ESSEX FIRE AUTHORITY
Essex Countv Fire & Rescue Service

MEETING	**Audit, Governance & Review Committee**	AGENDA ITEM	**12**
MEETING DATE	18 January 2017	REPORT NUMBER	**EFA/012/17**
SUBJECT	**Mid-Year Treasury Management Report**		
REPORT BY	The Finance Director & Treasurer		
PRESENTED BY	The Finance Director and Treasurer, Mike Clayton		

SUMMARY

In accordance with the requirements of the CIPFA Code of Practice on Treasury Management, a set of indicators were approved by the Authority in February 2016, which are intended to demonstrate that capital investment plans are affordable, and that consequential borrowing will be based upon sound treasury management strategy. The Code of Practice requires these indicators to be monitored and reviewed on a rolling basis. The purpose of this report is therefore to report on the Authority's performance in the first eight months of 2016/17 against these indicators.

RECOMMENDATIONS

It is recommended that Members of the Audit, Governance and Review committee:

1. Note the treasury management position for 2016/17; and

2. Note performance against the treasury management indicators for 2016/17.

BACKGROUND

There are two separate and distinct elements to capital financing that need to be provided for in the Authority's budget. The first is the requirement to finance the capital expenditure of the Authority from the annual revenue budget. The second issue is the need to fund the cash requirements for capital expenditure when payments fall due. This report deals with both aspects of capital financing.

Funding Capital Expenditure from the Revenue Budget

Within the Authority's revenue budget there is a provision for the annual charge required to fund past capital expenditure. This is known as the Minimum Revenue Provision (MRP) charge for capital financing. This is the amount required for each financial year to ensure that the capital expenditure of the authority is charged against the income and expenditure account and financed through the Authority's income. This financing provision can also come from the Authority's capital receipts (the sale of previously funded assets), or from capital grants received.

For capital expenditure the annual charge for each asset is calculated on a depreciation basis, based on the original cost of the capital expenditure. Unlike the normal depreciation charge the value of the capital financing charge does not alter if the asset's value changes. Prior to 2008 all capital expenditure was financed over a fixed 25 year period.

In 2015/16 we made a statutory provision of £3.6m. The balance of capital expenditure yet to be financed from capital receipts, grants or the revenue expenditure budget was £39.0m at 31 March 2016 and forward projections of the capital financing charges arising from the planned level of capital expenditure are covered in this report.

Cash and Capital Expenditure

Separate considerations apply to the cash funding of capital expenditure as it is incurred. The Authority will generate cash during the year if there is a net underspend against the revenue budget and from any non-cash provisions within the accounts such as the capital financing charge described above.

If capital expenditure exceeds the available cash in any financial year the Authority can borrow the cash required. There are two main sources of cash for local authorities, these are the use of asset leases and secondly the Public Works Loan Board (PWLB). The attractiveness of each option depends on a number of factors including the relative interest rates for the Authority. The interest rates are influenced by market factors including the availability of cash to lenders, longer term government gilt interest rates, the tax regime and availability of tax allowances to commercial lenders etc. The Authority has not used lease finance since 2005, but the position is subject to annual review by the Treasurer.

At 31 March 2016 the Authority had £29.5m of PWLB loans, of which, a loan of £1.5m was repaid in August 2016. At the same time we had £16.2m of cash. The penalties on early repayment of PWLB loans mean that there is a significant cost to the Authority if surplus cash is used to reduce borrowings, whilst the Authority's expenditure plans mean that the cash surplus will be utilised over the next few years.

One part of the cash surplus can be said to equate to the reserves that the Authority has built up from past years underspending against the revenue budget. At 31 March 2016 these reserves totalled £12.2m.

TREASURY MANAGEMENT GUIDANCE

Local Authorities determine their own level of borrowing for capital purposes, based upon their judgement regarding the affordability, prudence and sustainability of that borrowing. The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management underpins this capital financing system to support authorities in taking decisions upon capital investment.

