DEVON & SOMERSET
FIRE & RESCUE AUTHORITY

REPORT REFERENCE NO.	**DSFRA/11/14**
MEETING	**DEVON & SOMERSET FIRE & RESCUE AUTHORITY (Ordinary Meeting)**
DATE OF MEETING	**27 MAY 2011**
SUBJECT OF REPORT	**ANNUAL TREASURY MANAGEMENT REPORT 2010/2011**
LEAD OFFICER	**TREASURER**
RECOMMENDATIONS	***That the performance in relation to the treasury management activities of the Authority for 2010/2011, as set out in this report, be noted.***
EXECUTIVE SUMMARY	The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management requires that the Authority receives a report in respect of borrowing and investment activities during the year and compares this performance against the treasury management strategy adopted. The report includes a performance report relating to the 2010/11 financial year.
RESOURCE IMPLICATIONS	As indicated within the report.
EQUALITY IMPACT ASSESSMENT	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	Appendix A – Prudential indicators 2010/2011.
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (including Prudential and Treasury Indicators) Report DSFRA/10/3 Policy as approved at the meeting held on the 19 February 2010.

1. INTRODUCTION

1.1 The Treasury Management Strategy for Devon & Somerset Fire & Rescue Authority (DSFRA) is underpinned by its adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2001 and subsequent amendments to that Code (the latest being November 2009). The Authority originally adopted the Code at its meeting on 16 March 2007, with the most recent revision being agreed at the Authority meeting on 19 February 2010. The Authority fully complies with the primary requirements of the Code, which includes:

- The creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Authority's treasury management activities.
- The creation and maintenance of Treasury Management Practices, which set out the manner in which the Authority will seek to achieve those policies and objectives.
- The receipt by the Authority of an annual strategy report for the year ahead, a mid year treasury update report and an annual review report of the previous year.
- The delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
- Delegation by the Authority of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Authority is the Resources Committee.

1.2 Treasury management in this context is defined as:

> *"The management of the local Authority's investments and 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. "*

2. THE ECONOMY

2.1 2010/11 proved to be another watershed year for financial markets. Rather than a focus on individual institutions, market fears moved to sovereign debt issues, particularly in the peripheral Euro zone countries. Local authorities were also presented with changed circumstances following the unexpected change of policy on Public Works Loan Board (PWLB) lending arrangements in October 2010. This resulted in an increase in new borrowing rates of 0.75 – 0.85%, without an associated increase in early redemption rates. This made new borrowing more expensive and repayment relatively less attractive.

2.2 UK growth proved mixed over the year. The first half of the year saw the economy outperform expectations, although the economy slipped into negative territory in the final quarter of 2010 due to inclement weather conditions. The year finished with prospects for the UK economy being decidedly downbeat over the short to medium term while the Japanese disasters in March, and the Arab Spring, especially the crisis in Libya, caused an increase in world oil prices, which all combined to dampen international economic growth prospects.

2.3 The change in the UK political background was a major factor behind weaker domestic growth expectations. The new coalition Government struck an aggressive fiscal policy stance, evidenced through heavy spending cuts announced in the October Comprehensive Spending Review, and the lack of any "giveaway" in the March 2011 Budget. Although the main aim was to reduce the national debt burden to a sustainable level, the measures are also expected to act as a significant drag on growth.

2.4 Gilt yields fell for much of the first half of the year as financial markets drew considerable reassurance from the Government's debt reduction plans, especially in light of Euro zone sovereign debt concerns. Expectations of further quantitative easing also helped to push yields to historic lows. However, this positive performance was mostly reversed in the closing months of 2010 as sentiment changed due to sharply rising inflation pressures. These were also expected (during February / March 2011) to cause the Monetary Policy Committee to start raising Bank Rate earlier than previously expected.

2.5 The developing Euro zone peripheral sovereign debt crisis caused considerable concerns in financial markets. First Greece (May), then Ireland (December), were forced to accept assistance from a combined EU/IMF rescue package. Subsequently, fears steadily grew about Portugal, although it managed to put off accepting assistance until after the year end. These worries caused international investors to seek safe havens in investing in non-Euro zone government bonds.

2.6 Deposit rates picked up modestly in the second half of the year as rising inflationary concerns, and strong first half growth, fed through to prospects of an earlier start to increases in Bank Rate. However, in March 2011, slowing actual growth, together with weak growth prospects, saw consensus expectations of the first UK rate rise move back from May to August 2011 despite high inflation. The disparity of expectations on domestic economic growth and inflation encouraged a wide range of views on the timing of the start of increases in Bank Rate in a band from May 2011 through to early 2013. This sharp disparity was also seen in MPC voting which, by year-end, had three members voting for a rise while others preferred to continue maintaining rates at ultra low levels.

