AGENDA ITEM:

REPORT TO:	**MERSEYSIDE FIRE & RESCUE AUTHORITY**
DATE:	**17TH MAY 2012**
REPORT NO.	**CFO/ 081/12**
REPORTING OFFICER:	**DEPUTY CHIEF EXECUTIVE**
CONTACT OFFICER:	**IAN CUMMINS, HEAD OF FINANCE, EXTN. 4244**
OFFICERS CONSULTED:	
SUBJECT:	**TREASURY MANAGEMENT ANNUAL REPORT 2011/12**

APPENDIX A TITLE Treasury Management Annual Report Hard copy attached

Purpose of Report

1. To advise Members on the activities of the Treasury Management operation and actual performance against the agreed Prudential Indicators in 2011/12. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Authority is required to comply with both Codes through regulations issued under Section 15 of the Local Government Act 2003.

Recommendation

2. That the Treasury Management Annual Report 2011/12 (appended as Appendix A) be noted.

Introduction & Background

3. Treasury management is defined as:

   The management of the organisation's 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.

4. The CIPFA Code of Practice for Treasury Management in Local Authorities has been adopted by the Authority and a Treasury Policy Statement incorporated in Financial Regulations in accordance with the requirements of the Code. The arrangements for reporting Treasury management activities to Members are that a minimum of three reports are presented to members: -

- An Annual Treasury Strategy Report before the start of a financial year.
- An interim report during the second half of a financial year. Other interim reports will be prepared if necessary.
- An annual outturn report by 30th September following the financial year to which it relates.

Annual Treasury Strategy:

5. The Authority determines before the start of each financial year an agreed treasury management strategy to set certain parameters and guidelines around which the treasury management function will operate. The 2011/2012 – 2015/2016 Budget and Financial Plan report, CFO/016/11, that went to the Authority meeting on 17th February, 2011 set the Authority's treasury management strategy for 2011/12:

   The strategy sets limits for the next three years on:-

   - overall Level of External Debt
   - operational Boundary for Debt
   - upper limits on fixed interest rate exposure
   - upper limits on variable rate exposure
   - limits on the maturity structure of debt
   - limits on investments for more than 364 days

   The strategy covers:

   - prospects for interest rates;
   - capital borrowings and the portfolio strategy;
   - annual investment strategy;
   - debt rescheduling;
   - external debt prudential indicators;

6. As short term interest rates were lower than long term borrowing rates the Authority as part of its approved treasury management strategy agreed to reduce Authority investments and borrow for short periods when necessary. Against this background, Treasury Officers have monitored the interest rate market and adopted a pragmatic approach to any changing circumstances.

Interim Treasury Management report:

7. As reported in the interim treasury management report, CF/013/12, to the Audit & Value For Money Scrutiny Panel on 5th January, 2012, it was decided to undertake some fixed rate borrowing because cash flow forecasts indicated that borrowing would be required later in the year and interest rates had reached a low point. In August, new borrowing of £2 million was arranged from PWLB to replace a loan that would reach maturity later in the year. The original loan had an interest rate of 4.55%. The replacement loans have an average rate of 2.67%. In December 2011, market forecasts were such that another low point had been reached and future movements were more likely to be upward. This resulted in a decision to borrow another £3 million. The loans were arranged at an average period of 4 years and at an average interest rate of

1.82%. This compares with the average PWLB 4-year rate offered during the year of 2.45%.

Annual Outturn Treasury Management report:

8. The Treasury Management Annual Report 2011/12 is appended as Appendix A to this report and it demonstrates that treasury management activity has been carried out in-line with the approved Treasury Management Strategy and therefore within the borrowing and treasury management limits set by the Authority throughout the year. Also Treasury Management practices have maintained full compliance with the relevant Codes and Statutes.

9. The Authority's Treasury Management function is carried out by Liverpool City Council via a service level agreement.

Equality & Diversity Implications

10. None arising from this report.

Staff Implications

11. There are no staff implications arising from this report.

Legal Implications

12. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Authority is required, by regulations issued under Section 15 of the Local Government Act 2003, to comply with both Codes.