The primary requirements of the Code are:

1. Creation and maintenance of a Treasury Management Policy Statement;

2. Creation and maintenance of Treasury Management Practices which set out how the Policy will be achieved;

3. Adoption of an annual Treasury Management Strategy Statement, including the policy on the minimum revenue provision for capital expenditure funding;

4. Mid-year and annual stewardship reports;

5. Delegation by the Authority of responsibilities – the monitoring of the Strategy is delegated to the Audit Governance and Review Committee.

This report has been prepared in accordance with the code of practice.

TREASURY MANAGEMENT STRATEGY STATEMENT

The Treasury Management Policy Statement was approved by the Authority in February 2016. The Authority regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Authority.

The statement identified 12 Treasury Management Practices

- TMP1 Risk management;
- TMP2 Performance measurement;
- TMP3 Decision-making and analysis;
- TMP4 Approved instruments, methods and techniques;
- TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements;
- TMP6 Reporting requirements and management information arrangements;
- TMP7 Budgeting, accounting and audit arrangements;
- TMP8 Cash and cash flow management;
- TMP9 Money laundering;
- TMP10 Training and qualifications;
- TMP11 Use of external service providers; and
- TMP12 Corporate governance.

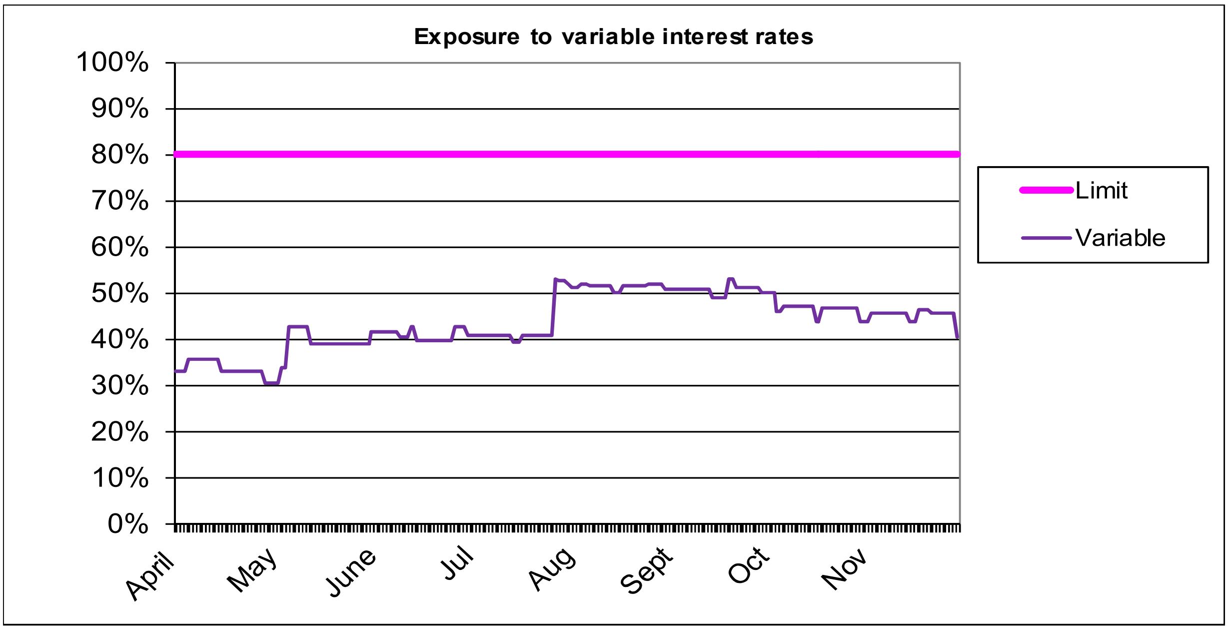
RISK MANAGEMENT

Credit & Counter Party Risk Management

With the cash balances that the Authority presently has the key risk to be managed is that of credit and counterparty risk management. Funds are currently held with the Authority's bankers (Lloyds Bank) and with one AAA rated money market fund (CCLA). In addition the Authority has a Debt Management Account Deposit Facility where surplus funds can be deposited with the Government's Debt Management Office. This is in accordance with the Authority's policy that requires counter parties, except the Authority's bankers, to have AA or AAA ratings.

