ESSEX FIRE AUTHORITY
Essex County Fire & Rescue Service

;MEETING	**Audit, Governance and Review Committee**	AGENDA ITEM	**9**
MEETING DATE	12 July 2017	REPORT NUMBER	**EFA/091/17**
SUBJECT	**Treasury Management Strategy**		
REPORT BY	The Finance Director & Treasurer, Mike Clayton		
PRESENTED BY	The Finance Director & Treasurer, Mike Clayton		

SUMMARY

A set of treasury management and capital financing 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. This report brings forward a review of the Authority's performance in 2016/17 against these indicators.

RECOMMENDATIONS

It is recommended that Members:

- Note the treasury management outturn position for 2016/17; and
- Note the performance against the capital financing indicators for 2016/17.

BACKGROUND

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 for Capital Finance in Local Authorities underpins this capital financing system to support authorities in taking decisions upon capital investment.

The aims of the Code are to assist local authorities to ensure that:

- Capital expenditure plans are affordable;
- All external borrowing is at a prudent and sustainable level;
- Treasury management decisions are taken in accordance with professional good practice;
- The authority is accountable, in taking decisions in relation to the above, by providing a clear and transparent framework; and
- The framework established by the Prudential Code is consistent with and supports local strategic and asset management planning and proper option appraisal.

In exceptional circumstances, the Code framework will demonstrate that there is a danger that the above aims will not be met, and so allow the Authority to take remedial action.

There are two aspects to the funding of capital expenditure. Firstly the treatment of capital financing costs through the Authority's Income and Expenditure Account. These are the capital financing charges which are equivalent to a depreciation provision for the assets purchased. Secondly, the treasury management of the cash flows associated with the capital expenditure and the use of external borrowing to provide the cash for capital expenditure.

CAPITAL FINANCING INDICATORS

The regulatory framework for self-management of capital finance focuses upon capital expenditure plans, external debt and treasury management. The capital financing indicators are designed to support and record decision-making in these three areas. The mandatory indicators are as follows:

Indicators for affordability

- Estimate of the incremental impact of capital investment upon Council tax
- Ratio of financing costs to net revenue stream

Indicators for prudence

- Net borrowing and the capital financing requirement
- Confirmation that treasury management is carried out in accordance with good professional practice
- External debt is within prudent and sustainable limits

Indicators for capital expenditure, external debt and treasury management

- Capital expenditure
- Capital financing requirement
- Authorised limit for external debt
- Operational boundary for external debt
- Actual level of external debt
- Interest rate exposures
- Maturity structure of borrowing

- Total principal sums invested for periods in excess of 364 days

It is intended that the capital financing indicators be considered collectively, to measure the Authority's performance over time. It should be noted that the individual authorities are free to determine their own indicators which form the basis for performance monitoring. The only indicator where there is a statutory obligation not to exceed the internally set limit is the authorised limit for external debt.

The following paragraphs contain the capital financing indicators approved by the Authority for 2016/17 and actual performance against these indicators. They also include the 2017/18 and future years indicators updated in the light of the 2016/17 outturn. A summary of the capital financing indicators for 2017/18 is shown at **Appendix A**.

CAPITAL EXPENDITURE PLANS

The estimates of capital expenditure to be incurred for the current and future years that were approved are summarised below:

	2016/17		2017/18	2018/19	2019/20
	Original Forecast £000s	Outturn £000s	Budget £000s	Estimate £000s	Estimate £000s
Capital Expenditure	**7,823**	**5,369**	**11,890**	**9,319**	**8,281**
Financed by					
Provision for Capital Financing	5,944	3,623	4,608	6,144	6,096
(Increase)/Decrease in Cash	1,879	1,746	7,282	3,175	2,185
Total Financing	**7,823**	**5,369**	**11,890**	**9,319**	**8,281**