2.7 Risk premiums were also a constant factor in raising money market deposit rates in periods beyond 3 months. Although market sentiment has improved, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, mean that investors remain cautious of longer-term commitment. The European Commission did try to address market concerns through a stress test of major financial institutions in July 2010. Although only a small minority of banks "failed" the test, investors were highly sceptical as to the robustness of the tests, as they also are over further tests now taking place with results due in mid-2011.

2.8 Charts 1 and 2 overleaf show movements since the start of 2010 in respect of investment returns and borrowing rates.

Chart 1: Bank Rate v LIBID investment rates

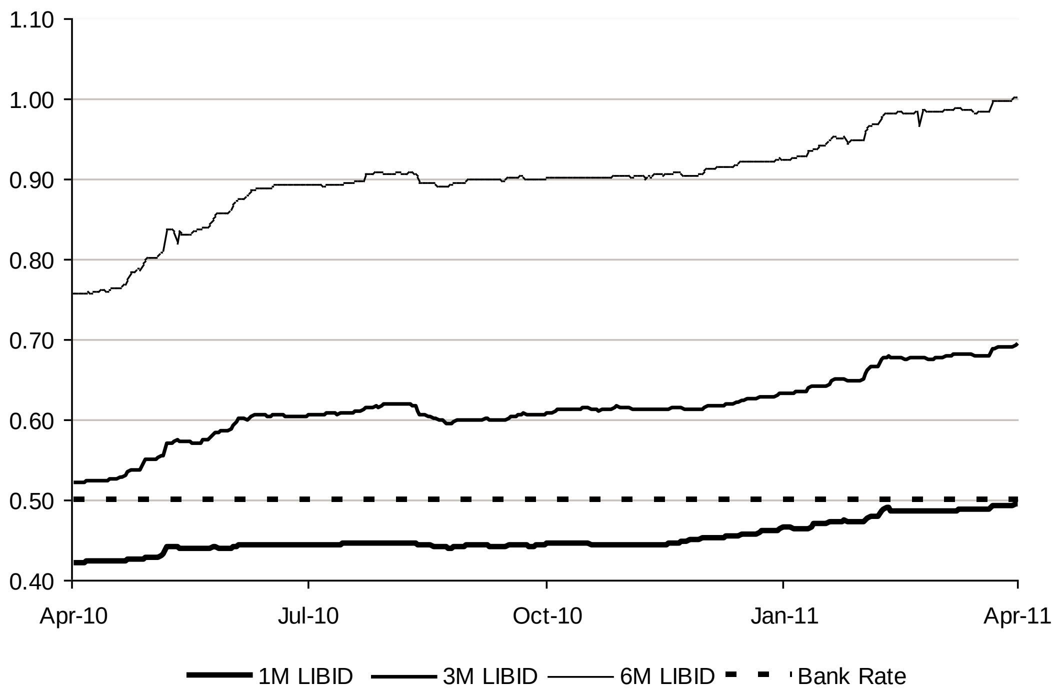
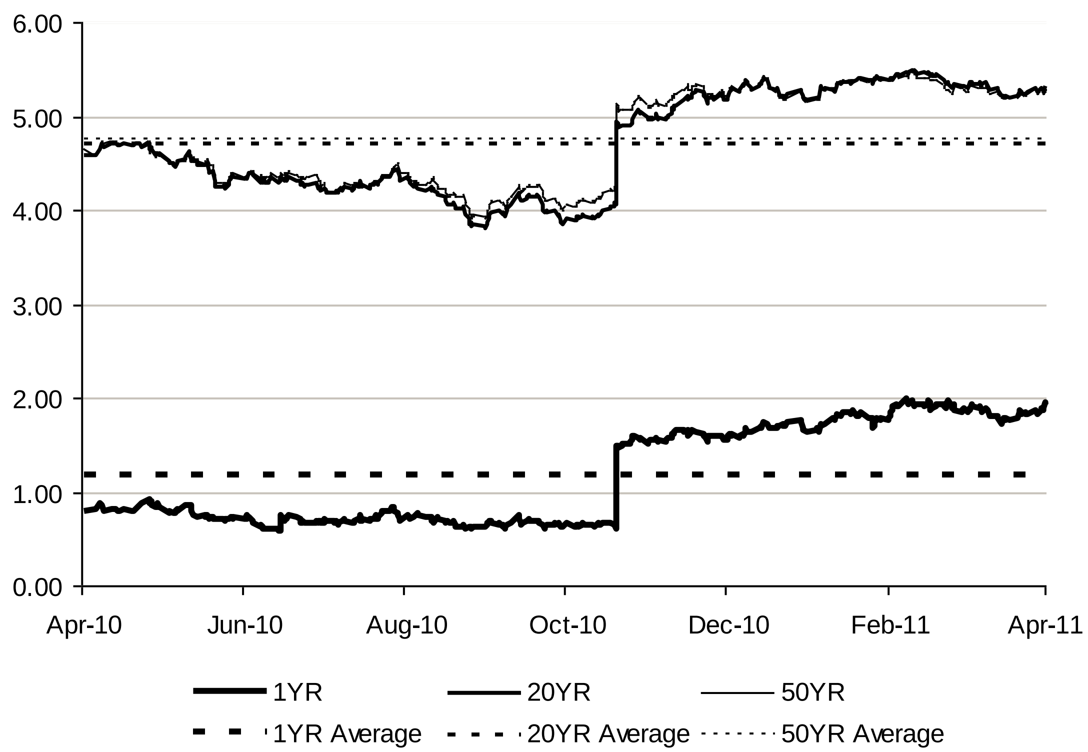


