606

6.21 The table shows that the capital expenditure plans of the Authority could be funded entirely from sources other than external borrowing.

Ratio of financing costs to net revenue stream

6.22 The ratio of financing costs to the net revenue stream shows the estimated annual revenue costs of borrowing (interest payable on debt plus the minimum revenue provision for repaying the principal less interest on balances) as a percentage of the amount in the draft revenue budget to be met from central government grant and by local taxpayers. Actual figures for 2011/12 and 2012/13 together with the estimate for 2012/13 are set out in the table below.

	2011/12 Actual £000	2012/13 Estimate £000	2012/13 Actual £000
Financing costs	68,678	70,468	70,468
Net revenue stream	1,404	1,409	1,239
Ratio	2.0%	2.0%	1.8%