PART 1 ITEM No 5

LANCASHIRE COMBINED FIRE AUTHORITY

RESOURCES COMMITTEE
Meeting to be held on 29 June 2016

YEAR END TREASURY MANAGEMENT OUTTURN 2015/16
(Appendices 1 and 2 refer)

Contact for further information:
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Executive Summary

The report sets out the Authority's borrowing and lending activities during 2015/16. All borrowing and investment activities undertaken throughout the year are in accordance with the Treasury Management Strategy 2015/16, and are based on anticipated spending and interest rates prevailing at the time.

Recommendation

The Resources Committee is asked to note and endorse the outturn position report

Information

In accordance with the updated CIPFA Treasury Management code of practice and to strengthen Members' oversight of the Authority's treasury management activities, the Resources Committee receives regular updates on treasury management issues including a mid-year report and a final outturn report. Reports on treasury activity are discussed on a quarterly basis with Lancashire County Council Treasury Management Team and the Director of Corporate Services and the content of these reports is used as a basis for this report to the Committee.

Economic Overview

Growth, Inflation, Employment:

The UK economy slowed in 2015 with GDP growth falling to 2.3% from a robust 3.0% the year before. Consumer Price Index (CPI) inflation hovered around 0.0% through 2015 with deflationary spells in April, September and October. The prolonged spell of low inflation was attributed to the continued collapse in the price of oil from $67 a barrel in May 2015 to just under $28 a barrel in January 2016, the appreciation of sterling since 2013 pushing down import prices and weaker than anticipated wage growth resulting in subdued unit labour costs. CPI picked up to 0.3% year/year in February, but this was still well below the Bank of England's 2% inflation target. The labour market continued to improve through 2015 and in Q1 2016, the latest figures (Jan 2016) showing the employment rate at 74.1% (the highest rate since comparable records began in 1971) and the unemployment rate at a 12 year low of 5.1%. Wage growth has however remained modest at around 2.2% excluding bonuses, but after a long period of negative real wage growth (i.e. after inflation) real earnings were positive and growing at their fastest rate in eight years, boosting consumers' spending power.

Global influences:

The slowdown in the Chinese economy became the largest threat to the South East Asian region, particularly on economies with a large trade dependency on China and also to prospects for global growth as a whole. The effect of the Chinese authorities' intervention in their currency and equity markets was temporary and led to high market volatility as a consequence. There were falls in prices of equities and risky assets. As the global economy entered 2016 there was high uncertainty about growth, the outcome of the US presidential election and the consequences of June's referendum on whether the UK is to remain in the EU. Between February and March 2016 sterling had depreciated by around 3%, a significant proportion of the decline reflecting the uncertainty surrounding the referendum result.

UK Monetary Policy:

The Bank of England's MPC (Monetary Policy Committee) made no change to policy, maintaining the Bank Rate at 0.5% (in March it entered its eighth year at 0.5%) and asset purchases (Quantitative Easing) at £375bn. In its Inflation Reports and monthly monetary policy meeting minutes, the Bank was at pains to stress and reiterate that when interest rates do begin to rise they were expected to do so more gradually and to a lower level than in recent cycles.

Improvement in household spending, business fixed investment, a strong housing sector and solid employment gains in the US allowed the Federal Reserve to raise rates in December 2015 for the first time in nine years to take the new Federal funds range to 0.25%-0.50%. Despite signalling four further rate hikes in 2016, the Fed chose not to increase rates further in Q1 and markets pared back expectations to no more than two further hikes this year.