Chart 2: Average v new borrowing rates

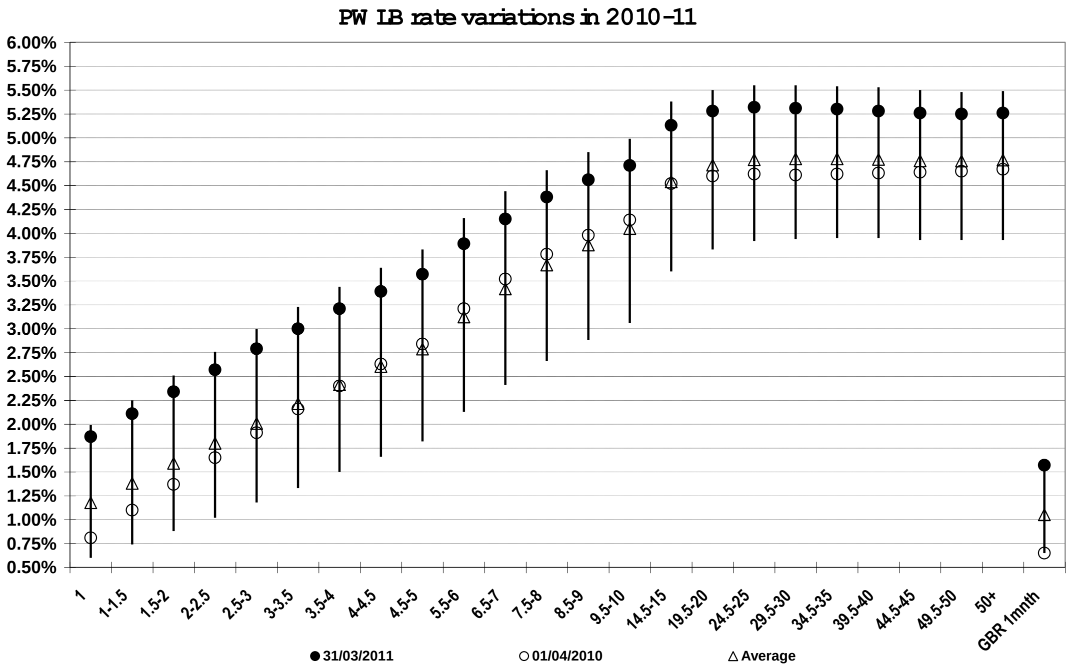


3. BORROWING

Public Works Loan Board (PWLB) borrowing rates 2010/2011

3.1 The graph and table for PWLB maturity rates below show, for a selection of maturity periods, the range (high and low points) in rates, the average rates and individual rates at the start and the end of the financial year.

3.2 Variations in most PWLB rates have been distorted by the October 2010 decision by the PWLB to raise it borrowing rates by about 0.75 – 0.85% e.g. if it had not been for this change, the 25 year PWLB at 31 March 2011 (5.32%) would have been only marginally higher than the position at 1 April 2010.