Interest Rate Risk Management

The main factor affecting the balance between exposure to fixed and variable interest rates is the increase in the Authority's cash balances. All of the Authority's long term borrowing is at fixed interest rates, and all of the investment of surplus funds is at variable rates. The relative proportions currently ensure that the maximum exposure to variable interest rates is below the 80% upper limit as shown in the graph below:



Other Risk Management Issues

The present level of cash balances means that the Authority has no exposure to refinancing risks for the next few years. There have been no issues around controls, regulatory risks, fraud or errors in the year.

CAPITAL EXPENDITURE PLANS

The actual capital expenditure that was incurred in 2015/16 and the estimates of capital expenditure to be incurred in 2016/17 are summarised below:

	2015/16	2016/17	
		Original	Updated
	Actual	Forecast	Forecast
	£000	£000	£000
Total Payments	**6,665**	**7,823**	**8,536**
Financed by			
Capital Receipts	-	-	8,536
Internal Resources	6,665	7,823	-
Total Financing	**6,665**	**7,823**	**8,536**

The 2016/17 forecast has increased following approval at Policy and Strategy in March to carry forward £713k of the 2015/16 capital budget for equipment (£597k) and vehicles (£116K). This forecast will continue to be reviewed during the year.

The incremental effects of these plans on our revenue expenditure are shown below:

Incremental effect on revenue of the 2016/17 capital programme and borrowing			
	2016/17 £000	2017/18 £000	2018/19 £000
Interest & MRP cost of 2016/17 programme	213	768	768
Interest & MRP cost of 2017/18 programme	-	210	755
Interest & MRP cost of 2018/19 programme	-	-	158
Incremental revenue cost in each year	**213**	**978**	**1,681**

Incremental impact of new capital investment on Council tax

The incremental impacts on the 2015/16 and 2016/17 council tax of the capital programmes are shown below:

Incremental effect on Council Tax of the 2015/16 & 2016/17 Capital Programme		
	2015/16 £000	2016/17 £000
Effect on Council tax	**£0.28**	**£0.35**

In practice this additional cost is managed through the overall budget process with the impact of savings from past and current projects contributing to the overall budget.

Ratio of financing costs to net revenue stream

Estimates of the ratio of financing costs to budget requirement for 2016/17 and the actual figures for 2015/16 are:

Ratio of financing costs to net revenue stream		
	2015/16 Actual	2016/17 Estimate
Original 2016/17 estimate	10.84%	10.52%
Updated estimate	**6.97%**	**9.34%**

The estimates include interest payable and receivable, and the amounts required for the repayment of external loans. Net revenue streams represent the amounts to be met from government grants and local taxpayers.

CAPITAL FINANCING REQUIREMENT

The Capital Financing Requirement (CFR) represents the amount of capital spending that has not yet been financed from capital receipts, capital grants or contributions from the revenue budget. This balance therefore reflects the authority's underlying need to borrow, or finance by other long-term means, for capital purposes. The CFR will be influenced by the capital expenditure in each year, the receipts from asset disposals and the level of government grants.

The comparison of the CFR to the original indicators for 2016/17, and the updated indicators for 2016/17 are shown below:

Estimate of Capital Financing Requirement				
	31/3/16 £000	31/3/17 £000	31/3/18 £000	31/3/19 £000
Original 2016/17 estimates	**41,913**	**38,615**	**31,959**	**26,501**
Updated 2016/17 indicators	**39,005**	**37,243**	**34,712**	**30,354**

Net borrowing and the Capital Financing Requirement

In order that, over the medium term, net borrowing is only undertaken for capital purposes, net external borrowing must not, except in the short term, exceed the total of the Capital Financing Requirement in the previous year, plus the estimates of any additional capital financing requirement for the current and next two financial years. The authority has not had net additional external borrowing since 2009/10 because it has funded capital expenditure from internal generated cash resources.