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

Incremental effect on revenue of the 2017/18 to 2019/20 capital programmes and borrowing			
	2017/18 £000s	**2018/19 £000s**	**2019/20 £000s**
Interest & MRP cost of 2017/18 programme	297	1,070	1,070
Interest & MRP cost of 2018/19 programme	-	233	839
Interest & MRP cost of 2019/20 programme	-	-	207
Incremental revenue cost in each year	**297**	**1,303**	**2,116**

The impact of capital investment on the level of council tax is used for comparative purposes. In practice other budget changes, including the ending of capital financing charges from earlier years investment mean that the incremental revenue cost of the capital budget is managed as a budget pressure, rather than as a driver for council tax increases. The incremental impact on the 2016/17 and 2017/18 council tax on the capital programmes is shown below:

Incremental effect on Council Tax of the 2016/17 & 2017/18 Capital Programme		
	2016/17 £000s	**2017/18 £000s**
Effect on Council tax	**£0.22**	**£0.48**

These figures represent the maximum potential impact, given the assumptions made.

The incremental impact of the proposed capital programme has been determined assuming that the revenue costs of borrowing would be fully met from Council tax. In reality, these costs would be financed from a combination of Revenue Support Grant, non-domestic rates, revenue account savings from earlier investment and Council tax income, though it is not possible to identify the different components.

The estimate of the incremental impact of capital investment decisions proposed in the capital programme report for the three year period beginning 2017/18, over and above capital investment decisions that have previously been taken by the Authority, are:-

Incremental effect on revenue and Council tax of the 2017/18 to 2019/20 programmes			
	2017/18 £000s	2018/19 £000s	2019/20 £000s
Total revenue cost in each year	297	1,303	2,116
Impact on Band D Council tax	£0.48	£2.10	£3.41
Estimated increase in Council tax that year resulting from the three year programme	0.80%	2.59%	2.00%

The full year effect of these programmes in 2018/19 and future years is £2,654k additional revenue payments per year, with a £4.28 impact on the Council tax. This does not include the effect of any new capital projects started in 2018/19 or later. This future revenue charge is considered explicitly when all major capital projects are brought forward for decision, and the funding of the additional revenue burden in both the short and medium term identified.

The freedom for authorities to borrow allows the Authority to set its own borrowing level above the level of Supported Borrowing issued by the Government. However as the Authority has no forecast to borrow for capital purposes in the next three years there is no projected effect on revenue or council tax of unsupported borrowing.

LONGER TERM AFFORDABILTY OF CAPITAL EXPENDITURE

A review of the longer term affordability of capital expenditure is being prepared and will be brought forward for Members information in October 2017 in conjunction with the medium term financial projections.

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.

Other cash flow factors and the management of reserves will determine whether external borrowing is required. This does not reduce the magnitude of the funds held for these long-term purposes, but reflects the adoption of an efficient and effective treasury management strategy.

The Authority has an integrated treasury management strategy and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. The Authority's treasury management policy statement for 2017/18 is set our later within this report. 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.

The comparison of the CFR to the original indicators for 2016/17, and the new indicators to be agreed for 2017/18 are shown below:-

Estimate of Capital Financing Requirement				
	31/3/17 £000	31/3/18 £000	31/3/19 £000	31/3/20 £000
Original estimates	**34,556**	**35,015**	**33,013**	**30,021**
Updated indicators	**39,173**	**41,278**	**39,276**	**36,284**

MINIMUM REVENUE PROVISION POLICY STATEMENT

The minimum revenue provision is the amount set aside from revenue expenditure and Council Tax to fund capital expenditure. Until 2008 this was calculated as 4% of the capital financing requirement – meaning that all capital spending was funded over a 25 year period. Under transition arrangements agreed by the Authority in April 2008, this method continued for 2009/10. Since then the approach adopted has been to finance the initial capital cost of assets over their lives using the depreciation method.

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 had no difficulty meeting this requirement in past years and no difficulties are envisaged for the current or future years. This view takes account of the current commitments, existing plans and the proposals contained within the revenue budget and capital programme which appear elsewhere on this agenda.

