

CHESHIRE FIRE AUTHORITY

MEETING OF: CHESHIRE FIRE AUTHORITY
DATE: 7TH DECEMBER 2022
REPORT OF: HEAD OF FINANCE
AUTHOR: WENDY BEBBINGTON

SUBJECT: TREASURY MANAGEMENT – MID YEAR
REPORT 2022/23

Purpose of Report

1. To update Members on performance against the Authority's Treasury Management Strategy (TMS).

Recommended That:

- [1] the report be noted; and
- [2] the future requirement for borrowing to support the ongoing capital programme is noted.

Background

2. The first requirement for treasury management is to ensure that the organisational cash flow is adequately planned with cash being available when it is needed. Surplus monies are invested in low risk counter-parties or instruments commensurate with the low risk appetite, providing adequate liquidity initially before considering investment return. This means the order of priority for all investment decisions is Security, Liquidity (access to cash) and then Yield (interest earned).
3. The second main function of treasury management is the funding of capital plans. These capital plans provide a guide to the borrowing need which is essentially the longer term cash flow planning to ensure that capital spending obligations can be met. The management of longer term cash may involve arranging long or short term loans or using longer term cash flow surpluses. On occasion any debt currently held may be re-structured in line with risk or cost objectives.
4. Accordingly, treasury management is defined as:

"The management of the authority's borrowing, 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."
5. This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of

Practice on Treasury Management (revised 2017) which recommends that those charged with governance are updated on treasury management activities regularly by way of a strategy at the start of the year, a mid-year review and an outturn report.

6. CIPFA published revised Prudential and Treasury Management Codes on 20 December 2021 and has stated that formal adoption is not required until the 2023/24 financial year.
7. The Authority had regard to these changes when approving an annual Treasury Management Strategy and an associated Capital Strategy for 2022/23 on 9 February 2022.
8. This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:
 - An economic update for the first part of the 2022/23 financial year;
 - A review of the Treasury Management Strategy Statement (including the Annual Investment Strategy);
 - The capital expenditure and borrowing position;
 - A review of the investment portfolio for 2022/23;
 - A review of compliance with Treasury and Prudential Limits for 2022/23.

ECONOMIC BACKGROUND

9. The first half of 2022/23 has seen political and economic volatility and uncertainty along with significant inflationary pressures, a weakening pound and a reduction in market confidence all leading to rises in interest rates. The Monetary Policy Committee (MPC) has now increased interest rates eight times in 2022 and raised rates by 0.75% to 3.0% at its November meeting, the highest level since the Global Financial Crisis. This latest increase was made on 2 November 2022 and reflected a split vote – seven members voting for a 75 basis points increase, one for 50 basis points and one for 25 basis points.
10. The MPC continues to grapple with getting inflation back on track over a three-year period following the new Prime Minister and Chancellor seeking to ensure, in their Autumn Statement, that the public finances are kept on a sound footing and that any projected gaps (possibly £50bn to £60bn) are fully funded from efficiencies and/or net tax increases.
11. Further, while the MPC said that the Government's energy support package "will lower and bring forward the expected peak in CPI inflation" and may, therefore, reduce the risk of "more persistent domestic price and wage pressures", it also said that it means "household spending is likely to be less weak than projected" and that "this would add to inflationary pressures in the medium term".

12. The MPC will now make a further assessment at its next scheduled meetings of the impact on demand and inflation following the Government's Autumn Statement announcements and act accordingly. The MPC will not hesitate to change interest rates by as much as needed to return inflation to the 2% target in the medium term, in line with its remit. Against this backdrop, the MPC will have to tread carefully. It will need to evidence to the markets that it sees the reduction in inflation as a primary objective, but also that it remains alert to the fact that it does not want any recession to be deeper and more prolonged than it needs to be.
13. The Authority has appointed Link Group as treasury advisors and part of their service is to assist with formulating a view on interest rates. Their latest forecast below sets out a view that both short and long-dated interest rates will remain elevated for some time, as the Bank of England seeks to manage inflation out of the economy, whilst the Government aims to protect households and businesses from the extreme pressure of ultra-high wholesale gas and electricity prices, whilst restoring confidence in the UK's longer term stability.

