CHESHIRE FIRE AUTHORITY

MEETING OF: **CHESHIRE FIRE AUTHORITY**
DATE: **12TH DECEMBER 2018**
REPORT OF: **HEAD OF FINANCE**
AUTHOR: **WENDY BEBBINGTON**

SUBJECT: **TREASURY MANAGEMENT – MID YEAR REPORT 2018-19**

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 requirement to borrow in line with previous approval for the Training Centre be 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. In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following:

   - a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
   - an overview of how the associated risk is managed
   - the implications for future financial sustainability

6. The associated 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.

7. The Authority agreed an annual Treasury Management Strategy for 2018/19 on 14 February 2018.

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 2018/19 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 2018/19;
   - A review of compliance with Treasury and Prudential Limits for 2018/19.

ECONOMIC BACKGROUND

9. The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee (MPC), to unanimously (9-0) vote to increase Bank Rate on 2 August 2018 from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

10. Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components such as oil prices, but is expected to fall back to the 2% inflation target over the

next two years. given a scenario of minimal increases in Bank Rate. The MPC has indicated that the Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

11. As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009 (the previous high point was in July 2015). Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

12. A summary of projected interest rates is provided in the table below.

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

TREASURY MANAGEMENT STRATEGY STATEMENT UPDATE

13. The Treasury Management Strategy Statement (TMSS) was approved by the Authority on 14 February 2018. 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

14. 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.

15. 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 current and next 3 years.

Table 1: Capital Expenditure Forecasts	**2018/19 £000**	**2019/20 £000**	**2020/21 £000**	**2021/22 £000**
Forecast Capital Programme	3,152	17,743	8,657	4,179
To be funded by new borrowing (estimate)	400	8,800	1,549	3,774
Estimated associated revenue cost of existing plus new borrowing (MRP & Interest Payable)	464	599	696	1,155

16. Historically the Authority has financed the majority of its capital programme from reserves and capital grants. Looking ahead, it seems almost certain that there will be no future capital grant funding for fire authorities and capital reserves are now all committed to the existing programme. As a result, the ongoing requirement to fund an annual capital programme for essential vehicle, equipment and technology replacements along with current and future strategic building projects will require the Authority to increase revenue funding of the programme and to enter into new external borrowing as estimated in the above table.

17. The Authority currently remains in an under-borrowed position, which means that historically decisions have been made to internally finance expenditure as opposed to borrowing. The position at 31 March 2019 is anticipated to be c£5m under-borrowed.

18. At this point maintaining under-borrowing at c£5m going forward is considered to be manageable and a sensible position in view of poor returns that can be achieved on cash balances invested. The cashflow impact will however be kept under review and it may well be necessary to reduce under-borrowing as cash reserves reduce due to ongoing budget pressures and as capital reserves are used to fund the currently approved new station build and modernisation projects.

19. The Authority had a loan portfolio of £1.892m at 31 October 2018 and there is currently a further requirement to borrow to finance the capital programme from 2018/19 onwards. The table above forecasts an initial borrowing requirement of around £11m between now and 2020/21 to fund the Training Centre project. The timing of this borrowing needs to be balanced carefully between capital expenditure timescales and prevailing and forecast market rates which will be kept under close review throughout the remainder of 2018/19 and 2019/20.

20. The following tables show the actual debt maturity profile of current borrowing as at 31 October 2018 and a comparison with approved Upper and Lower Limits.

