AGENDA ITEM: 9

NORTH WALES FIRE AND RESCUE AUTHORITY

16 March 2009

Prudential Indicators, Treasury Management Strategy and Minimum Revenue Provision Statement

Report by Ken Finch, Treasurer

1. PURPOSE OF REPORT

1.1 To present to Members the Prudential Indicators and Treasury Management Strategy for 2009/2010 and to seek approval for the Minimum Revenue Provision (MRP) Statement.

2. INTRODUCTION

2.1 The draft budget for 2009/2010 was presented to Members for approval on 15 December 2008 and normally the procedure would have been to present the Prudential Indicators and Treasury Management Strategy with the report. However, due to time constraints they were not included with the budget report so are being presented to Members as a separate report.

2.2 This report shows the Prudential Indicators for 2009/10 to 2011/12 and outlines the strategy to be followed regarding borrowing and investing the Authority funds in the financial year 2009/2010. The report also sets out proposals for the Authority's policy on MRP. The papers attached set out:-

(i) a list of prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities (Appendix A),

(ii) the Treasury Management Strategy and Annual Plan for 2009/2010 in accordance with the CIPFA code of Practice on Treasury Management (Appendix B);

(iii) the Minimum Revenue Provision Statement (Appendix C);

(iv) budget for 2009/10 in Best Value format (Appendix D).

3. BACKGROUND - MRP STATEMENT

3.1 The Authority is required to pay off an element of the accumulated capital spend each year through a revenue charge (the Minimum Revenue Provision – MRP). The Welsh Assembly Government (WAG) have issued new Regulations which require the Fire Authority to approve an MRP Statement in advance of each year.

4. RECOMMENDATIONS

4.1 It is recommended that the:

(i) Prudential Indicators set out in Appendix A be approved;

(ii) Treasury Management Strategy and Annual Plan for 2009/2010 set out in Appendix B be approved;

(iii) Minimum Revenue Provision Policy in Appendix C be approved.

APPENDIX A

PRUDENTIAL INDICATORS FOR NORTH WALES FIRE AUTHORITY

1. The actual capital expenditure that was incurred in 2007-2008 and the estimates of capital expenditure to be incurred for the current and future years that have previously been approved by Members at the meeting of the Fire Authority in December 2008 are:

2007/08 £'000 Actual	2008/09 £'000 Outturn	2009/10 £'000 Estimate	2010/11 £'000 Estimate	2011/12 £'000 Estimate
3,906	5,825	5,606	4,000	4,000

2. Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2007-2008 are:

2007/08 Actual	2008/09 Outturn	2009/10 Estimate	2010/11 Estimate	2011/12 Estimate
3.94%	4.95%	6.18%	7.73%	8.41%

The estimates of financing costs include current commitments and the proposals approved in the budget report in December 2008.

3. Estimates of the end of year capital financing requirement for the authority for the current and future years and the actual capital financing requirement at 31 March 2008 are:

31/03/08 £'000 Actual	31/03/09 £'000 Outturn	31/03/10 £'000 Estimate	31/03/11 £'000 Estimate	31/03/12 £'000 Estimate
10,813	16,316	20,522	22,829	24,934

4. The capital financing requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, North Wales Fire Authority does not associate borrowing with particular items or types of expenditure. North Wales Fire Authority has, at any point in time, a number of cashflows both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day to day cash management, no distinction can be made between revenue cash 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 a capital purpose.

5. CIPFA's Prudential Code for Capital Finance in Local Authorities includes the following as a key indicator of prudence:

"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing 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 the next two financial years."

The Treasurer reports that the authority had no difficulty meeting this requirement in 2007-2008, nor are there any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in the budget report submitted for Members approval in December 2008.

6. In respect of its external debt, it is recommended that the Fire 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 previously agreed limit for the current year since no change to this is necessary. These limits separately identify borrowing from other long term liabilities such as finance leases. The Fire Authority is asked to approve these limits and to delegate authority to the Treasurer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for money for the authority. Any such changes made will be reported to the Fire Authority at its next meeting following the change.

Authorised Limit for External Debt

	2008/09	2009/10	2010/11	2011/12
	£'000	£'000	£'000	£'000
Borrowing	19,316	22,522	24,829	26,934

7. The Treasurer reports that these authorised limits are consistent with the authority's current commitments, existing plans and the proposals in this budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Treasurer confirms that they are based on the estimate of most likely, prudent but not worse case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account; as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.