The Authority has an integrated treasury management strategy and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. In day-to-day cash management, no distinction can be made between revenue and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. In contrast, the capital financing requirement reflects the authority's underlying need to borrow for capital purposes.

In respect of its external debt, the Authority approves authorised limits for its total external debt gross of investments. These limits separately identify borrowing from other long-term liabilities, such as finance leases.

The recommended limits are based upon the estimate of most likely, prudent, but not worst-case scenario, with sufficient headroom for fluctuations in cash balances. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the CFR and estimates of cash flow requirements for all purposes.

The authority also approves operational boundaries for external debt. This is based on the same estimates as the authorised limit, but reflects directly the Treasurer's estimate of the most likely, prudent, but not worst case scenario, without the additional headroom included within the authorised limit to allow for unusual cash flow movements, and equates to the maximum external debt projected by this estimate. The operational boundary represents a key management tool for monitoring by the Treasurer.

	2015/16 £000	2016/17 £000
Actual Borrowing	29,500	28,000
Authorised limit	35,600	38,700
Operational Boundary	32,600	35,700

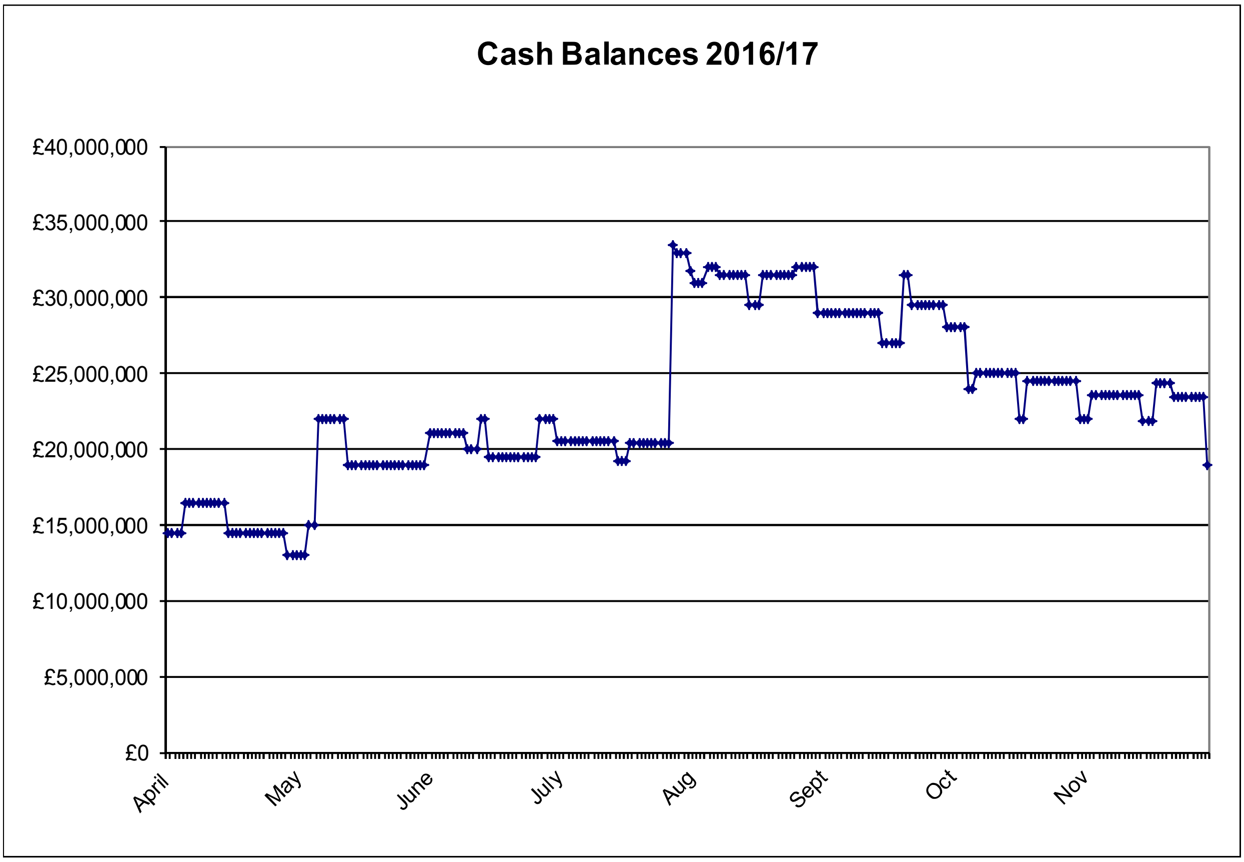
The authority has remained within the operational limit during 2016/17.