Financial Implications & Value for Money

13. The estimated cost of Treasury Management Services was £18,100 in 2011/12 as per the approved budget provision.

14. The Authority's overall debt outstanding during the year was;

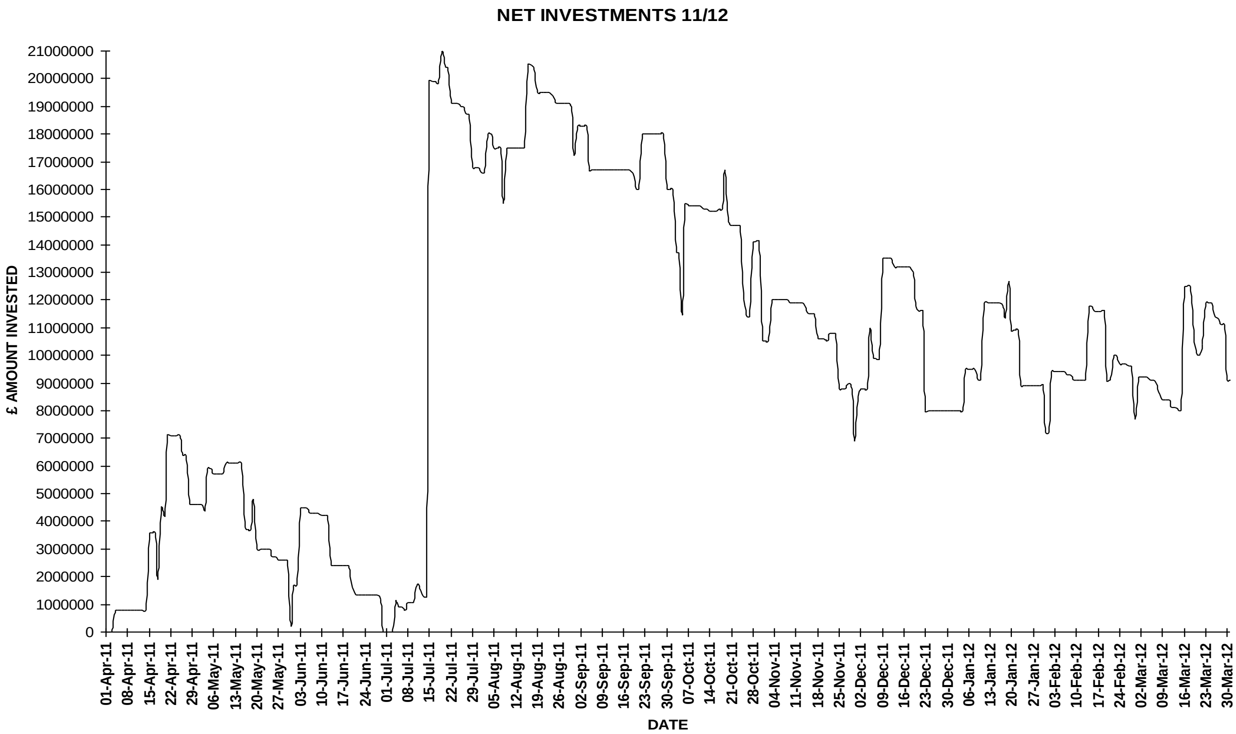
	For Period ending													
	Opening Position	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Closing Position
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
PWLB	43,075	0	0	0	0	2,000	0	(2,000)	0	3,000	0	0	0	46,075
net short term loans	0			300	(300)	0	0	0	0	0				0
	43,075	0	0	300	(300)	2,000	0	(2,000)	0	3,000	0	0	0	46,075

After excluding short term loans, (often only taken out for overnight cashflow reasons) the movement on the Authority's long term debt for the year was:

	£'M
01/04/11	43.1
31/03/12	46.1

The Authority paid interest of £2.2m on this debt during the year, £0.5m less than budgeted. Lower than anticipated borrowing due to the re-phasing of capital schemes from 2011/12 into future years contributed towards the reduced interest expenditure. The total debt servicing cost was £5.0m. The outstanding debt of £46.1m compares to the estimated value of the Authority's assets (against which the borrowing took place) of c£50m as at 31.03.12

15. Investments moved during the year as outlined in the graph below:



16. The Authority receives significant grant income in advance of spending each year and therefore on any particular date (especially early in the year) tends to have monies to invest. In particular the firefighter pension account grant of £19m is paid in July but actual pension payments are spread relatively evenly throughout the year. Other grants and contributions, such as the £0.5m PFI grant, have been received in the year but will not be applied until future years.