Link Group Interest Rate View 08.11.22		Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE		3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings		3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings		4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings		4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB		4.30	4.30	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB		4.50	4.50	4.40	4.30	4.20	4.00	3.90	3.70	3.60	3.50	3.40	3.30	3.20
25 yr PWLB		4.70	4.70	4.60	4.50	4.40	4.30	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB		4.30	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.40	3.30	3.20	3.20

14. In terms of the above Bank Rate expectations, previously anticipated peak levels next year have dropped in light of the near-universal reversal of policies announced in the September mini-budget as well as Bank of England action to calm gilt markets. For 2022, market pricing is now more biased towards a move to 3.5% for December's meeting, with a further 0.5% increase priced in for February 2023, before the MPC scales down the rate of increase by 0.25% in both March and May 2023. Thereafter, market expectations ease back on expected increases, with no change thereafter anticipated for meetings through to December 2023.
15. In view of the significant ongoing political and economic volatility, interest rate forecasting with any degree of certainty is currently impossible and it may be that interest rates remain higher for longer than currently forecast.

TREASURY MANAGEMENT STRATEGY STATEMENT UPDATE

16. The Treasury Management Strategy Statement (TMSS) was approved by the Authority on 9 February 2022. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

CAPITAL PROGRAMME & BORROWING

17. In preparing the capital programme, attention is given to understanding the potential liabilities and risks associated with the expenditure and funding of the annual capital programme. In particular, the combined impact on the overall financial position of the Authority in terms of revenue and capital budgets, to ensure that such activity remains proportionate. There is a relationship in anticipating that borrowing will be required to fund the capital programme and the associated Minimum Revenue Provision and Interest Payable revenue costs.
18. The table below provides an indication of the capital programme, the resulting amount of annual borrowing required and the associated revenue financing costs over the next 3 years.

Table 1: Capital Expenditure Forecasts	2022/23 £000	2023/24 £000	2024/25 £000
Forecast Capital Programme	9,336	10,909	6,865
To be funded by new borrowing (estimate)	7,300	4,050	250
Estimated associated revenue cost of existing plus new borrowing (MRP & Interest Payable)	1,044	1,349	1,530

19. The Authority currently has a loan portfolio of £12.012m which includes external borrowing of £11m to finance the Training Centre project, secured from PWLB at favourably low fixed rates in March 2021 (£4m at 1.99%), July 2021 (£4m at 1.65%) and November 2021 (£3m at 1.63%).
20. The above table shows the amount of planned capital expenditure to be financed by an additional borrowing requirement (around £11.6m), mainly in respect of the in progress Crewe and Wilmslow major Estates projects. Additional new borrowing will therefore be required over the period.
21. Historically the Authority has financed the majority of its capital programme from reserves and capital grants. Looking ahead, it seems certain that there will be no future capital grant funding for fire authorities and capital reserves have now been fully committed to the existing programme for some time. As a result, any future new or additional approval of capital expenditure over and above the currently planned programme, will need to be funded by further new borrowing in addition to the new borrowing already approved.
22. In addition, the ongoing requirement to fund an annual capital programme for essential vehicle, equipment and technology replacements beyond the current financial planning period will also require the Authority to allocate significant levels of revenue funding to the programme and/or to enter into new external borrowing.