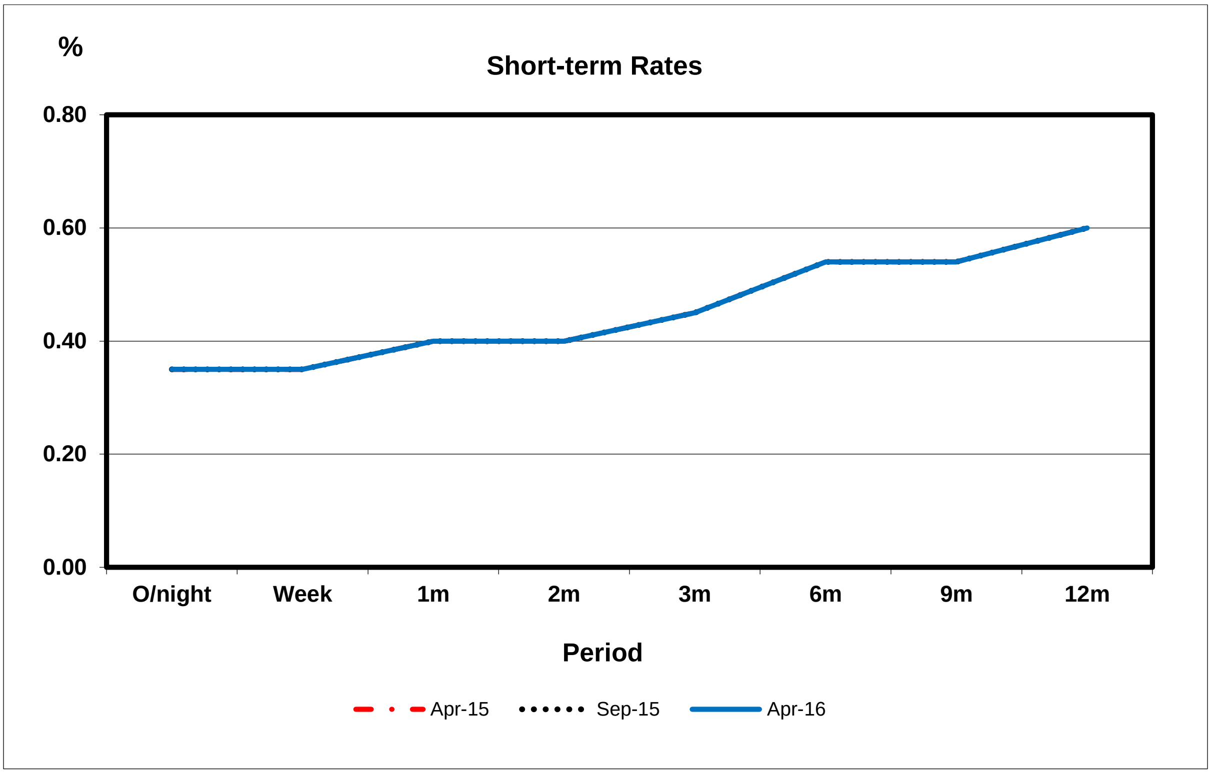
However central bankers in the Eurozone, Switzerland, Sweden and Japan were forced to take policy rates into negative territory. The European Central Bank also announced a range of measures to inject sustained economic recovery and boost domestic inflation which included an increase in asset purchases (Quantitative Easing).

Market reaction: From June 2015 gilt yields were driven lower by the a weakening in Chinese growth, the knock-on effects of the fall in its stock market, the continuing fall in the price of oil and commodities and acceptance of diminishing effectiveness of central bankers' unconventional policy actions. Added to this was the heightened uncertainty surrounding the outcome of the UK referendum on its continued membership of the EU as well as the US presidential elections which culminated in a significant volatility and in equities and corporate bond yields.

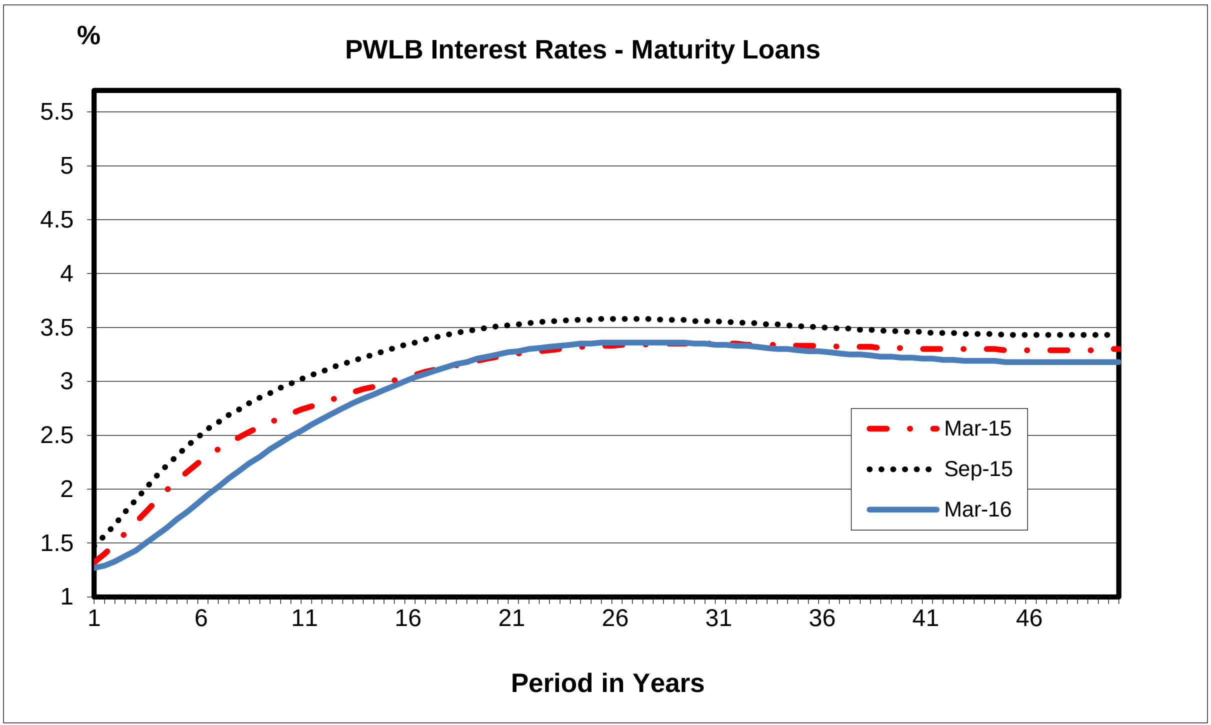
10-year gilt yields moved from 1.58% on 31/03/2015 to a high of 2.19% in June before falling back and ending the financial year at 1.42%. The pattern for 20-year gilts was similar, the yield rose from 2.15% in March 2015 to a high of 2.71% in June before falling back to 2.14% in March 2016. The FTSE All Share Index fell 7.3% from 3664 to 3395 and the MSCI World Index fell 5.3% from 1741 to 1648 over the 12 months to 31 March 2016.

