

1. Purpose

- 1.1. Hampshire Fire & Rescue 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 2014/15, 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 & Rescue Authority. No treasury management activity is without risk; the effective identification and management of risk are integral to the Fire & Rescue Authority’s treasury management objectives.
- 2.4. All treasury activity has complied with the Fire & Rescue Authority’s Treasury Management Strategy and Investment Strategy for 2014/15, and all relevant statute, guidance and accounting standards. In addition the Fire & Rescue Authority’s treasury advisers, Arlingclose, provide support in undertaking treasury management activities.
- 2.5. The Fire & Rescue Authority has complied with all prudential indicators set in its Treasury Management Strategy; these are detailed fully in Appendix 1.

3. Economic Background

Growth and Inflation

- 3.1. The robust pace of GDP growth of 3% in 2014 was underpinned by a buoyant services sector, supplemented by positive contributions from the production and construction sectors. Resurgent house prices, improved consumer confidence and healthy retail sales added to the positive outlook for the UK economy given the important role of the consumer in economic activity.
- 3.2. Annual CPI inflation fell to zero for the year to March 2015, down from 1.6% a year earlier. The key driver was the fall in oil prices (which fell to \$44.35 a barrel; a level not seen since March 2009) and a steep drop in wholesale energy prices with extra downward momentum coming from supermarket competition resulting in lower food prices. Bank of England Governor, Mark Carney, wrote an open letter to the Chancellor in February, explaining that the Bank expected CPI to temporarily turn negative, but rebound around the end of 2015 as the lower prices dropped out of the annual rate calculation.

Labour Market

- 3.3. The UK labour market continued to improve and remains resilient across a broad base of measures including real rates of wage growth. January 2015 showed a headline employment rate of 73.3%, while the rate of unemployment fell to 5.7% from 7.2% a year earlier. Comparing the three months to January 2015 with a year earlier, employee pay increased by 1.8% including bonuses and by 1.6% excluding bonuses.

UK Monetary Policy

- 3.4. The Bank of England's Monetary Policy Committee (MPC) maintained interest rates at 0.5% and asset purchases (quantitative easing) at £375bn. Its members held a wide range of views on the response to zero CPI inflation, but just as the MPC was prepared to look past the temporary spikes in inflation to nearly 5% a few years ago, they felt it appropriate not to get panicked into responding to the current low rate of inflation. The minutes of the MPC meetings reiterated the Committee's stance that the economic headwinds for the UK economy and the legacy of the financial crisis meant that increases in the Bank Rate would be gradual and limited, and below average historical levels.
- 3.5. Arlingclose's expectation for the first rise in official interest rates remains quarter 2 of 2016. The risks to this forecast remain weighted to the downside; in particular, signs of more widespread deflation or political uncertainty could prompt a further downward revision to the forecast. Arlingclose projects a slow rise in the Bank Rate. The pace of interest rate rises will be gradual and the extent of rises limited.
- 3.6. A continuation of Base Rates being held at record lows has limited the return that can be made for investment balances. Despite positive economic indicators there remain risks for investors due to the UK banks 'bail-in' legislation. The credit risk associated with making unsecured bank deposits will increase relative to the risk of other investment options available to the Fire & Rescue Authority. Whilst the likelihood of suffering a loss from the default of a bank remains relatively unchanged, the 'bail-in' regime has significantly increased the impact a default would have in terms of the scale of loss the Fire & Rescue Authority could be exposed to.

4. Local Context

- 4.1. At 31/03/2015 the Fire & Rescue Authority's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £13.3m, while usable reserves and working capital which are the underlying resources available for investment were £34.5m.
- 4.2. At 31/03/2015, the Fire & Rescue Authority had £8.35m of borrowing and £34.4m of principal invested. The Fire & Rescue Authority's current strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing.
- 4.3. The Fire & Rescue Authority has a reducing CFR and its capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall as capital receipts are used to finance capital expenditure and reserves are used to finance the revenue and capital budget.

5. Borrowing Strategy

- 5.1. At 31/03/2015 the Fire & Rescue Authority held £8.35m of loans, (this position has not changed since 31/03/2014) as part of its strategy for funding previous years' capital programmes.
- 5.2. The Fire & Rescue Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Fire & Rescue Authority's long-term plans change being a secondary objective.
- 5.3. Affordability and the "cost of carry" remained important influences on the Fire & Rescue Authority's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained, and are likely to remain at least for the next two years, lower than long-term rates, the Fire & Rescue Authority determined it was more cost effective in the short-term to use internal resources instead of taking out new borrowing.
- 5.4. The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose assists the Authority with the monitoring of internal and external borrowing.