TREASURY MANAGEMENT 2016/17

Investments – First eight months of 2016/17

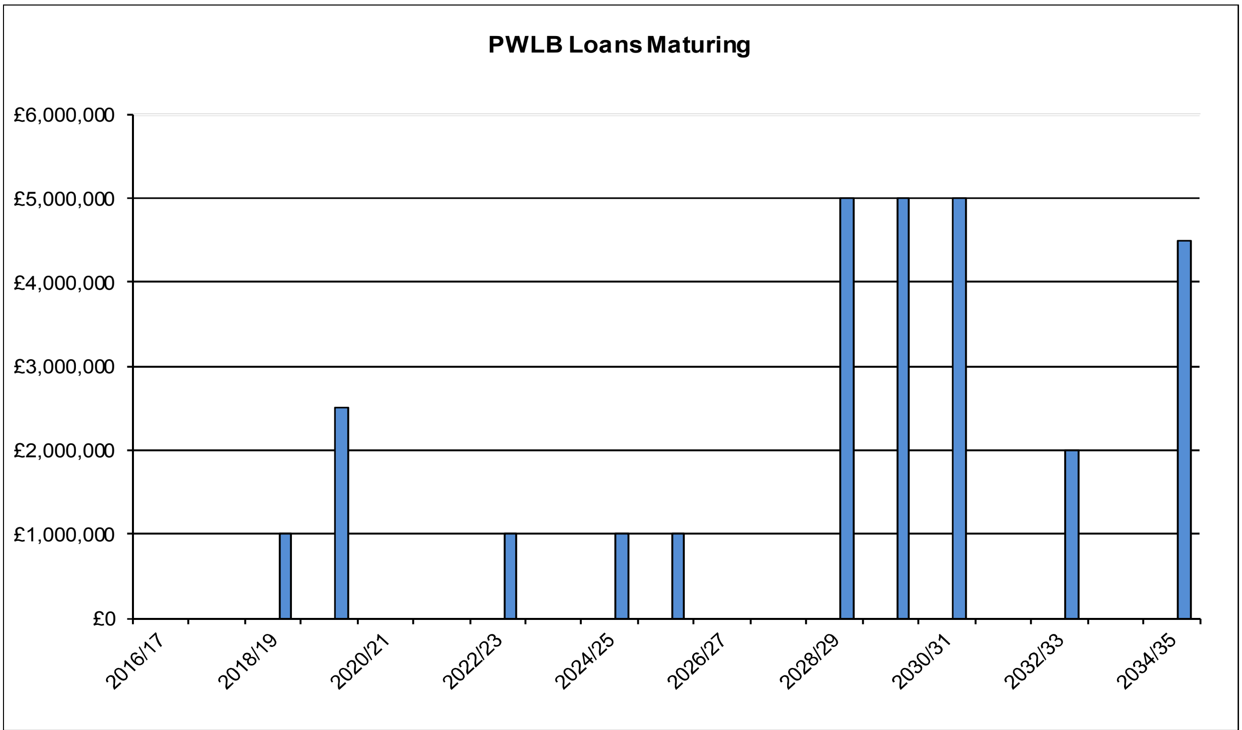
Most of the Authority's income is received on a bi-monthly basis from billing authorities and Central government. As illustrated in the graph below, the level of outstanding investments decreases during each month as expenditure is incurred, with the largest reductions occurring when the monthly payrolls are paid. Funds are invested with either Lloyds or CCLA (Charities, Churches and Local Authorities money market fund) or the Debt Management Account Deposit Facility. The interest earned by the Authority on its investments during the first eight months of 2016/17 was **£57k** at an average rate of **0.35%**.