23. The approved Treasury Management Strategy included provision for £7.5m of new external borrowing during 2022/23. However, in view of the sharp rise in interest rates and current market volatility, together with reduced cashflow pressure from the re-profiling of the Station Modernisation Programme expenditure into 2023/24 and 2024/25, this new borrowing is currently being deferred. Market rates and forecasts will continue to be kept under close review in order to secure the borrowing at the optimum point.
24. The Authority currently remains in an under-borrowed position, which means that decisions have been made to internally finance expenditure as opposed to entering into new external borrowing. As a result of deferring the planned 2022/23 new external borrowing, the position at 31 March 2023 is now forecast to be around £10.6m internally borrowed. This is temporarily above the target of £6m, but consistent with the current strategy of increasing internal borrowing over the period of major estates projects delivery in order to minimise new long term external borrowing over this period. It will be achieved through careful cashflow management,
25. At this point increasing internal borrowing as detailed above, supported by short periods of temporary external borrowing if required, is considered to be manageable and a sensible target position in view of the current high cost of borrowing and forecasts that this will begin to reduce as the economy stabilises over the next two to three years. The position will continue to be monitored closely throughout the remainder of 2022/23 and reviewed again as part of the 2023/24 Treasury Management Strategy.
26. The following tables show the actual debt maturity profile of current borrowing as at 31 October 2022 and a comparison with approved Upper and Lower Limits.

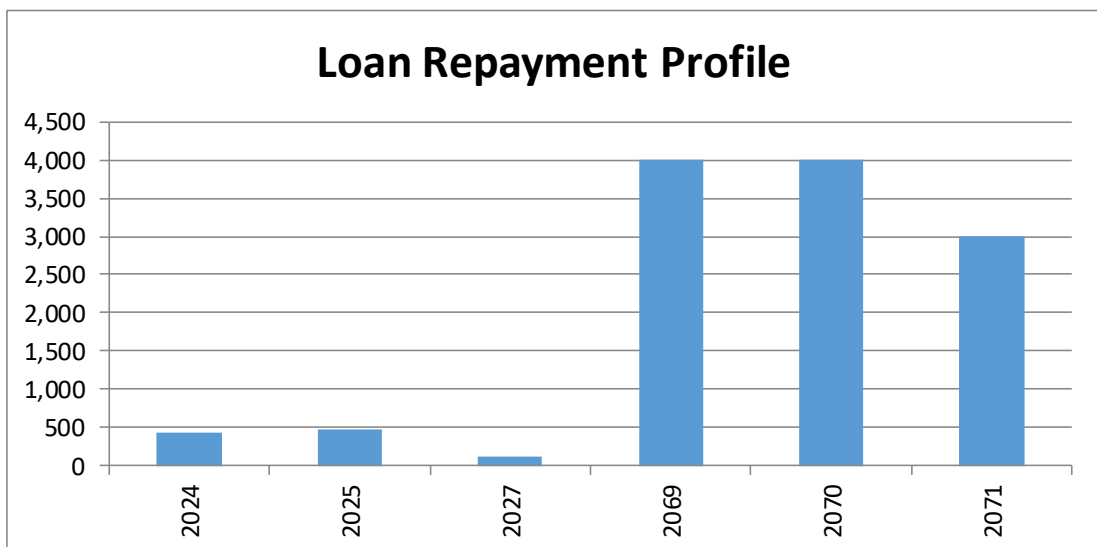


Table 2 Maturity Structure of Borrowing				
	Upper Limit %	Lower Limit %	Actual 31/10/22 %	Amount £000
Under 12 months	15	0	0	0
12 months and within 24 months	15	0	3	426
24 months and within 5 years	25	0	5	586
5 years and 10 years	25	0	0	0
10 years and above	100	50	92	11,000
Total			100	12,012

27. This indicator is designed to be a control over an authority having large concentrations of fixed rate debt having to be replaced at times of uncertainty over interest rates. The limits set represent sensible boundaries and are intended to draw attention to potential issues before they arise.
28. Advice has again been sought from the Authority's treasury management advisors who suggest that opportunities have been very limited in the current economic climate given the consequent structure of interest rates and associated early loan repayment penalties. No debt rescheduling has therefore been undertaken or is anticipated in the current financial year.