PWLB BORROWING RATES 2010/11 for 1 to 50 years

	1	1.5-2	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
01/04/2010	0.810%	1.370%	1.910%	2.400%	2.840%	4.140%	4.620%	4.650%	0.650%
31/03/2011	1.870%	2.340%	2.790%	3.210%	3.570%	4.710%	5.320%	5.250%	1.570%
HIGH	1.990%	2.510%	3.000%	3.440%	3.830%	4.990%	5.550%	5.480%	1.570%
LOW	0.600%	0.880%	1.180%	1.500%	1.820%	3.060%	3.920%	3.930%	0.650%
Average	1.177%	1.590%	2.009%	2.413%	2.788%	4.050%	4.771%	4.756%	1.052%
Spread	1.390%	1.630%	1.820%	1.940%	2.010%	1.930%	1.630%	1.550%	0.920%
High date	07/02/2011	07/02/2011	07/02/2011	07/02/2011	09/02/2011	09/02/2011	09/02/2011	09/02/2011	07/03/2011
Low date	15/06/2010	12/10/2010	12/10/2010	12/10/2010	12/10/2010	31/08/2010	31/08/2010	31/08/2010	01/04/2010

DSFRA Borrowing Strategy

Prudential Indicators:

3.3 It is a statutory duty for the Authority to determine and keep under review the "Affordable Borrowing Limits". The Authority's' approved Prudential Indicators (affordability limits) are outlined in the approved TMSS.

3.4 During the financial year DSFRA operated within the treasury limits and Prudential Indicators set out in the Authority's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in Appendix A.

DSFRA Borrowing during and at the end of 2010/2011

3.5 As at the end of March 2011, due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), external borrowing for the Authority of £3.000m was undertaken throughout the year at the rates shown in the table below.

	Summary of loan movements during 2010/2011			
		Amount £m		
	Value of loans outstanding as at 1/4/10	**26.650**		
	Loans taken during 2010/2011			
Date of Loan	Type of loan		Life (Years)	Interest Rate
25/05/2010	Maturity	0.500	16.5	4.20%
25/05/2010	Maturity	0.500	33.5	4.29%
25/05/2010	Maturity	0.500	34.5	4.28%
25/05/2010	Maturity	0.500	35.5	4.29%
25/05/2010	Maturity	0.500	36.5	4.29%
25/05/2010	Maturity	0.500	49.5	4.29%
	Loans repaid during 2010/2011	(1.041)		
	Loans rescheduled during 2010/2011	0		
	Total value of loans outstanding as at 31/3/2011	**28.609**		

4. INVESTMENTS

Investment rates in 2010/2011

4.1 The tight monetary conditions following the 2008 financial crisis continued through 2010/11 with little material movement in the shorter term deposit rates. Bank Rate remained at its historical low of 0.5% throughout the year, although growing market expectations of the imminence of the start of monetary tightening saw 6 and 12 month rates picking up.

4.2 Overlaying the relatively poor investment returns was the continued counterparty concerns, most evident in the Euro zone sovereign debt crisis which resulted in rescue packages for Greece, Ireland and latterly Portugal. Concerns extended to the European banking industry with an initial stress testing of banks failing to calm counterparty fears, resulting in a second round of testing currently in train. This highlighted the ongoing need for caution in treasury investment activity. The table below indicates the highs and lows over varying investment periods during the last financial year.

	Overnight	7 Day	1 Month	3 Month	6 Month	1 Year
01/04/2010	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
31/03/2011	0.44%	0.46%	0.50%	0.69%	1.00%	1.47%
High	0.44%	0.46%	0.50%	0.69%	1.00%	1.47%
Low	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
Average	0.43%	0.43%	0.45%	0.61%	0.90%	1.35%
Spread	0.03%	0.04%	0.07%	0.17%	0.24%	0.28%
High date	31/12/2010	30/03/2011	31/03/2011	31/03/2011	31/03/2011	31/03/2011
Low date	01/04/2010	01/04/2010	01/04/2010	01/04/2010	01/04/2010	01/04/2010

DSFRA Investment Strategy

4.3 The Authority's Annual Investment Strategy, which is incorporated in the Treasury Management Strategy Statement, outlines the Authority's investment priorities as follows:

- Security of Capital
- Liquidity

4.4 The Authority will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with highly credit rated financial institutions using the Sector suggested creditworthiness matrices, including Credit Default Swap (CDS) overlay information provided by Sector. In addition to this approach the Authority has the ability to use building societies under specified and non-specified investments.