The increase in May reflects the monies received from the sale of the former HQ site, Hutton, and the sharp increase in July reflects the funding provided by the government for the deficit on the Authority's Firefighter Pensions Account.

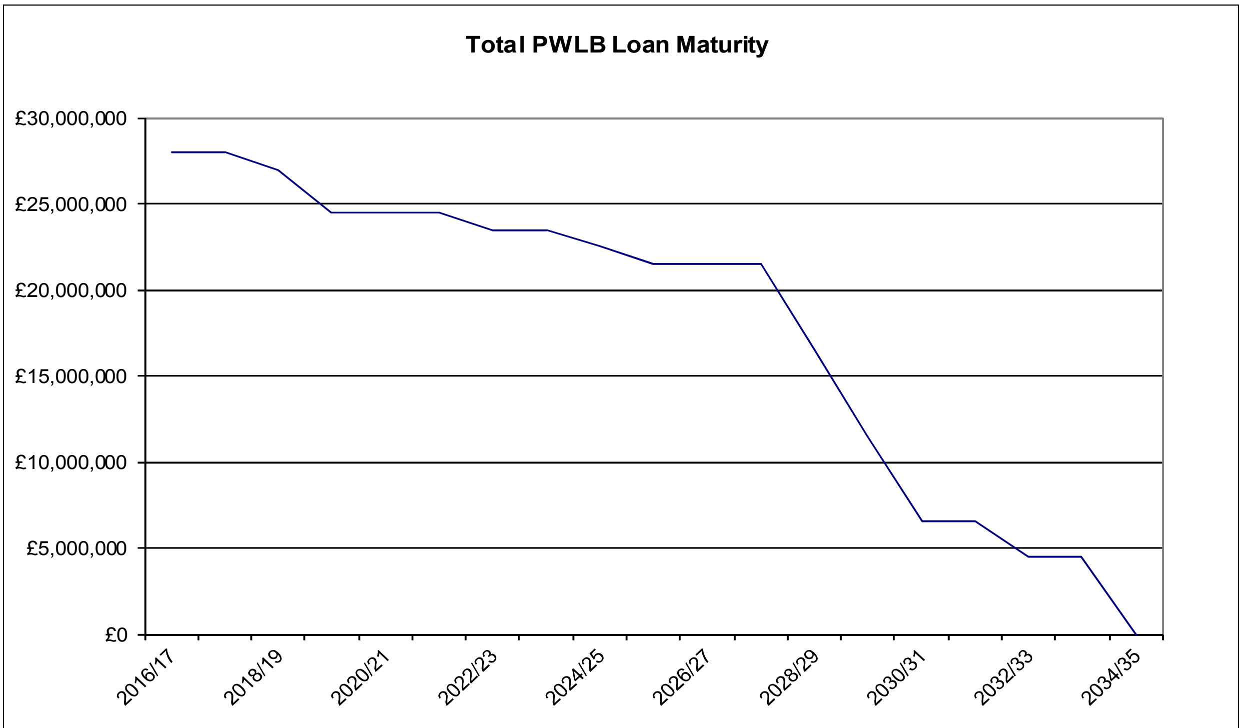


Borrowings and repayments

The total level of long term debt at 30 November 2016 was **£28.0m.** The first graph below shows the maturity profile of all outstanding PWLB loans, and the second the cumulative profile.



The longest dated loan is one of **£4.5m** that runs until December 2034.