INVESTMENT PORTFOLIO 2022/23

29. The Annual Investment Strategy has the priorities of security, liquidity and yield. The aim is to achieve the optimum yield within the approved investment counter-parties which are scrutinised regularly for creditworthiness within the security principle. Liquidity is achieved within the forecast spending profile and cashflows.
30. Over recent years, it has been impossible to generate significant levels of investment income due to the 0.1% base rate, leading to available short-term investment rates with suitable counterparties being barely above zero. However, the recent increases to base rate, current market forecasts and proactive cashflow management, have enabled the Authority to secure significantly increased short to medium term rates of return over recent months. Interest on balances earned to date is £169k to 31 October, with final 2022/23 outturn currently forecast to be around £340k (£41k 2021/22) compared with the annual budget (£10k) for investment income in 2022/23.
31. The Authority has continued with a cautious approach to its choice of counterparties. As at 25 November 2022, the Authority's investments were with UK Debt Management Office, Santander, Aberdeen Standard Liquidity Money Market Fund and NatWest, all of which are used regularly to manage day-to-day cashflows. Other investment counterparties used

during the year are Goldman Sachs. The current investment counterparty criteria selection approved in the Treasury Management Strategy is meeting the requirement of the treasury management function.

Investments 25/11/2022	£'000
UK Debt Management Office	8,000
Santander UK	4,500
Natwest	117
Aberdeen Standard Liquidity MMF	8,000
Total	20,617

32. There have been no known instances of non-compliance with approved Annual Investment Strategy limits during the year.

REVIEW OF COMPLIANCE WITH PRUDENTIAL INDICATORS

33. It is a statutory duty for those charged with governance to determine and keep under review a range of prudential indicators and treasury limits. During the financial year to date, treasury management activities have operated within the approved indicators and limits and in compliance with the Treasury Management Practices. The following table compares the estimated performance on key prudential indicators in 2022/23 against those approved by the Authority in February 2022.

Prudential Indicators	2022/23 Indicator £000	2022/23 Revised Estimate £000	Comment
Capital expenditure	16,177	9,336	Pause / re-profiling of Station Modernisation project and later than anticipated start to Crewe new build.
Capital Financing Requirement	25,424	22,624	
Annual change in capital financing requirement	9,298	6,498	
Gross borrowing requirement: (Under) / Over borrowing	(5,912)	(10,612)	Deferral of planned £7.5m borrowing in 2022/23 offset by lower borrowing requirement as above.
Ratio of financing costs to net revenue stream	2.32%	1.50%	Deferral of new borrowing and increased investment interest received reduces net financing costs.

Treasury Indicators	2022/23 Indicator £000	2022/23 Revised Estimate £000	
Authorised limit for external debt	24,212	24,212	Set 9/2/22, no change planned during 2022/23.
Operational boundary for external debt	22,212	22,212	
Actual external debt			Planned £7.5m new borrowing deferred due to current high interest rates and improved cash balances resulting from re-profiling of Station Modernisation project into 2023/24 and 2024/25.
- Borrowing	19,512	12,012	
- Other long term liabilities	0	0	
Total	19,512	12,012	
Upper limit of fixed interest rate exposure	100%	100%	
Upper limit of variable interest rate exposure	25%	0%	No variable rate loans held or planned
Upper limit for principal sums invested for over 365 days	£nil	£nil	No longer term investments held or planned.

Financial Implications

34. The subject of this report is financial.

Legal Implications

35. The Local Government Act 2003 and the associated CIPFA Code of Practice for Treasury Management recommends that those charged with governance are updated on treasury management activities regularly by way of a strategy at the start of the year, a mid-year review and an outturn report.

Equality & Diversity Implications

36. There are no known equality and diversity issues arising from this report.

Environmental Implications

37. There are no known environmental issues arising from this report.

CONTACT: DEMOCRATIC SERVICES, CLEMONDS HEY, WINSFORD

TEL [01606] 868804

BACKGROUND PAPERS: None