Interest Rate Environment

Short term interest rates continue at very low levels since the Bank of England reduced the base rate to 0.5% in March 2009. Short term investment levels available in the market remained below 0.6% through the year as illustrated in the chart below.



The chart below gives an indication of how PWLB rates have changed during the year:



Lancashire County Council's treasury management advisors Arlingclose Treasury Consultants has changed its forecast of interest rates movement. It now considers that the next move in the Bank base rate will be in Q2 2018. Last year it was anticipated that the next increase would have been in Q2 2017. (Note that the Quarter and Half years referred to are calendar years, as opposed to financial years).

Period	Bank Rate	3 month LIBID	12 month LIBID	20-year guilt Yield
Q2 2016	0.50	0.50	1.00	2.30
Q3 2016	0.50	0.50	1.05	2.35
Q4 2016	0.50	0.55	1.10	2.40
Q1 2017	0.50	0.60	1.10	2.45
Q2 2017	0.50	0.65	1.15	2.50
Q3 2017	0.50	0.70	1.20	2.55
Q4 2017	0.50	0.75	1.25	2.60
Q1 2018	0.50	0.80	1.30	2.65
Q2 2018	0.75	0.85	1.35	2.68
H1 2019	0.75	1.05	1.40	2.75

Due to the economic outlook the forecast of low interest rates is expected to continue.

Cash Flow

Cash flow predictions are made on a rolling basis in order to ensure that the Authority has sufficient funds to meet its day to day requirements and also inform investment and borrowing decisions.

Appendix 1 shows the actual cash flows over the last 12 months, split between fixed deposits and the call account, whilst appendix 2 shows the accuracy of cash flow projections over the same period.

Broadly speaking it can be seen that the cash flow projections are reasonably accurate. The cash flow position, along with the interest rate environment, form part of the regular discussions between the Director of Corporate Services and the Lancashire County Council Treasury Management Team, in order to inform future decisions on borrowing and investments.

Borrowing

The Fire Authority's cash investments remain significantly in excess of borrowing requirements. Hence the Authority has adopted a policy to set aside additional monies in the form of additional Minimum Revenue Provisions (MRP) in order to reduce borrowing requirements and enable the repayment of debt as it matures, as well as reducing credit rate risk.

This policy has seen overall debt reduce from £8.1m in 2009/10 to its current level of £5.8m. No new borrowing has been taken out in the year, and £0.25m of debt matured in the year.

	2015/16
	£'000
Borrowing at 31 March 2015	6,014
Repayment of Maturing Debt	(250)
New Borrowing	-
Borrowing at 31 March 2016	**5,764**

During the year the Authority has to make a charge to revenue to make a provision to pay debt. This statutory minimum revenue charge is broadly 4% of previous capital expenditure funded from borrowing adjusted to take into account a shorter asset life of some assets. In 2015/16 this charge was £0.010m.