8. The Fire Authority is also asked to approve the following operational boundary for external debt for the same time period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit but reflects directly the Treasurer's estimate of the most likely, prudent but not worse case scenario, without the additional headroom included within the authorised limit to allow for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in year monitoring by the Treasurer. Within the operational boundary, figures for borrowing and other long term liabilities, in a similar fashion to the authorised limit. Any such changes will be reported to the Fire Authority at its next meeting following the change.

Operational Boundary for External Debt

	2008/09	**2009/10**	**2010/11**	**2011/12**
	£'000	**£'000**	**£'000**	**£'000**
Borrowing	16,316	20,522	22,829	24,934

9. The Fire Authority's actual external debt at 31 March 2008 was £11,513,428. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the external debt reflects the position at one point in time.

10. In taking its decision on this report, the Fire Authority is asked to note that the authorised limit determined for 2009-2010 (see paragraph 6 above) will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

11. The estimate of the incremental impact of capital investment decisions approved in the budget report, over and above capital investment decisions that have previously been taken by the Fire Authority are:

The net increase in the contribution from the Constituent Authorities

2009/10	**2010/11**	**2011/12**
£123,325	£691,207	£1,202,274

12. In considering its programme for capital investment, the Fire Authority is required within the Prudential Code to have regard to:

- affordability, e.g. implications for the contributions from the Constituent Authorities
- prudence and sustainability, e.g. implications for external borrowing

- value for money, e.g. option appraisal
- stewardship of assets, e.g. asset management planning
- service objectives, e.g. strategic planning for the authority
- practicality, e.g. achievability of the forward plan.

13. A key measure of affordability is the incremental impact on the contribution from the Constituent Authorities, and the Fire Authority could consider different options for its capital investment programme in relation to their differential impact on the contributions.

North Wales Fire Authority's Treasury Management Strategy and Annual Plan for 2009-2010

1. Introduction

The treasury management service is an important part of the overall financial management of the Authority's affairs. The prudential indicators in Appendix A consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Authority meets balanced budget requirement under the Local Government Finance Act 1992. There are specific treasury prudential indicators included in this strategy which require approval.

North Wales Fire Authority adopted the CIPFA Code of Practice on Treasury Management on 15 December 2003. This is a requirement of the Prudential Code, which has been introduced as part of the Local Government Act 2003. The code provides an overall framework for members and officers to reduce the risks associated with the treasury function. The code requires that a report on the strategy to be followed in the forthcoming year be presented to the Fire Authority. The strategy as set out below complies with the code and is submitted as required.

2. Overview

The strategy details the likely activities of the Treasury Management staff in 2009-2010. Conwy County Borough Council undertakes the treasury function on behalf of the North Wales Fire Authority as part of the service level agreement. Due to the relatively small amounts of surplus cash held by the Fire Authority some investments may be invested under the name of Conwy County Borough Council for simplicity and detailed records of the investments maintained by the Treasury Management staff. Conwy has appointed Butlers as treasury advisors and the strategy is based on their market forecasts as outlined in their various publications.

The strategy report will cover several areas as follows:

(i) The Authority's debt and investment projections;
(ii) The expected movement in interest rates;
(iii) The Authority's borrowing strategy;
(iv) The Authority's investment strategy;
(v) Treasury performance indicators;

(i) **Debt and Investment Projections 2009/10 – 2011/12**

The current position - February 2009

Public Works Loan Board (PWLB) - £15,013,428
Investments - £1,910,000

The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed. The table below shows this effect on the treasury position over the next three years. It also highlights the expected change in investment balances.

£'000	2008/09 Revised	2009/10 Estimated	2010/11 Estimated	2011/12 Estimated
External Debt				
Debt at 1 April	11,513	16,316	20,522	22,829
Movement in CFR	5,503	4,206	2,307	2,105
Maturing Debt Replacement	0	4,395	5,500	2,500
Adjustment for prior years/advance borrowing	-700	0	0	0
Debt at 31 March	16,316	20,522	22,829	24,934
Annual change in debt	4,803	4,206	2,307	2,105
Investments				
Total Investments at 31 March	2,000	1,800	1,600	1,400
Investment change	-1,070	-200	-200	-200

(ii) **Expected Movement in Interest Rates**

Averages %	**Base Rate**	**5-year Gilt**	**20-yr Gilt**	**50-yr Gilt**
2008/09	3.9	4.2	4.8	4.5
2009/10	1.0	2.4	4.8	4.7
2010/11	1.7	3.2	4.9	4.8
2011/12	2.4	4.0	5.1	4.9

* PWLB borrowing is normally between 0.10% - 0.15% above the equivalent gilt yield

The interest rate outlook for 2008-2009 onwards has been produced by the Authority's treasury management consultants (Butlers).
The UK economy has entered a profound recession, made worse by a combination of negative growth and dislocation of the financial markets. In an attempt to ease the economic situation the Base Rate has been reduced to an historic low of 1% with a distinct possibility that rates could

fall to ½ % before the end of the financial year. Long term rates will suffer conflicting forces - the global recession should drive bond yields to lower levels but heavy gilt issues by the government seeking to finance its deficit could limit the downside potential for yields.

