CHESHIRE FIRE AUTHORITY

MEETING OF: **CHESHIRE FIRE AUTHORITY**
DATE: **6th DECEMBER 2023**
REPORT OF: **TREASURER**
AUTHOR: **PAUL VAUGHAN**

SUBJECT: TREASURY MANAGEMENT – MID YEAR REPORT 2023/24

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 by 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 2021) 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, followed by quarterly reviews and an outturn report.

6. CIPFA published revised Prudential and Treasury Management Codes on 20 December 2021 with formal adoption being required for 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 2023/24 on 15 February 2023.

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 2023/24 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 2023/24;
- A review of compliance with Treasury and Prudential Limits for 2023/24.

ECONOMIC BACKGROUND

9. The first half of 2023/24 saw:

- Interest rates rise by a further 1%, taking the Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
- A 0.5% month on month decline in real GDP in July.
- CPI inflation falling from 8.7% in April to 6.7% in September, its lowest rate since February 2022, but still the highest in the G7.
- Core CPI inflation declining to 6.1% in September from 7.1% in April and May, a then 31 year high.

10. As the growing drag from higher interest rates intensifies over the next six months, the economy is expected to continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year, but the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too as the Bank of England is expected to keep interest rates at the probable peak of 5.25% until the second half of 2024.

11. In its latest monetary policy meetings on 20 September and 1 November, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes, however, show that the decision remains "finely balanced". In September five of the nine committee members voted to maintain the rate at 5.25% with the remaining four members preferring a further 0.25% increase. In November, this margin had increased from 5:4 to 6:3 to maintain the Bank Rate at 5.25%

12. The Bank of England did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish view that rates will likely "need to be restrictive for an extended period of time".

13. The Authority has appointed Link Group as its treasury advisors and part of their service is to assist with formulating a view on interest rates. The latest forecast on 7th November sets out a view that short, medium and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

Link Group Interest Rate View	07.11.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.25	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.30	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.40	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.50	3.30	3.30	3.30	3.30	3.30
5 yr PWLB	5.00	4.90	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.60	3.50	3.50	3.50
10 yr PWLB	5.10	5.00	4.80	4.70	4.40	4.20	4.00	3.80	3.70	3.70	3.60	3.60	3.50
25 yr PWLB	5.50	5.30	5.10	4.90	4.70	4.50	4.30	4.20	4.10	4.10	4.00	4.00	4.00
50 yr PWLB	5.30	5.10	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.80	3.80	3.80

TREASURY MANAGEMENT STRATEGY STATEMENT UPDATE

14. The Treasury Management Strategy Statement (TMSS) was approved by the Authority on 15 February 2023. 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 AND BORROWING

15. In preparing the capital programme, attention is given to understanding the potential liabilities and risks associated with the expenditure and funding of expenditure, in particular, the combined impact on the overall financial position of the Authority in terms of revenue and capital budgets. This is 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.

16. 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	**2023/24 £000**	**2024/25 £000**	**2025/26 £000**
Forecast Capital Programme	10,284	7,075	5,375
To be funded by new borrowing (estimate)	4,456	250	250
Estimated associated revenue cost of existing plus new borrowing (MRP & Interest Payable)	979	1,333	1,418

17. 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%).

18. The above table shows the amount of planned capital expenditure still to be financed by an additional borrowing requirement (around £5m), which is in addition to the additional borrowing requirement of £6.4m already incurred in 2022/23. The overall new borrowing requirement over the current financial planning period is therefore around £11.4m, which is in line with approved plans to finance the completed major estates project in Wilmslow, the in progress new Crewe Fire Station and the continuing modernisation of Service houses. Additional new borrowing will therefore be required over the period.

19. It should also be noted that there is currently no financial provision included in any plans relating to either Ellesmere Port or Warrington Fire Stations. If significant additional capital expenditure is approved in respect of these sites, it will be necessary to increase the future borrowing requirement and to recognise the impact of associated financing costs in the Medium Term Financial Plan.

