CHESHIRE FIRE AUTHORITY

MEETING OF: **FIRE AUTHORITY**
DATE: **19th JUNE 2019**
REPORT OF: **HEAD OF FINANCE**
AUTHOR: **WENDY BEBBINGTON**

SUBJECT: **TREASURY MANAGEMENT ANNUAL REPORT 2018-19**

Purpose of Report

1. To present a review of the Authority's treasury management activities during 2018-19.

Recommended that Members**:**

[1] Note the report on treasury management activity for 2018-19; and

[2] The prudential and treasury management outturn indicators as detailed in the report be noted.

Background

2. The Chartered Institute of Public Finance and Accountancy (CIPFA) define Treasury Management 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."

3. 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.

4. This annual report provides Members with details of the treasury management activities undertaken in 2018-19. It also considers compliance with the Authority's Treasury Management Practices (TMPs) during the year.

5. This report includes details of:

   a) the Authority's loans portfolio position at 31 March 2019;
   b) the Authority's investment portfolio position at 31 March 2019;
   c) a summary of performance for the year 2018-19;
   d) the Authority's performance in 2018-19 against the key Prudential Indicators;

6. Members should be aware that all the 2018-19 figures in the report remain subject to audit.

The Economy and Interest Rates

7. After weak economic growth in quarter one of 2018, growth picked up in quarters 2 and 3, before cooling off in the final quarter due largely to the uncertainties over Brexit. However, some recovery in the rate of growth is expected going forward. After the Monetary Policy Committee (MPC) raised the bank rate from 0.5% to 0.75% in August 2018, it is unsurprising that they have abstained from any further increases since then and we are unlikely to see any further action from the MPC until the uncertainties over Brexit clear.

8. If the event of a disorderly exit, it is likely that bank rate would be cut to support growth. Nevertheless, the MPC has been having increasing concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.5%, (excluding bonuses), in the three months to December 2018 before falling only marginally to 3.4% in the three months to January 2019. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

9. As for CPI inflation itself, this has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February. However, in the February 2019 Bank of England Inflation Report, the latest forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%. The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario. 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.

10. The table below provides a summary of the Public Works Loan Board (PWLB) borrowing rates comparing the start of the year and the end of the year and provides a picture of how the rates moved throughout the year.

	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2018	1.48%	1.85%	2.23%	2.57%	2.29%
29/03/2019	1.48%	1.55%	1.85%	2.40%	2.23%
Low	1.28%	1.50%	1.80%	2.33%	2.16%
Date	29/05/2018	26/03/2019	28/03/2019	26/03/2019	26/03/2019
High	1.64%	2.07%	2.50%	2.93%	2.79%
Date	04/10/2018	10/10/2018	10/10/2018	10/10/2018	12/10/2018
Average	1.50%	1.80%	2.20%	2.66%	2.47%

Outlook for 2019-20

11. In May 2019, the MPC are far more upbeat than in February, as they stated that global trade tensions have "stabilised", and that markets and businesses are both calmer now. However, May's Inflation Report did point out that "domestic tensions remain". In the same report, the Bank of England predicted a gradual increase in inflationary pressures, but with inflation remaining around the Bank's 2% target, and it forecast GDP growth to reach around 2% in 2021. Meanwhile, unemployment is expected to keep steadily decreasing, reaching a low of 3.5% by Quarter 1 2022.

12. The resignation of Prime Minister Theresa May supports the view that the chances of a Brexit deal have fallen and that the chances of another delay and a no deal Brexit have risen. Financial markets have probably already priced this in, with concerns over the global economy also rising.

13. Despite the political uncertainty, the UK economy is in reasonable shape. Nonetheless, a further delay to Brexit or a no deal would likely result in GDP growth, interest rates, the pound and gilt yields all staying lower for longer and would leave the economy more exposed to the pressures from overseas.

Portfolio Position at 31 March 2019

14. A summary of the Authority's long term borrowing and investments at 31 March 2019 is shown in Table 1, including the equivalent position for 31 March 2018 for reference.

Table 1 – Portfolio Position

	31 March 2018 £000	31 March 2019 £000
Long Term Borrowing	1,903	1,892
Investments	(23,980)	(25,190)
Net Borrowing / (Investments)	(22,077)	(23,298)

15. Long term borrowing as at 31 March 2018 included PWLB loans totalling £1,892k and a balance of £11k due to SALIX, a not for profit organisation which lends to fund carbon reduction schemes. This £11k loan balance was repaid in 2018-19.