EXTERNAL DEBT

In respect of its external debt, it is recommended that the Authority approves the following authorised limits for its total external debt gross of investments for the next three financial years, and agrees the continuation of the current year's limit as no amendment is necessary. These limits separately identify borrowing from other long-term liabilities, such as finance leases.

Authorised limit	**2017/18 £000**	**2018/19 £000**	**2019/20 £000**
Borrowing	40,100	43,300	45,400
Other long-term liabilities	0	0	0
Total	**40,100**	**43,300**	**45,400**

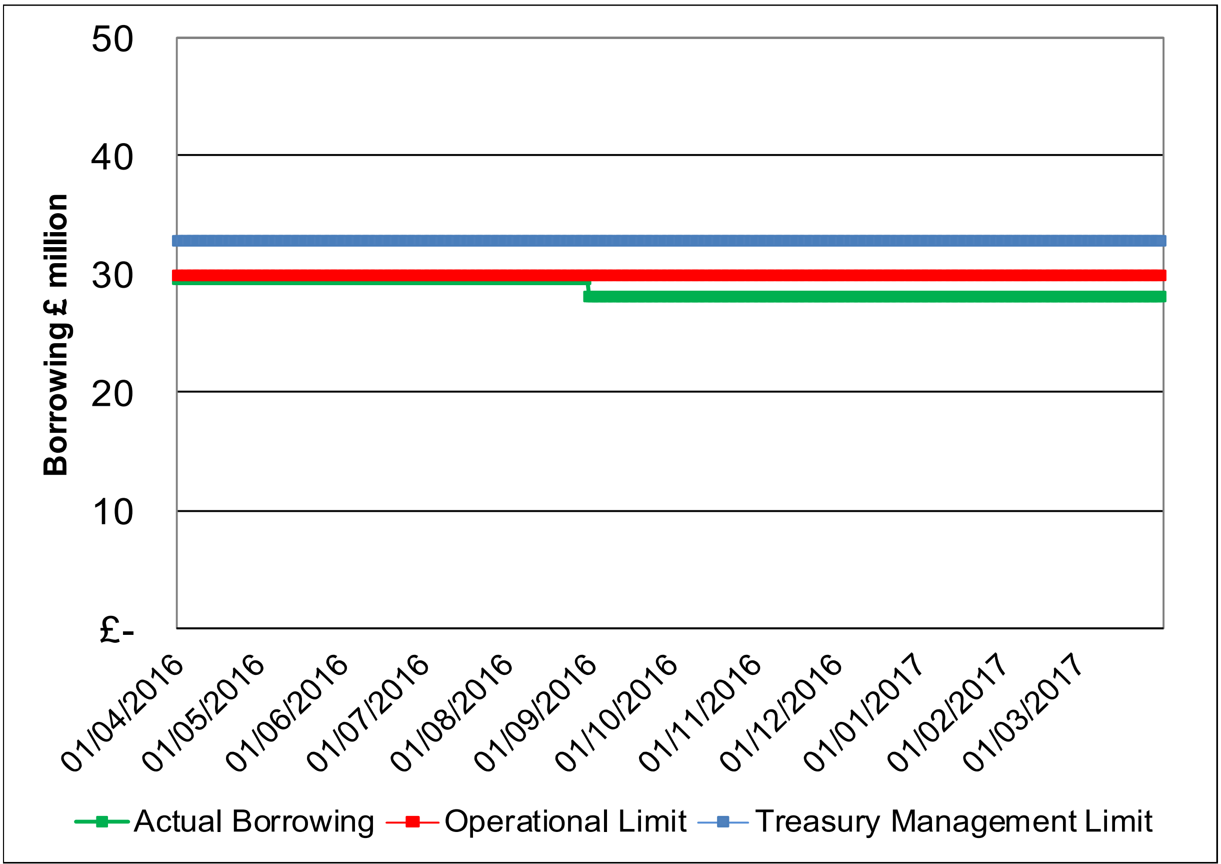
The limits are based upon the estimate of most likely, prudent, but not worst-case scenario, with sufficient headroom for fluctuations in cash balances. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the CFR and estimates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

The Authority is also asked to approve the following operational boundary for external debt for the same time period. The proposed operational boundary 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.