Maturity structure of borrowing

The Authority has set upper and lower limits for the maturity structure of its borrowings. The proposed limits were calculated as the projected amount of fixed borrowing that is maturing in each period, as a percentage of the total projected borrowing that is fixed rate.

Maturity profile upper limits		
	2016/17	
Period	Original Limit %	Actual Profile %
under 12 months	-	-
12 to 24 months	7	-
24 months to 5 years	20	28
5 to 10 years	20	28
10 years and over	100	100

RISK MANAGEMENT IMPLICATIONS

The purpose of this report is to set out the risks and the approach to risk in the financing of capital expenditure.

LEGAL IMPLICATIONS

The Treasury Management Code places significant responsibilities upon the Treasurer. Through the Treasury Management Code the Treasurer must ensure that all relevant matters with regard to setting or revising these indicators are reported to Members. The Treasurer is also responsible for establishing procedures for monitoring performance against the Treasury Management indicators.

It is for the Authority, to make the judgement between the constraints of affordability and the demands of services for capital investment. The advice of the Treasurer is, however, important as the Treasury Management Code has to be considered in conjunction with the specific duties placed upon the Treasurer, by section 114 of the 1988 Act, for proper financial administration.

FINANCIAL IMPLICATIONS

The financial implications are set out in the report.

USE OF RESOURCES

There are two implications for the Authority regarding the use of resources and value for money implications of the approach to funding capital expenditure. Firstly, there is the balance between utilising cash surplus generated by the Authority and held as Reserves, and external borrowing. The Authority's approach to the retention of reserves is considered as part of the budget setting process. The intention is to provide funds to enable significant fluctuations in expenditure within a budget year to be absorbed, whilst maintaining on-going expenditure funded by government grants and council tax.

The cash generated as reserves are used to reduce borrowings, should the reserves be needed to fund expenditure, the borrowings of the authority will increase. The second implication is in the choice of lender. The lender of choice for the Authority is the Public Works Loan Board.

EQUALITY IMPLICATIONS

There are no equality implications associated with the recommendations within this report.

ENVIRONMENTAL IMPLICATIONS

There are no environmental implications associated with the recommendations within this report.

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985	
List of appendices attached to this paper: Appendix A – Treasury Management Indicators	
List of background documents (not attached):	
Proper Officer:	The Finance Director and Treasurer
Contact Officer:	The Finance Director and Treasurer, Mike Clayton, Essex County Fire & Rescue Service, Kelvedon Park, London Road, Rivenhall, Witham CM8 3HB Tel: 01376 576000 E-mail: mike.clayton@essex-fire.gov.uk

Treasury Management Indicators		2015/16 Actual	2016/17 Original Forecast	2016/17 Updated Forecast
Indicators for Affordability				
Ratio of financing costs to net revenue streams	%	6.97%	9.94%	9.34%
Indicators for Prudence				
Net borrowing and capital financing requirement		*It is not envisaged that net borrowing will exceed the Capital Financing Requirement over this period.*		
Confirmation of treasury management good practice		*Treasury management will be carried out in accordance with approved policies and practices.*		
External debt within prudent and sustainable limits		*Treasury management indicators for external debt take account of their affordability.*		
Indicators for capital expenditure				
Capital expenditure	£000	6,665	7,823	8,536
Capital financing requirement	£000	39,005	38,615	37,243
Indicators for external debt				
Actual external debt	£000	29,500	28,000	28,000
Authorised limit	£000	35,600	37,500	38,700
Operational boundary	£000	32,600	34,500	35,700
Interest rate exposures				
Upper limit - fixed rates	%	100	100	100
Upper limit - variable rates	%	80	80	80
Maturity structure of borrowing (upper limit)				
Under 12 months	%	13	-	-
12 months and within 24 months	%	-	7	-
24 months and within 5 years	%	26	20	28
5 years and within 10 years	%	20	20	28
10 years and above	%	100	100	100
Total sum invested for more than 364 days	£000	-	-	-