Table 1: Borrowing Activity in 2014/15

	Balance on 31/03/2014 £m	New net borrowing £m	Balance on 31/03/2015 £m	Average Rate %
CFR	14.00		13.26	
Long Term Borrowing	8.35	-	8.35	4.71%
TOTAL EXTERNAL DEBT	8.35	-	8.35	4.71%
Increase / (Decrease) in Borrowing £m			-	

Debt Rescheduling

- 5.4.1. The premium charge for early repayment of Public Works Loan Board (PWLB) debt remained relatively expensive for the loans in the Authority's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

Abolition of the PWLB

- 5.5. In January 2015 the Department of Communities and Local Government (CLG) confirmed that HM Treasury (HMT) would be taking the necessary steps to abolish the PWLB. HMT has confirmed however that its lending function will continue unaffected and local authorities will retain access to borrowing rates which offer good value for money. The Authority intends to use the PWLB's replacement as a potential source of borrowing if required.

6. Investment Activity

- 6.1. The European Parliament approved the EU Bank Recovery and Resolution Directive (BRRD) on 15 April 2014. The combined effect of the BRRD and the UK's Deposit Guarantee Scheme Directive (DGSD) is to promote deposits of individuals and SMEs above those of public authorities, large corporates and financial institutions. Other EU countries, and eventually all other developed countries, are expected to adopt similar approaches in due course.
- 6.2. The outlawing of bail-outs, the introduction of bail-ins, and the preference being given to large numbers of depositors rather than local authorities including Fire & Rescue Authorities, means that the risks of making unsecured deposits rose relative to other investment options. Towards the end of 2014/15, the Fire & Rescue Authority therefore increasingly favoured secured investment options or diversified alternatives such as covered bonds, non-bank investments and pooled funds over unsecured bank and building society deposits.
- 6.3. The Fire & Rescue Authority has held invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2014/15 the Fire & Rescue Authority's investment balances have ranged between £28.2 and £41.5 million.
- 6.4. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Fire & Rescue Authority's aim is to achieve a yield commensurate with these principles.

Table 2: Investment Activity in 2014/15

Investments	Balance on 31/03/2014 £m	Balance on 31/03/2015 £m	Average Rate on 31/03/2015	Average Life on 31/03/2015 (years)
Short term Investments (call accounts, deposits) - Banks & Building Societies - Local Authorities	22.50	21.17	0.81%	0.29
Long term Investments - Banks & Building Societies - Local Authorities	3.00	1.50	1.12%	1.34
Money Market Funds	0.00	6.97	0.46%	0.00
Other Pooled Funds	0.00	2.00	2.09% ¹	n/a
Corporate Bonds (unsecured)	0.00	2.80	0.71%	0.55
TOTAL INVESTMENTS	25.50	34.44	0.82%	0.44
Increase/ (Decrease) in Investments (£m)		8.94		

- 6.5. During 2014/15, the Fire & Rescue Authority diversified its range of investments in order to reduce the risk of loss of funds. Over the year the Fire

¹ Rate of return based on 7 months of monthly returns.

& Rescue Authority made new investments in certificates of deposits, and investing in money market funds through opening 5 new accounts. The Fire & Rescue Authority also invested in fixed corporate bonds, covered floating rate notes, and a long-term pooled property fund.

- 6.6. The Fire & Rescue Authority invested £2m into a pooled property fund in September 2014, which returned a dividend of 2.09% during 2014/15. There was a reduction in the value of the asset of £38,000 which reflects the difference between the offer price paid in September 2014, and a more prudent bid price used for the valuation in the accounts at 31 March 2015. This loss would only be realised if the investment was sold, however it is planned that this asset would be held as a long-term investment. The rationale for the initial investment of this pooled property fund was to hold the asset for the long term, over which time the value should increase, although some ups and downs are to be expected.
- 6.7. Security of capital has remained the Fire & Rescue Authority's main investment objective. This has been maintained by following the Fire & Rescue Authority's counterparty policy as set out in its Treasury Management Strategy Statements for 2014/15.
- 6.8. Counterparty credit quality was assessed and monitored with reference to credit ratings, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

7. Investment Outturn

- 7.1. The Fire & Rescue Authority maintained a sufficient level of liquidity through the use of call accounts and money market funds. The Fire & Rescue Authority sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate has been maintained at 0.5% since March 2009 and short-term money market rates have remained at relatively low levels which continued to have a significant impact on cash investment income.
- 7.2. The Fire & Rescue Authority's average cash balances were £34.7m during the year and interest earned for the year was £327,000, giving a yield of 0.94%.

8. Compliance with Prudential Indicators

- 8.1. The Fire & Rescue Authority confirms compliance with its Prudential Indicators for 2014/15, which were set in February 2014 as part of the Fire & Rescue Authority's Treasury Management Strategy Statement.