Operational Boundary	**2017/18 £000**	**2018/19 £000**	**2019/20 £000**
Borrowing	37,100	40,300	42,400
Other long-term liabilities	0	0	0
Total	**37,100**	**40,300**	**42,400**

The Authority has remained well within the operational limit during 2016/17 as shown in the graph below which outlines the Authority's total external debt compared to the operational and authorised limits. The actual level of borrowing at 31 March 2017 was **£28.0m**.

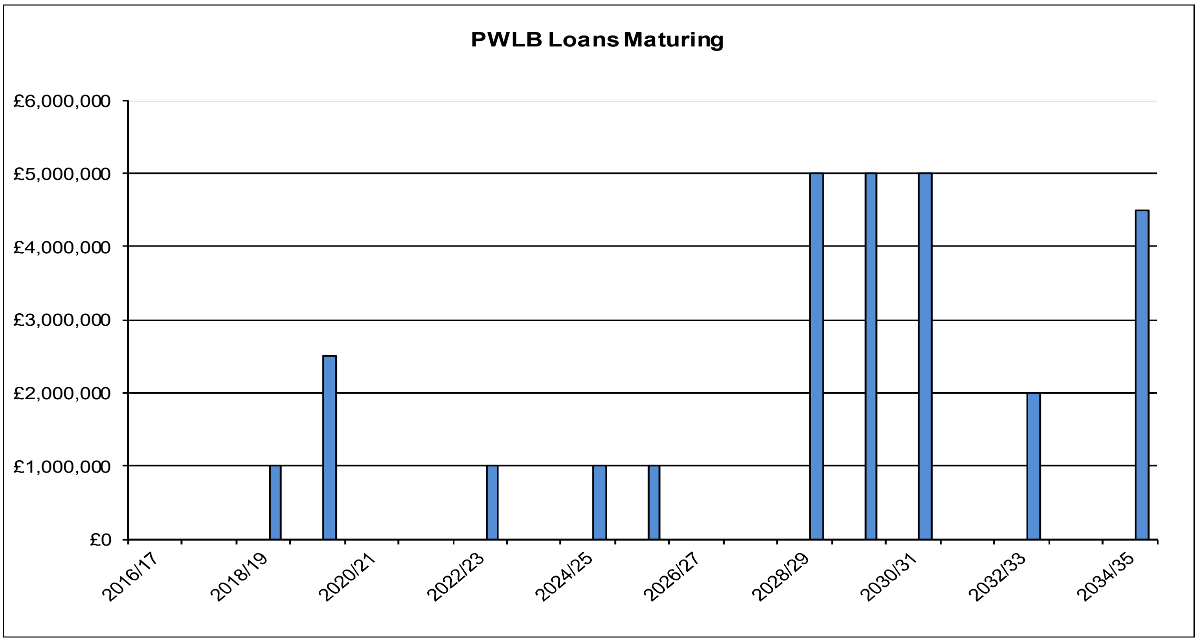
Figure 1 – Borrowing 2016/17



BORROWINGS AND REPAYMENTS