20. 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 will be diminished as they help fund the existing programme. As a result, the ongoing requirement to fund an annual capital programme for essential vehicles, equipment and technology replacements along with future strategic building projects will require the Authority to allocate significant levels of revenue funding to the programme and/or to enter into new external borrowing.

21. The approved Treasury Management Strategy includes provision for £4m of new external borrowing during 2023/24, however in view of continuing high interest rates, together with reduced cashflow pressure from re-profiling of Fire Station Modernisation Programme expenditure into late

2023/24 and future years, the timing of 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.

22. 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 approved 2022/23 and 2023/24 new external borrowing, the position at 31 March 2024 is now forecast to be around £13.9m internally borrowed. This is temporarily above the 2023/24 target of £10m, 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.

23. 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 short term 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. It is not, however, sustainable on a longer term basis as current reserve balances are used to support current financial plans, most notably the ongoing Fire Station Modernisation Programme. The position will continue to be monitored closely throughout the remainder of 2023/24 and reviewed again as part of the 2024/25 Treasury Management Strategy.

24. The following tables show the actual debt maturity profile of current borrowing as at 31 October 2023 and a comparison with approved Upper and Lower Limits.

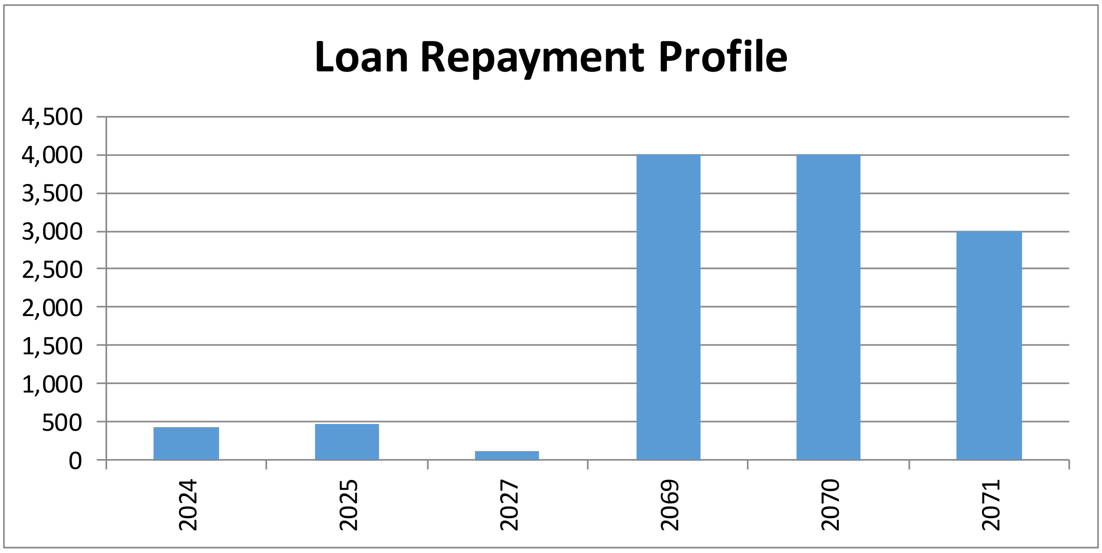


Table 2 Maturity Structure of Borrowing				
	Upper Limit %	Lower Limit %	Actual 31/10/23 %	Amount £000
Under 12 months	15	0	3	426
12 months and within 24 months	15	0	4	467
24 months and within 5 years	25	0	1	119
5 years and 10 years	25	0	0	0
10 years and above	100	50	92	11,000
Total			100	12,012

25. 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.

26. Advice has again been sought from the Authority's Treasury Management advisors on the potential for debt restructuring. They suggest that opportunities have been very limited in the current economic climate given the 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.