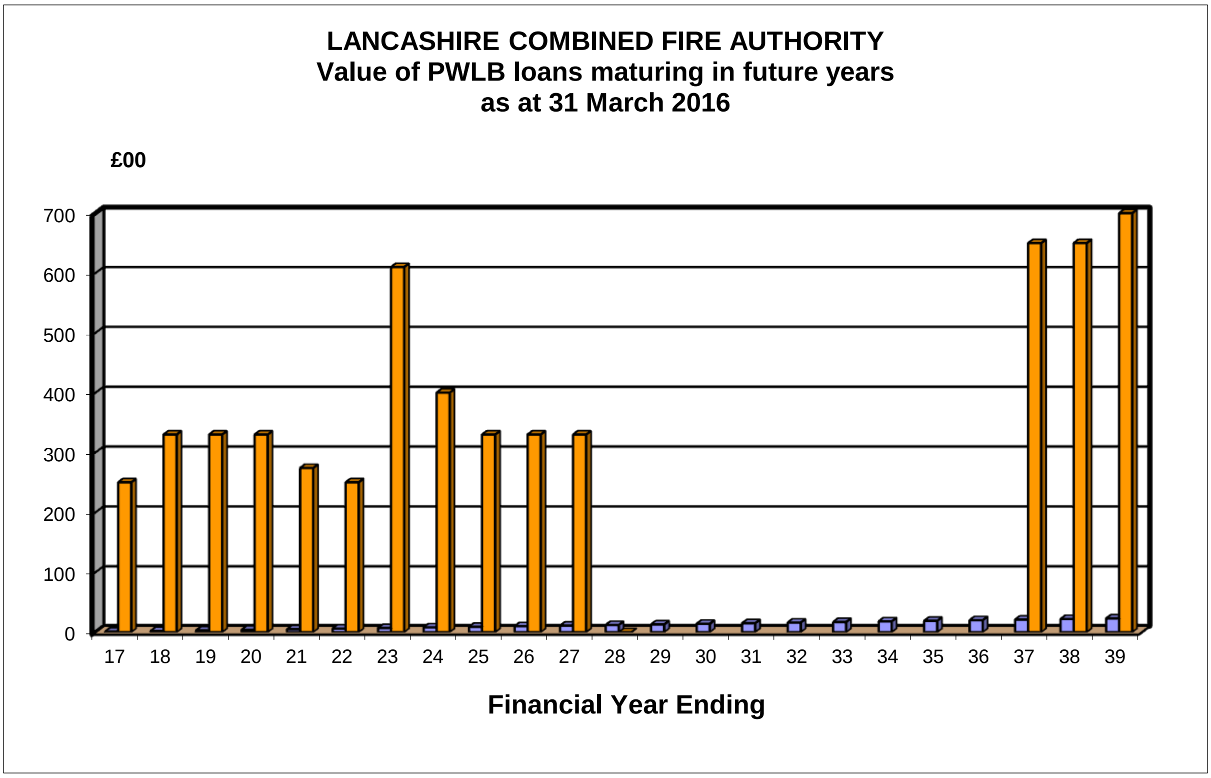
In addition, in the budget setting process for 2014/15 it was decided that an additional MRP payments were to be made in order to set aside sufficient monies to provide scope to pay off debt in 5 years' time. This was reflected in an additional voluntary charge of £0.162m in 2015/16.

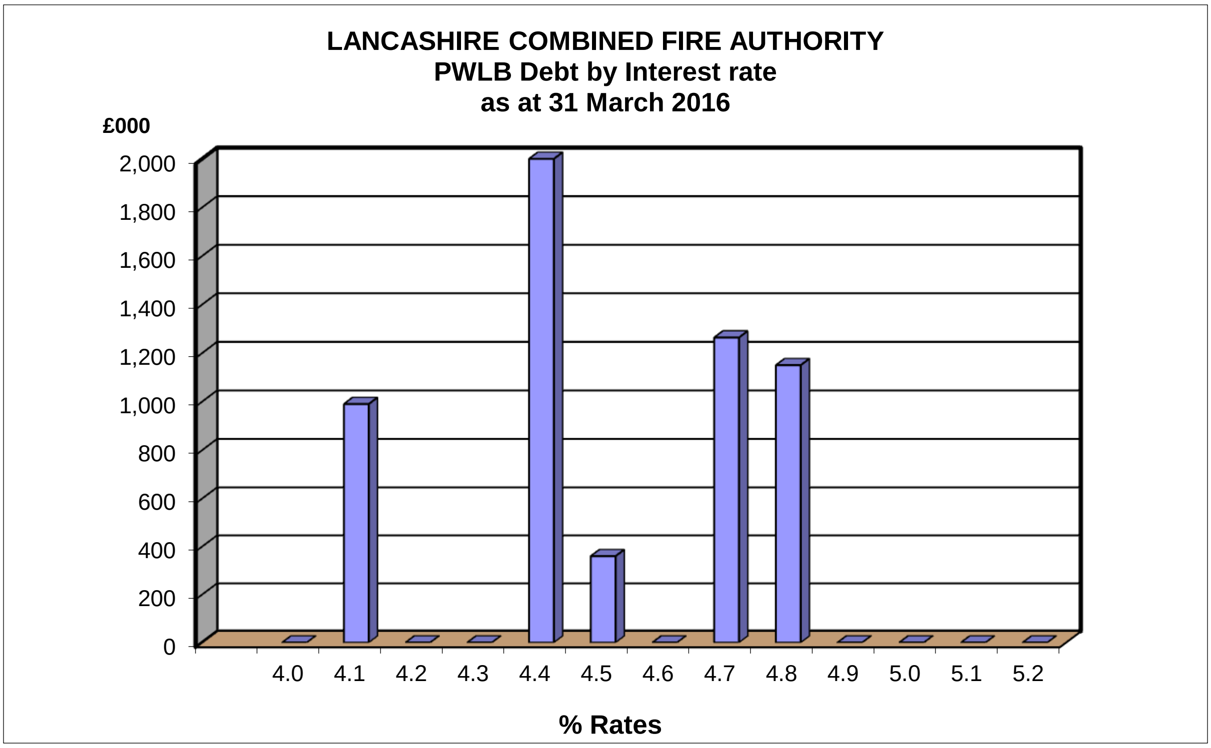
The negative borrowing requirement shown in the table below will be carried forwards until 2018/19, when the Authority will hold £4.849m after repaying debt as it falls due. This balance is anticipated match the level of debt outstanding at 31 March 2019. An annual review of the penalties due on early repayment is carried out, and should these be considered favourable the Authority will consider whether to repay the debt.