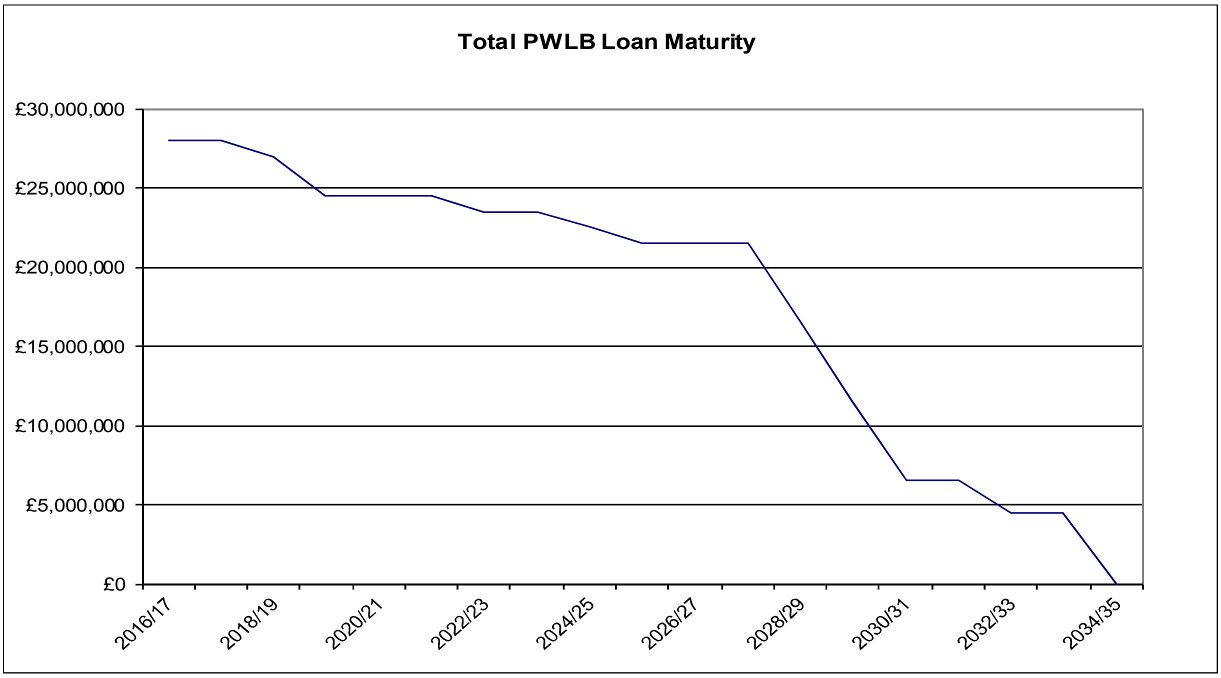
The level of long term debt at 31 March 2017 was **£28.0m.** The first graph below shows the maturity profile of all outstanding PWLB loans, and the second the cumulative profile.

Figure 2 – Repayment Profile



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

Figure 3 – Debt Profile



MATURITY STRUCTURE OF BORROWING

The Authority sets upper and lower limits for the maturity structure of its borrowings. The limits are 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.