(iii) **Borrowing Strategy**

The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Authority will take a cautious approach to its treasury strategy.

The risks associated with long-term fixed interest rates are expected to be for higher rates over the medium term. The Treasurer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. It is likely that shorter term rates may provide better opportunities. This may include borrowing in advance of future years requirements.

With the likelihood of a steepening of the yield curve debt restructuring is to focus on switching from longer term fixed rates to cheaper short term debt, although the Treasurer will monitor prevailing rates for any opportunities during the year.

The option of postponing borrowing and running down investment balances will also be considered to reduce counterparty risk and hedge against the expected fall in investment returns. However, the level of investments continues to fall as Provisions held by the Authority decrease so this option will only yield limited benefits.

(iv) **Investment Strategy/Counterparties**

The primary principle governing the Authority's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

All investments will be made as cash deposits to banks, building societies and local authorities. Some loans will be made through one of several broking firms who are used by Conwy and others will be direct with the institution. The majority of investments will be no longer than 364 days and will be made according to the latest market forecasts. Under the National Assembly Guidance for Investments any investment that is longer than one-year maturity is a non-specified investment and as such the Authority must set a limit on the amount to be invested. Due to the small amount of investments held by the Authority the limit for non-specified investments is set at £2 million.

The Treasurer will maintain a counterparty list in compliance with the following criteria:-

Banks £5m limit
All UK and Irish banks and their subsidiaries that have good ratings (Fitch or equivalent). This is currently defined as

short term	F1
long term	A
Individual/financial Strength	B
Support	3

Banks whose ratings fall below those in the table above will be used if wholesale deposits are covered by a government guarantee.

Central Government £5m limit
Debt management Office

Local Authorities £2m limit
All except those subject to limitation of council tax and precepts under Part 1 of the Local Government Finance Act 1992.

Building Societies £2m limit
Building societies with a rating (as for the banking sector).

The criteria set out above for choosing counterparties provide a sound approach to investment in normal market conditions and Members are asked to approve this base criteria. However, due to the exceptional market conditions investments will be limited to those counterparties with a higher credit quality than the minimum criteria. Time periods for investments will also be restricted due to the uncertainty over counterparty creditworthiness. These restrictions will remain in place until the banking system returns to normal conditions.

(v) **Treasury Performance Indicators**

There are three further treasury prudential indicators the purpose of which is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs.

It is recommended that the Authority sets upper and lower limits for the maturity structure of its fixed rate borrowings as follows:

	Upper Limit	Lower Limit
Under 12 Months	40%	0%
12 Months and within 24 Months	40%	0%
24 Months and within 5yrs	50%	0%
5 yrs and within 10 yrs	75%	0%
10 yrs and above	100%	0%

It is recommended that the Authority approve the following limits on Fixed and Variable interest rates.

	% Borrowing
Fixed Interest Rate	55 – 100
Variable Interest Rate	0 – 45

Appendix C

Minimum Revenue Provision Statement

Background

1. The Capital Financing Requirement (CFR) is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources and is essentially a measure of the Authority's underlying boprrowing need. The Authority is required to pay off an element of the accumulated capital spend each year through a charge to the revenue account (the MRP) although it is also allowed to undertake additional voluntary payments.

2. Regulations have been issued which require the Fire Authority to approve an MRP statement in advance of each year.

MRP Policy

3. Members are recommended to approve the following MRP policy:

   For capital expenditure incurred before 1 April 2009 and any subsequent expenditure the MRP policy will be to repay
   - 4% of the outstanding balance of capital expenditure incurred on Land & Buildings
   - and for Vehicles, Plant, Equipment and Infrastructure the MRP will be based on the estimated life of the assets.

4. The above policy is in line with the Regulations and also follows the practice operated by the Fire Authority for a number of years. The budget for 2009/10 approved by Members in December 2008 was set using the above practices.