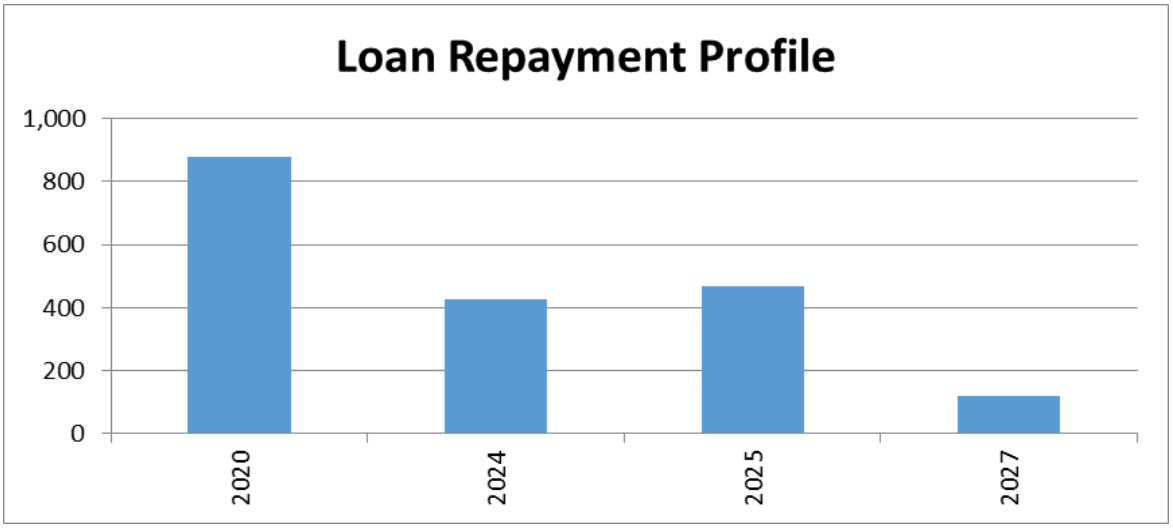

Table 2 Maturity Structure of Borrowing				
	Upper Limit %	**Lower Limit %**	**Actual 31/10/18 %**	**Amount £000**
Under 12 months	25	0	0	0
12 months and within 24 months	25	0	47	880
24 months and within 5 years	50	0	0	0
5 years and 10 years	60	0	53	1,012
10 years and above	100	5	0	0
Total			100	1,892

21. The actual maturity structure for borrowing falls slightly outside the agreed profile, as can be seen in Table 2. However, as the Authority has such relatively low levels of borrowing and currently has such a healthy investment position, this is not considered to be a material risk. Over recent years, the Authority has not required any new additional

borrowing and has not therefore been easily able to influence the maturity structure.

22. 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 following the margin added to gilt yields which has impacted PWLB new borrowing rates since 2010. No debt rescheduling has therefore been undertaken or is anticipated in the current financial year.

INVESTMENT PORTFOLIO 2018/19

23. The Annual Investment Strategy has the priorities of security, liquidity and yield. The aim 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.

24. The Authority continues to maintain high levels of cash at 31st October 2018 due partly to the temporary positive cash flow implications of receiving annual Firefighters Pension Government Grant in July each year and also ahead of delivery of the currently approved strategic building projects.

25. As a result, interest on balances earned in 2018/19 is £115k to 31st October compared with the annual budget (£100k) for investment income in 2018/19, despite continuing low interest rates throughout 2018/19 and maintaining the current c£5m under-borrowing position which has resulted in savings on loan interest payable that more than offsets lower interest earned on cash balances.

26. The Authority has continued with a cautious approach to its choice of counterparties. As at 31st October 2018, the Authority's investments were with Aberdeen Standard Liquidity Money Market Fund, Bank of Scotland, Santander, Goldman Sachs and Barclays.

Investments 31/10/2018	£000
Aberdeen Standard	5,140
Bank of Scotland	9,300
Santander UK	3,500
Goldman Sachs	6,000
Barclays	5,000
Total	**28,940**

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

REVIEW OF COMPLIANCE WITH PRUDENTIAL INDICATORS

28. 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 2018/19 against those approved by the Authority in February 2018.

Table 3: Prudential and Treasury Indicators			
Prudential Indicators	2018/19 Indicator £000	2018/19 Revised Estimate £000	Comment
Capital expenditure	6,356	3,152	Re-profiling of Training Centre spending into 2019/20 partly offset by initial forecast expenditure re: new Crewe/Chester Station scheme approvals.
Capital Financing Requirement Annual change in capital financing requirement	11,656 4,522	7,301 (78)	Re-profiling of Training Centre spending into 2019/20 to be funded by borrowing
Gross borrowing requirement: (Under) / Over borrowing	(4,751)	(5,396)	2017/18 and 2018/19 Training Centre project spend financed temporarily by internal borrowing.
Ratio of financing costs to net revenue stream	1.30%	1.11%	Borrowing re: Training Centre Project not now anticipated 2018/19.
Treasury Indicators	2018/19 Indicator £000	2018/19 Revised Estimate £000	
Authorised limit for external debt Operational boundary for external debt	9,105 7,065	9,105 7,065	Set 14/2/18, No change planned during 2018/19
Actual external debt - Borrowing - Other long term liabilities Total	 6,892 13 6,905	 1,892 13 1,905	Initial borrowing re: Training Centre Project not now anticipated until 2019/20.
Upper limit of fixed interest rate exposure	100%	100%	
Upper limit of variable interest rate exposure	40%	0%	No variable rate loans held or planned

Table 3: Prudential and Treasury Indicators			
Upper limit for principal sums invested for over 365 days	£5m	£nil	No longer term investments held or planned.

Financial Implications

29. The subject of this report is financial.

Legal Implications

30. 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

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

Environmental Implications

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

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BACKGROUND PAPERS: None