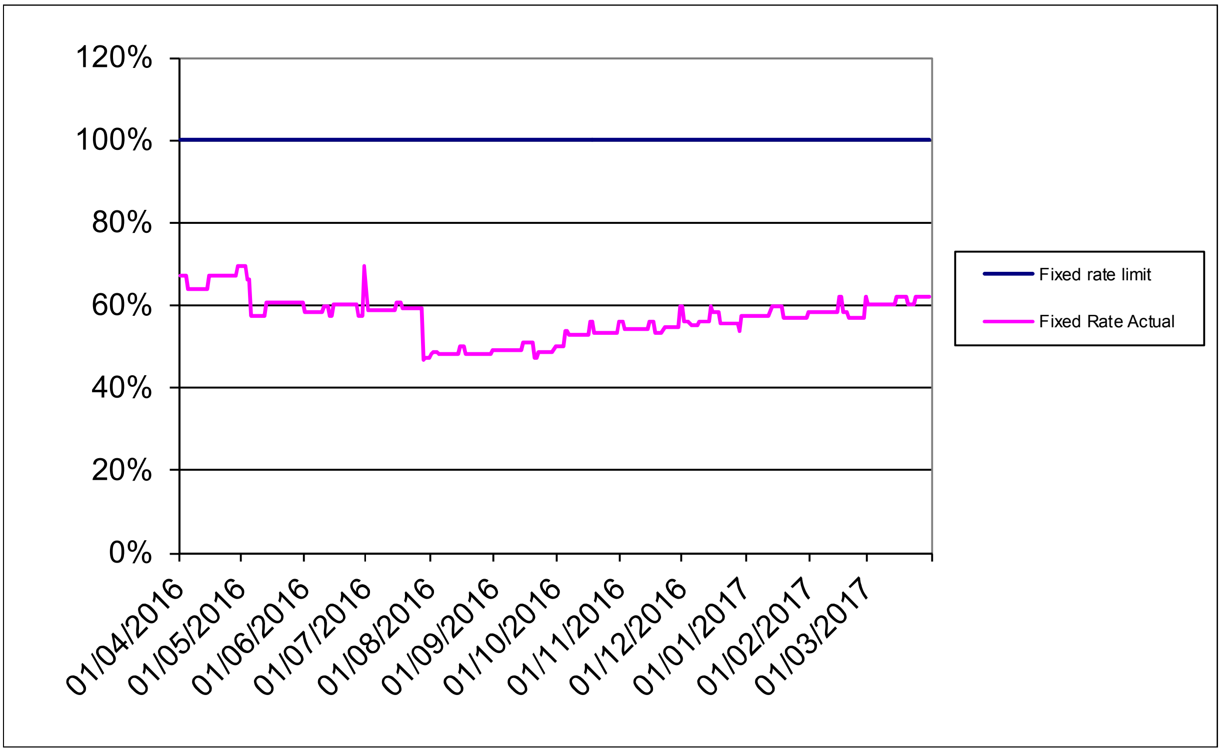
Maturity profile upper limits						
	2017/18		2018/19		2019/20	
Period	Lower Limit %	Upper Limit %	Lower Limit %	Upper Limit %	Lower Limit %	Upper Limit %
under 12 months	0	0	0	8	0	21
12 to 24 months	0	8	0	23	0	0
24 months to 5 years	0	23	0	8	0	9
5 to 10 years	0	23	0	16	0	60
10 years and over	0	100	0	100	0	100

The Authority has not exceeded the maturity profile upper limit in 2016/17.

INTEREST RATE EXPOSURE

The measure of interest rate exposure includes both funds that are borrowed and those that are invested. At present all of the authority’s borrowings are at fixed interest rates for the period of their term, limiting exposure to the interest rates on new borrowing. Interest on cash deposits is generally at a variable rate, although some medium terms (3 months to one year) lending opportunities may be used. The chart below shows the overall exposure to variable interest rates during 2016/17.

Figure 4 – Interest Rate Exposure



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 Capital Financing Code places significant responsibilities upon the Treasurer. Through the 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 prudential 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 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 is 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 arising from this report.

ENVIRONMENTAL IMPLICATIONS

There are no Environmental Implications associated within this report.

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985	
List of background documents	
Proper Officer:	Finance Director & Treasurer
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Treasury Management Indicators		2015/16 Actual	2016/17 Original	2016/17 Outturn	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Indicators for Affordability							
Ratio of financing costs to net revenue streams	%	6.97%	6.83%	6.83%	8.33%	10.53%	10.46%
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		*Prudential indicators for external debt take account of their affordability.*					
Indicators for capital expenditure							
Capital expenditure	£000	6,665	7,823	5,369	11,890	9,319	8,281
Capital financing requirement	£000	30,580	34,556	39,173	41,278	39,276	36,284
Indicators for external debt							
Actual external debt	£000	29,500	28,000	28,000	N/A	N/A	N/A
Authorised limit	£000	42,600	36,500	32,800	40,100	43,300	45,400
Operational boundary	£000	39,600	33,500	29,800	37,100	40,300	42,400
Interest rate exposures							
Upper limit - fixed rates	%	100	100	100	100	100	100
Upper limit - variable rates	%	80	80	80	80	80	80
Maturity structure of borrowing (upper limit)							
Under 12 months	%	13	-	-	8	21	N/A
12 months and within 24 months	%	-	7	8	23	-	N/A
24 months and within 5 years	%	26	20	23	8	9	N/A
5 years and within 10 years	%	20	20	23	16	60	N/A
10 years and above	%	100	100	100	100	100	N/A
Total sum invested for more than 364 days	£000	-	-	-	-	-	-