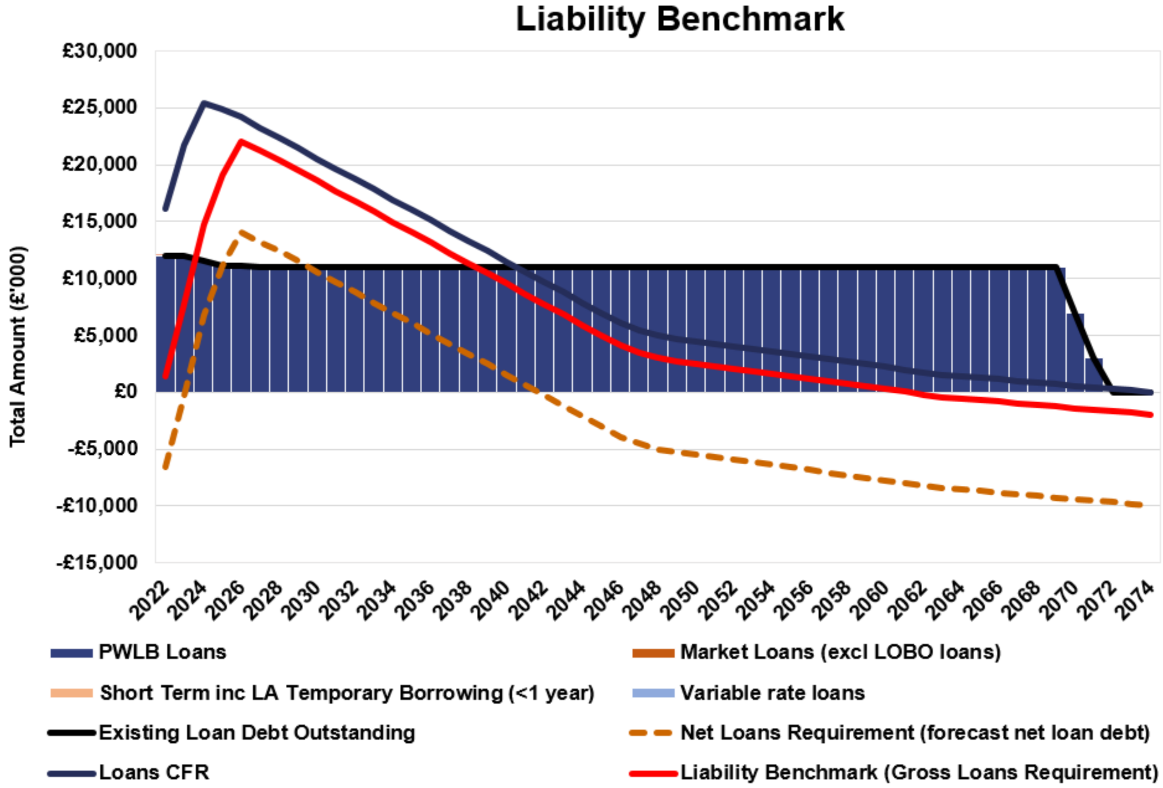
LIABILIITY BENCHMARK

27. A new prudential indicator from 2023/24 is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum. However, CIPFA strongly recommends that the LB is produced for at least ten years and should ideally cover the full debt maturity profile of a public body. The chart below covers the Authority's full debt maturity profile as recommended.

28. There are four components to the Liability Benchmark:

1. **Existing loan debt outstanding**: the Authority's existing loans that are still outstanding in future years.
2. **Loans Capital Financing Requirement (CFR)**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.
3. **Net loans requirement**: this shows the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on approved prudential borrowing, planned MRP and any other major cash flows forecast.

4. **Liability benchmark (or gross loans requirement)**: this equals net loans requirement plus short-term liquidity allowance.



29. The aim of the LB is to minimise/reduce refinancing, interest rate and credit risks by informing the timing and duration of new external borrowing.

30. The position is largely unchanged from that reported in the Treasury Management Strategy and shows that the Authority's LB is currently rising sharply to a peak in around 2026 indicating the additional borrowing requirement associated with delivery of the currently approved major estates projects. This requirement then reduces as provision is made to repay outstanding borrowing via the annual MRP charge whilst no further Capital Expenditure financed by borrowing is currently planned beyond 2026.