	2015/16
	£'000
Borrowing requirement b/fwd from previous year	(5,760)
Repayment of Maturing Debt	250
Borrowing for Capital Programme	-
Less • Statutory MRP	(10)
• Voluntary MRP	(162)
Total Borrowing Requirement to carry forward	(5,682)

* Note MRP is the sum of money we are required to set aside each year to reduce our overall level of debt. Historically this has equated to a 4% statutory amount plus an additional voluntary element to allow the future repayment of all PWLB debt.

The charts over the page show the current maturity profile and interest rate profile of the Authority's borrowings.





Total interest payable on PWLB borrowing amounts to £0.275m, which equates to an average interest rate of 4.57%. This compares favourably with the average rate paid by English counties nationally which is 4.60%

Investments

For a number of years following the financial crisis of 2008, in order to reduce credit risk to the Authority, Lancashire County Council (credit rating by Moodys AA2) was the counterparty for all of the Authority's investments. However this counterparty list was expanded for in the 2014/15 Treasury Management Strategy to include other high quality counterparties.

Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving low investment returns.

The addition of the other counterparties into the investment policy is intended to improve investment returns whilst retaining the very high credit quality of the portfolio.

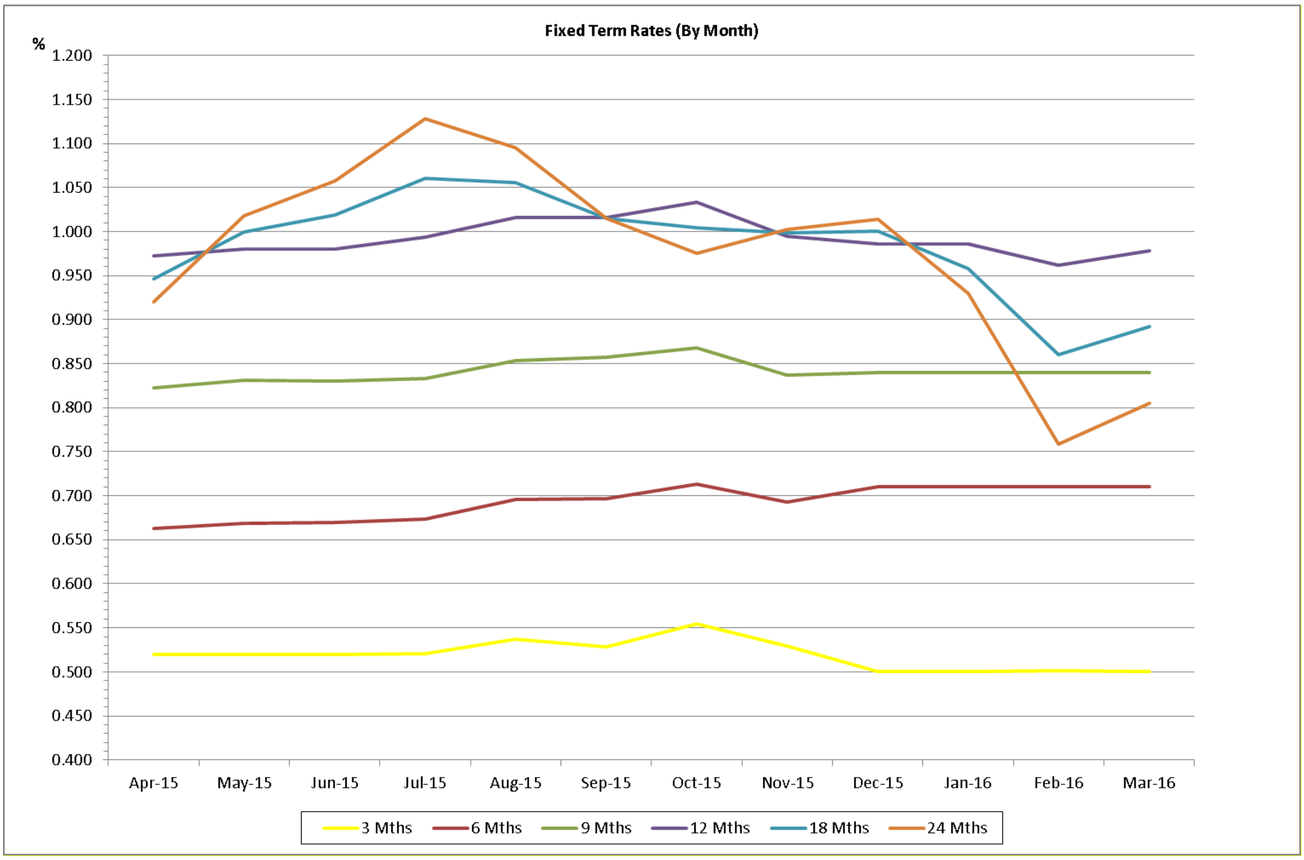
In accordance with this policy, two long term investments are held with UK local authorities as outlined below:

Start Date	End Date	Principal	Rate	Annual Interest
30/6/14	28/6/19	£5,000,000	2.4%	£120,000
31/7/14	31/7/17	£5,000,000	1.6%	£80,000

In addition to these the Authority had access to the call account provided by Lancashire County Council which paid the base rate throughout 2015/16. Each working day the balance on the Authority's current account is invested in this to ensure that the interest received on surplus balances is maximised. The average balance in this account during the year was £43.178m accruing interest of £166k.

The overall interest earned during this period was £366k at a rate of 0.69% which compares favourably with the benchmark 7 day notice index which averages 0.36% over the same period.

The chart over the page shows the current interest rates for different investment maturities.



All of these investments are made in accordance with the current Treasury Management Strategy and the CIPFA treasury management code of practice.

Cash flow and interest rates continue to be monitored by the Director of Corporate Services and the County Council's treasury management team, and when rates are felt to be at appropriate levels further term deposits will be placed.

Prudential Indicators

In order to control and monitor the Authority's treasury management functions, a number of prudential indicators are determined against which performance may be measured. The revised indicators for 2015/16 are shown in the table below alongside the actual outturn position.

	Revised	**Actual**
Adoption of the CIPFA Code of Practice for Treasury Management	Adopted	Adopted
Authorised limit for external debt	£000	£000
A prudent estimate of total external debt, which does not reflect the worst case scenario, but allows sufficient headroom for unusual cash movements		
Borrowing	8,000	5,764
Other long-term liabilities – these relate to vehicle finance leases and the PFI agreements	15,500	14,958
Total	23,500	20,722

Operational boundary for external debt		
A prudent estimate of debt, but no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the Authority's current plans		
Borrowing	7,000	5,764
Other long-term liabilities – these relate to vehicle finance leases and the PFI agreements	15,500	14,958
Total	22,500	20,722
Upper limit for fixed interest rate exposure		
Borrowing	100%	100%
Investments	100%	0%
Upper limit for variable rate exposure		
Borrowing	25%	Nil
Investments	100%	100%
Upper limit for total principal sums invested for over 364 days (per maturity date)	15,000	Nil
Maturity structure of debt	**Upper/ Lower Limits**	**Actual**
Under 12 months	30%/nil	4.34
12 months and within 24 months	30%/nil	11.45
24 months and within 5 years	50%/nil	10.48
5 years and within 10 years	80%/nil	33.31
10 years and above	90%/nil	40.42
Historically the above maturity structure has proved to be sound. It aims to produce a stable debt structure over the longer-term whilst permitting the exploitation of favourable interest rates at the short end of the market if they arise.		

Financial Implications

The following table summarises the Financing costs for the Authority, comparing actual with budget:-

	Revised Budget	**Actual**	**Reason for variance**
Interest Payable on PWLB loans	£0.275m	£0.275m	In line with revised budget
Interest Receivable on call account and fixed term investments	(£0.264m)	(£0.366m)	We have generated £106k additional investment income reflecting high levels of cash balances
Minimum Revenue Provision re PWLB loans	£0.0172m	£0.172m	In line with revised budget
Net financing costs from Treasury Management activities*	£0.183m	£0.081m	

* There are financing costs associated with vehicle finance leases and the PFI agreements, which are not included in the balances above as they are not the result of Treasury Management activities.