17. A combination of grants received in advance of spending, the new net additional borrowing of £3m discussed above,, the receipt a £1.8m CLG capital grant reducing anticipated borrowing, and re-phasing of capital expenditure of £4m from 2011/12 into 2012/13 has meant the Service has had higher than anticipated investments throughout the year. Investments were£9.1m on the 31 March. The table below sets out where those investments were applied in line with the low risk Treasury management Strategy.

ANALYSIS OF INVESTMENTS END OF MARCH 2012				
Institution	**Credit Rating**	**MM Fund***	**Bank / Other**	**Building Society**
		£	**£**	**£**
IGNIS	**AAA**	1,000,000	-	-
Blackrock	**AAA**	1,000,000	-	-
Goldman	**AAA**	1,100,000		-
Natwest	**A**		2,000,000	
Nationwide BS	**A**		-	2,000,000
HBOS	**A**		2,000,000	
Totals		3,100,000	4,000,000	2,000,000
Total Current Investments				9,100,000
**MM Fund - Money Market Funds -these are funds that spread the risk associated with investments over a wide range of credit worthy institutions.*				

The movement during the year was:

	£'M
01/04/11	0.0
31/03/12	9.1

18. Income earned on investments was £0.09m and in line with budget expectations.

Risk Management, Health & Safety and Environmental Implications

19. Robust management of the Authority's cash, investments and loans reduces the risk of poor security of investments, the lack availability of funds when required, and a poor return on investments.

Contribution to Our Mission – To Achieve; Safer Stronger Communities – Safe Effective Firefighters"

20. A good Treasury Management Strategy ensures that funds are available to meet the approved financial plan and therefore the delivery of services required to achieve the Authority's mission.

BACKGROUND PAPERS

- Audit Commission Act 1996
- Account & Audit Regulations 1996 & 2003
- Code of Audit Practice, Audit Commission, April 2005
- 2011/2012-2015/2016 Budget and Financial Plan report, CFO/016/11, Authority 17th February, 2011
- Interim Treasury Management report, CF/013/12, Audit & Value For Money Scrutiny Panel 5th January, 2012

APPENDIX A

TREASURY MANAGEMENT ANNUAL REPORT 2011/12

INTRODUCTION

1. The CIPFA Code of Practice for Treasury Management in Local Authorities has been adopted by the Authority. The Code requires that Treasury Management activities are subject to regular reports to Members. This report represents the final report on Treasury Management for 2011/12.

2. The strategy for the year was identified in the Treasury Management Strategy Statement 2011/12. The strategy covers the following areas:

   (a) prospects for interest rates;
   (b) capital borrowing and debt rescheduling;
   (c) annual investment strategy;
   (d) external debt prudential indicators;
   (e) treasury management prudential indicators.
   (f) performance indicators;
   (g) treasury management advisers

PROSPECTS FOR INTEREST RATES

3. Short-term rates have remained at 0.5%, in line with the forecast for them to stay on hold because of the crisis in the Euro-zone, tight economic policies and weak consumer confidence. The recovery in the economy has been weak and protracted.

4. Longer term rates were also expected to remain steady in the early part of 2011/12 but rise later in the year. By the end of November 2011, those rates fell from 5.25% at the start of the year, to around 4.25% as a result of quantitative easing i.e. the purchase of gilts by the Treasury and the flight of investment funds to safe haven instruments. However, the influence of these factors weakened before the close of the financial year and longer-term Public Works Loans Board (PWLB) rates reached 4.35% at the end of the year.

5. The strategy indicated that the overall structure of interest rates whereby short term rates are lower than long term rates was expected to remain throughout 2011/12. In this scenario, the strategy would be to reduce investments and borrow for short periods and possibly at variable rates when required.

CAPITAL BORROWINGS AND DEBT RESCHEDULING

6. The Authority's net capital borrowing requirement for 2011/12 was estimated at £10 million. It was decided to undertake some fixed rate borrowing because cash flow forecasts indicated that borrowing would be required later in the year and interest rates had reached a low point. In August, new borrowing of £2 million was arranged from PWLB to replace a loan that would reach maturity later in the year. The original loan had an interest rate of 4.55%. The replacement loans have an average rate of 2.67%.