DSFRA Investments during and at the end of 2010/2011

4.5 No institutions in which investments were made during 2010/11 had any difficulty in repaying investments and interest in full during the year and the Authority had no liquidity difficulties.

4.6 A full list of investments held as at 31 March 2011 are shown in the table overleaf:

Investments as at 31st March 2011				
Counterparty	Maximum to be invested	Total amount invested	Call or Term	Interest rate(s)
	£m	£m		
Bank of Scotland	5.0	1.645	C	0.75%
		1.0	T	2.00%
Cater Allen	5.0	1.5	T	0.82%
		1.5	T	1.41%
Kent Reliance B/S	1.5	1.5	T	0.95%
Nottingham B/S	1.5	1.5	T	1.80%
Principality B/S	1.5	1.5	T	0.70%
West Bromwich B/S	1.5	1.5	T	0.75%
Total invested as at 31st March 2011		**11.645m**		

4.7 Funds available for investment are on a temporary basis, the level of which are dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

4.8 As illustrated, the Authority outperformed the benchmark by 37 bp**.** The Authority's budgeted treasury investment income for 2010/11 was £0.070m against which £0.137m was achieved, exceeding the budget by £0.067m.

Benchmark	**Average level of funds available for Investment**	**Benchmark Return**	**Authority Performance**	Investment Interest Earned
7 day	£15.174m	0.43%	0.80%	£137,407

5. SUMMARY

5.1 In compliance with the requirements of the CIPFA Code of Practice of Treasury Management, this report provides members with a summary report of the treasury management activities during 2010/2011. As is indicated in this report, none of the Prudential Indicators have been breached, and a prudent approach has been taken in relation to investment decisions taken during the year, with priority being given to liquidity and security over yield. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments continued to be dominated by risk considerations resulting in relatively low returns compared to borrowing rates. Despite this, the Authority achieved returns above the LIBID 7 day rate, which is the benchmark return for this type of short term investments.

5.2 The Authority's debt and investment position at the beginning and the end of the year was as follows:

SUMMARY	31st March 2011 Principal	Rate/ Return	31st March 2010 Principal	Rate/ Return
Fixed Rate Funding:				
-PWLB	£28.609m	4.219%	£26.651m	4.177%
Total Debt	***£28.609m***	***4.219%***	***£26.651m***	***4.177%***
Investments:				
-In-House	£11.645m	0.80%	£2.810m	0.91%
Total Investments	***£11.645m***	***0.80%***	***£2.810m***	***0.91%***

KEVIN WOODWARD
Treasurer

PRUDENTIAL INDICATOR	2009/10 £m actual	2010/11 £m approved	2010/11 £m actual
Capital Expenditure			
Non - HRA	9.707	7.539	3.466
HRA (applies only to housing authorities)	0	0	0
TOTAL	9.707	7.539	3.466
Ratio of financing costs to net revenue stream			
Non - HRA	3.21%	3.80%	4.01%
HRA (applies only to housing authorities)	0%	0%	0%
Capital Financing Requirement as at 31 March (borrowing only)			
Non – HRA	28.148	32.128	28.251
HRA (applies only to housing authorities)	0	0	0
TOTAL	28.148	32.128	28.251
Annual change in Cap. Financing Requirement			
Non – HRA	6.871	3.980	0.103
HRA (applies only to housing authorities)	0	0	0
TOTAL	6.871	3.980	0.103
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase/(decrease) in council tax (band D) per annum	(£1.02)	(£0.25)	£(0.25)
TREASURY MANAGEMENT PRUDENTIAL INDICATORS			
	£m	**£m**	**£m**
Authorised Limit for external debt -			
borrowing	36.628	40.488	40.488
other long term liabilities	0	0	0
TOTAL	36.628	40.488	40.488
Operational Boundary for external debt -			
borrowing	33.761	37.726	37.726
other long term liabilities	0	0	0
TOTAL	33.761	37.726	37.726

	Actual 31st March 2011	upper limit %	lower limit %
Limits on borrowing at fixed interest rates	100%	100%	70%
Limits on borrowing at variable interest rates	0%	30%	0%
Maturity structure of fixed rate borrowing during 2010/11			
Under 12 months	3.51%	10%	0%
12 months and within 24 months	5.20%	15%	0%
24 months and within 5 years	9.62%	30%	0%
5 years and within 10 years	2.28%	50%	0%
10 years and above	79.39%	100%	50%