Human Resource Implications

None

Equality and Diversity Implications

None

Business Risk Implications

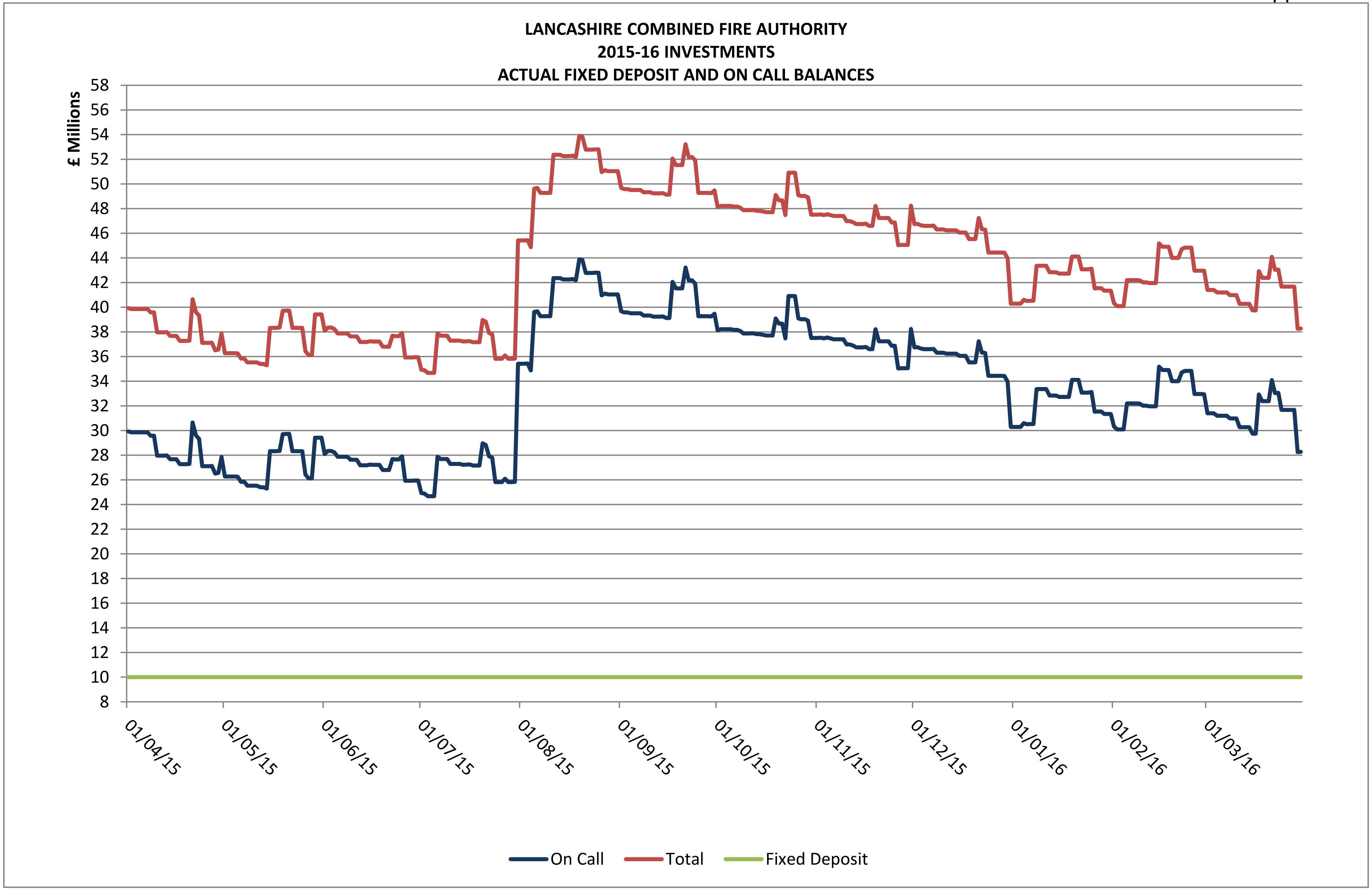
The Treasury Management Strategy is designed to maximise interest earned, minimise interest paid whilst maintaining an acceptable level of risk. The reviews of performance provide Members with an assurance that this has been complied with.

Environmental Impact

None

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact
Treasury Management Strategy 2015/16	February 2015	Keith Mattinson, Director of Corporate Services
SORP and Guidance	February 2016	Keith Mattinson, Director of Corporate Services
Reason for inclusion in Part II, if appropriate:		