9. Treasury Management Indicators

- 9.1. The Fire & Rescue Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures

- 9.2. This indicator is set to control the Fire & Rescue Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed will be:

Table 4 – Interest Rate Exposures

	Approved Limits for 2014/15 £m	Maximum during 2014/15 £m	Compliance with Limits:
Upper limit on fixed interest rate investment exposure	£5m	£5.5m	No
Upper limit on variable interest rate investment exposure	£35m	£38.5m	No
Upper limit on fixed interest rate borrowing exposure	£16m	£8.9m	Yes
Upper limit on variable interest rate borrowing exposure	£16m	£6.0m	Yes

- 9.3. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.
- 9.4. During 2014/15 the upper limits for interest rate investment exposure were breached; £5.5m against a fixed interest rate upper limit of £5.0m, and £38.5m against a variable interest rate upper limit of £35.0m. This was due to the fact that cash balances for the Fire & Rescue Authority were much greater than forecast. In the 2015/16 Treasury Management Strategy these limits have been increased to £17.0m for fixed interest rate investments, and £50.0m for variable interest rate investments.

Maturity Structure of Borrowing

- 9.5. This indicator is set to control the Fire & Rescue Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 5 – Maturity Structure of Borrowing

	Upper	Lower	Actual
Under 12 months	50%	0%	0%
12 months and within 24 months	50%	0%	0%
24 months and within 5 years	50%	0%	1%
5 years and within 10 years	75%	0%	37%
10 years and within 20 years	75%	0%	41%
20 years and above	100%	0%	21%

Principal Sums Invested for Periods Longer than 364 days

- 9.6. The purpose of this indicator is to control the Fire & Rescue Authority's exposure to the risk of incurring losses by seeking early repayment of its

investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

Table 6 – Principal Sums Invested for Periods Longer than 364 days

	2014/15	2015/16	2016/17
Limit on principal invested beyond year end	£5.0m	£5.0m	£5.0m
Actual	£3.5m		

Prudential Indicators 2014/15

The Local Government Act 2003 requires the Fire & Rescue Authority to have regard to CIPFA's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Fire & Rescue Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The Fire & Rescue Authority's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	2014/15 Approved £m	2014/15 Revised £m	2014/15 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m
Total Expenditure	9.0	5.3	3.1	17.9	7.0
Capital Receipts	3.0	1.0	0.0	3.1	0.0
Government Grants	1.7	1.9	0.7	4.0	0.0
Capital Payments Reserve	3.2	0.0	0.0	6.2	6.0
Revenue Contributions	1.1	2.4	2.4	2.2	1.0
Capital Contributions	0.0	0.0	0.0	2.4	0.0
Total Financing	9.0	5.3	3.1	17.9	7.0

Estimates of Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Fire & Rescue Authority's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.15 Approved £m	31.03.15 Actual £m	31.03.16 Estimate £m	31.03.17 Estimate £m
General Fund	13.3	13.3	12.7	12.2

The CFR is forecast to fall by £1.1m over the next three years as capital expenditure financed by debt is outweighed by resources put aside for debt repayment.

Gross Debt and the Capital Financing Requirement

In order to ensure that over the medium term debt will only be for a capital purpose, the Fire & Rescue Authority should ensure that debt does not, except in the short

term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	31.03.15 Approved £m	31.03.15 Revised £m	31.03.15 Actual £m	31.03.16 Estimate £m	31.03.17 Estimate £m
Borrowing	8.4	8.4	8.4	8.4	8.4
Finance leases	0.3	0.1	0.1	0.0	0.0
Total Debt	8.7	8.5	8.5	8.4	8.4

Total debt is expected to remain below the CFR during the forecast period.

The actual debt levels are monitored against the Operational Boundary and Authorised Limit for External Debt, below.

Operational Boundary for External Debt

The operational boundary is based on the Fire & Rescue Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Operational Boundary	2014/15 Approved £m	2014/15 Revised £m	2014/15 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m
Borrowing	15.7	16.0	8.4	15.5	15.0
Finance leases	0.3	0.1	0.1	0.0	0.0
Total Debt	16.0	16.1	8.5	15.5	15.0

Authorised Limit for External Debt

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Fire & Rescue Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2014/15 Approved £m	2014/15 Revised £m	2014/15 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m
Borrowing	18.5	18.7	8.4	18.2	17.7
Finance leases	1.0	0.1	0.1	0.0	0.0
Total Debt	19.5	18.8	8.5	18.2	17.7

Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2014/15 Approved %	2014/15 Revised %	2014/15 Actual %	2015/16 Estimate %	2016/17 Estimate %
General Fund	1.37%	1.30%	1.30%	1.22%	1.32%

Incremental Impact of Capital Investment Decisions

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	2014/15 Approved £	2014/15 Actual £	2015/16 Estimate £	2016/17 Estimate £
General Fund - increase in annual Band D Council Tax	1.25	1.41	2.51	1.63

Adoption of the CIPFA Treasury Management Code

The Fire & Rescue Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* on 18 February 2010.