31. In view of this, by around 2038 (one year earlier than the 2039 date previously anticipated due to the £0.5m underspend re: the completed Wilmslow estate project reducing the overall forecast borrowing requirement), the LB will have reduced back down to the level of the existing loan portfolio, indicating that although there is a significant short to medium term requirement for new borrowing, this borrowing would ideally be for a range of durations up to around 15 years, i.e. filling the white triangular period in the chart between 2023 and 2038 where the LB (red line) exceeds the current loan portfolio (black line/bar chart).

32. The chart continues to show that that the existing loan debt portfolio will be fully repaid by 2072 and that the requirement to borrow (CFR) will also be reduced to nil by 2074, indicating that the Authority's current MRP policy remains prudent and appropriate.

33. The chart then indicates that without any further new approved capital expenditure financed by borrowing beyond the period of the current Capital Strategy, the existing borrowing portfolio exceeds the LB after 2038. If this remains the case then it indicates either excess cash requiring investment or an opportunity to repay/restructure debt over this future period.

INVESTMENT PORTFOLIO 2023/24

34. 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.

35. Increasing interest rates and proactive cashflow management have enabled the Authority to secure significantly increased short to medium term rates of return over recent months and will again result in a surplus versus budget in 2023/24. It is however anticipated that the opportunity to generate ongoing investment returns at current levels will reduce significantly towards the end of 2023/24 as planned capital expenditure, and the continuing deferral of approved borrowing, has a significant impact upon cashflow balances available for investment. Interest on balances earned to date is £432k to 31 October, with final 2023/24 outturn currently forecast to be around £680k (£417k 2022/23) compared with the annual budget (£10k) for investment income in 2023/24.

36. The Authority has continued with a cautious approach to its choice of counterparties. As at 31 October 2023, the Authority's investments were with Lloyds Bank of Scotland, Santander, Federated Hermes Money Market Fund, 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 the UK Debt Management Office. The current investment counterparty criteria selection approved in the Treasury Management Strategy is meeting the requirement of the treasury management function.

Investments 31/10/2023	£'000
Natwest	1,180
Lloyds Bank of Scotland	2,000
Santander UK	5,000
Federated Hermes MMF	5,100
Aberdeen Standard Liquidity MMF	2,710
Total	**15,990**

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

REVIEW OF COMPLIANCE WITH PRUDENTIAL INDICATORS

38. 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 2023/24 against those approved by the Authority in February 2023.

Table 3: Prudential and Treasury Indicators			
Prudential Indicators	2023/24 Indicator £000	2023/24 Revised Estimate £000	Comment
Capital expenditure	9,592	10,284	Re-profiling of expenditure relating to Crewe new build and Fire Station Modernisation Programme, along with slippage relating to planned vehicle purchases from 2022/23 into 2023/24.
Capital Financing Requirement	25,925	25,454	
Annual change in capital financing requirement	3,301	3,719	
Gross borrowing requirement: (Under) / Over borrowing	(10,339)	(13,868)	Lower overall borrowing requirement due to £0.5m underspend re: Wilmslow project and deferral of £4m new external borrowing planned in 2023/24 (paragraphs 21-23 refer)
Ratio of financing costs to net revenue stream	2.07%	1.89%	Temporary deferral of new borrowing reduces in-year financing costs.

Treasury Indicators	2023/24 Indicator £000	2023/24 Revised Estimate £000	
Authorised limit for external debt	20,636	20,636	Set 15/2/23, no change planned during 2023/24.
Operational boundary for external debt	18,636	18,636	
Actual external debt			Current borrowing £12.012m less £0.426m to be repaid 2023/24 = £11.586m. New short term borrowing of £4m planned for 2023/24 now deferred until 2024/25 (paragraphs 21-23 refer).
- Borrowing	15,586	11,586	
- Other long term liabilities	0	0	
Total	15,586	11,586	
Upper limit of fixed interest rate exposure	100%	100%	
Upper limit of variable interest rate exposure	25%	Nil	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

39. The subject of this report is financial.

Legal Implications

40. 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, followed by quarterly reviews and an outturn report.

Equality & Diversity Implications

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

Environmental Implications

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

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BACKGROUND PAPERS: None