7. In December 2011, market forecasts were that another low point had been reached and future movements were more likely to be upward. This resulted in a decision to borrow another £3 million. The loans were arranged at an average period of 4 years and at an average interest rate of 1.82%. This compares with the average PWLB 4-year rate offered during the year of 2.24%.

ANNUAL INVESTMENT STRATEGY

8. The investment strategy for 2011/12 set out the priorities as the security of capital and liquidity of investments. Investments are made in accordance with ODPM Guidance and CIPFA Code of Practice. Investments are made in sterling with an institution on the counterparty list and for a maximum of one-year duration.

9. Extreme caution was taken in placing investments to ensure security of funds rather than rate of return. The use of deposit accounts with high rated banks and AAA rated money market funds has enabled reasonable returns in a low interest rate environment. The average rate of return achieved on average principal available in 2011/12 was 1.16%. This compares with an average seven day deposit (7 day libid) rate of 0.48%.

10. The Investment Strategy specified that investments are only made with banks with a high credit rating. UK banks must have at least an “A” long term rating for inclusion on the Authority’s counterparty list. The money markets are continually monitored for information regarding the creditworthiness of financial institutions and notifications are received of any changes to credit ratings made by any of the rating agencies. An institution is immediately suspended from the Authority’s list of institutions should any doubt arise about its financial standing regardless of whether its credit rating is downgraded.

EXTERNAL DEBT PRUDENTIAL INDICATORS

11. The external debt indicators of prudence for 2011/12 required by the Prudential Code were set in the strategy as follows:

Authorised limit for external debt:	£65 million
Operational boundary for external debt:	£55 million

Against these limits, the maximum amount of debt reached at any time in the financial year 2011/12 was £46.1 million.

TREASURY MANAGEMENT PRUDENTIAL INDICATORS

12. The treasury management indicators of prudence for 2011/12 required by the Prudential Code were set in the strategy as follows:

a) Interest Rate Exposures

Upper limit on fixed interest rate exposures:	100%
Upper limit on variable interest rate exposures:	50%

The maximum that was reached in the financial year 2011/12 was as follows:

Upper limit on fixed interest rate exposures: 100%
Upper limit on variable interest rate exposures: 0%

b) Maturity Structure of Borrowing
Upper and lower limits for the maturity structure of borrowing were set and the maximum and minimum that was reached for each limit at any time in the financial year 2011/12 was as follows:

Maturity Period	Upper Limit	Lower Limit	Maximum Actual	Minimum Actual
Under 12 months	30%	0%	5%	2%
12 months and within 24 months	30%	0%	6%	2%
24 months and within 5 years	30%	0%	10%	1%
5 years and within 10 years	30%	0%	11%	3%
10 years and above	90%	0%	86%	74%

c) Total principal sums invested for periods longer than 364 days
The limit for investments of longer than 364 days was set at £2 million for 2011/12. No such investments were placed during 2011/12.

PERFORMANCE INDICATORS

13. The Code of Practice on Treasury Management requires the Authority to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

14. The indicators for the treasury function are:

Borrowing - Average rate of long term borrowing for the year compared to average available. The total £5 million new loans are at an average interest rate of 2.17% for an average period of 5 years. The average 5 year PWLB offered rate in the financial year 2011/12 was 2.53%. Therefore, the average borrowing rate was 0.36% below the benchmark in 2011/12.

Investments – Internal returns compared to the 7 day LIBID rate. The return in the financial year 2011/12 was 0.68% above the benchmark.

TREASURY MANAGEMENT ADVISORS

15. The treasury management service is provided to the Authority by Liverpool City Council. The terms of the service are set out in an agreed Service Level Agreement. The Council employs treasury management advisers appointed under a competitive procurement exercise who provide a range of services which include: -

- Technical support on treasury matters, capital finance issues.
- Economic and interest rate analysis.
- Debt services which includes advice on the timing of borrowing.

- Debt rescheduling advice surrounding the existing portfolio.
- Generic investment advice on interest rates, timing and investment instruments.
- Credit ratings/market information service comprising the three main credit rating agencies.

16. Whilst Liverpool City Council and its advisers provide the treasury function, ultimate responsibility for any decision on treasury matters remains with the Authority.

CONCLUSION

17. Treasury Management activity in 2011/12 has been carried out in compliance with the relevant Codes and Statutes and within the borrowing and treasury management limits set by the Authority under the prudential code.