LANCASHIRE COMBINED FIRE AUTHORITY
2015-16 INVESTMENTS
ACTUAL FIXED DEPOSIT AND ON CALL BALANCES
£ Millions
58
56
54
52
50
48
46
44
42
40
38
36
34
32
30
28
26
24
22
20
18
16
14
12
10
8
01/04/15
01/05/15
01/06/15
01/07/15
01/08/15
01/09/15
01/10/15
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01/01/16
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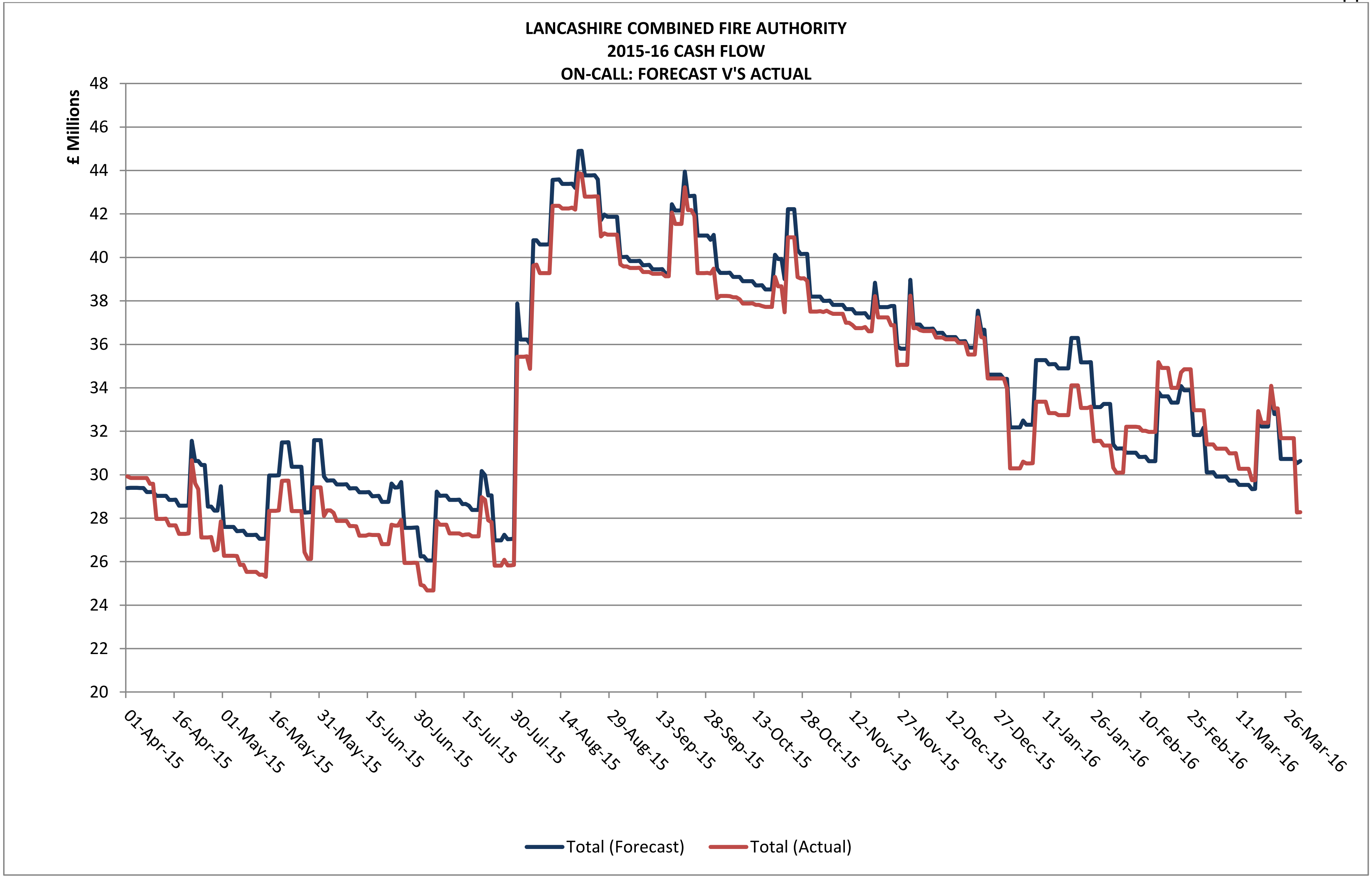
01/03/16
On Call
Total
Fixed Deposit


LANCASHIRE COMBINED FIRE AUTHORITY
2015-16 CASH FLOW
ON-CALL: FORECAST V'S ACTUAL
£ Millions
48
46
44
42
40
38
36
34
32
30
28
26
24
22
20
01-Apr-15
16-Apr-15
01-May-15
16-May-15
31-May-15
15-Jun-15
30-Jun-15
15-Jul-15
30-Jul-15
14-Aug-15
29-Aug-15
13-Sep-15
28-Sep-15
13-Oct-15
28-Oct-15
12-Nov-15
27-Nov-15
12-Dec-15
27-Dec-15
11-Jan-16
26-Jan-16
10-Feb-16
25-Feb-16
11-Mar-16
26-Mar-16
Total (Forecast)
Total (Actual)