16. Investment balances (including cash on deposit in Money Market Funds) have increased during 2018-19 due mainly to a temporary increase in CFA reserves, partly offset by £1m lower regional Emergency Services Mobile Communication Project (ESMCP) funds held on behalf of North West Fire Authorities at 31/3/19. The temporary increase in reserves held is the result of slippage in the timing of approved major capital project expenditure (see paragraph 17 below) together with lower than forecast revenue expenditure in 2019/20.

Treasury Management Performance 2018-19

Investments

17. The Authority has continued to find it difficult to generate significant rates of return on investments in light of continuing low interest rates throughout 2018-19. Investment income in 2018-19 is £216k, increased from the £125k generated in 2017-18. This year on year increase is mainly due to the August 2018 bank base rate increase from 0.5% to 0.75% together with higher cash balances available for investment as a result of unavoidable delays to approved significant capital investment schemes during 2018-19, most notably in respect of the new Operational Training Centre and replacement Chester Fire Station.

18. The Authority has continued with a cautious approach to its choice of counterparties. As at 31 March 2019, the Authority's investments are with Lloyds Bank of Scotland, Goldman Sachs UK, Santander UK and Aberdeen Standard Money Market Liquidity Fund, which the Authority continues to use regularly to manage day to day cashflows. No other investment counterparties were used during 2018-19.

19. There have been no known instances of non compliance with TMPs during the year.

Borrowing

20. The amount of borrowing as at 31st March 2019 is £1.892m. During 2018-19 interest rates have been monitored and no debt rescheduling took place during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

21. The Authority has approved up to £11m of new borrowing to finance the Operational Training Centre project in order to maintain sufficient cash resources to finance its existing ongoing capital expenditure commitments along with new and emerging capital expenditure needs, as detailed in the annual Treasury Management Strategy. This borrowing has not yet been secured due to current reserve levels and the fact that significant expenditure associated with the build phase has now slipped into the current financial year.

22. The timing of this need to borrow will, however, be kept under close review throughout 2019-20, balancing current extremely low PWLB fixed long term borrowing rates against the level of cash balances held. In the event of significant upward risk to borrowing rates over the coming months it may well be prudent to secure the borrowing towards the start of the build phase, accepting that this will temporarily further increase the Authority's current cash balances.

23. 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 current position is c£5m under-borrowed which has not changed significantly for a number of

years. This position may need to be reduced with new external borrowing should it begin to place pressure on day to day available cash balances. However this is not an issue at the present time due to current reserve levels.

24. The actual maturity structure for borrowing falls slightly outside the agreed profile, as can be seen in Table 2. 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. However, as the Authority has 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.

Table 2 Maturity Structure of Borrowing				
	Upper Limit %	**Lower Limit %**	**Actual %**	**Amount £000**
Under 12 months	25	0	46	880
12 months and within 24 months	25	0	0	0
24 months and within 5 years	50	0	23	426
5 years and 10 years	60	0	31	586
10 years and above	100	5	0	0

Prudential and Treasury Indicators

25. The Authority must approve Prudential and Treasury Indicators annually, to reflect the impact of the capital programme on the Authority's financial position. Table 3 below shows performance in 2018-19 against the indicators, which were approved by the Authority in February 2018.

Table 3: Prudential and Treasury Indicators			
Prudential Indicators	2018-19 Indicator £000	2018-19 Outturn £000	Comment
Capital expenditure	6,356	1,295	Operational Training Centre build phase expenditure of c£5m forecast for 2018-19, now profiled for 2019-20.
Capital financing requirement	11,656	7,253	
Annual change in capital financing requirement	4,522	(126)	
Gross borrowing requirement: (Under) / Over borrowing	(4,751)	(5,348)	

Table 3: Prudential and Treasury Indicators			
Ratio of financing costs to net revenue stream	1.30%	0.82%	Lower net financing costs due to revised timing of approved Operational Training Centre project borrowing and increased investment interest earned in 2018-19
Treasury Indicators	2018-19 Indicator £000	2018-19 Outturn £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 during 2018-19
Actual external debt - Borrowing - Other long term liabilities Total	 6,892 13 6,905	 1,892 13 1,905	Initial £5m borrowing re: Training Centre Project now rescheduled for 2019-20 or 2020-21.
Upper limit of fixed interest rate exposure	100%	100%	
Upper limit of variable interest rate exposure	40%	Nil	
Upper limit for principal sums invested for over 364 days	£5m	£nil	

26. The above data shows that the organisation remained within both the authorised limit and operational boundary for external debt. These are limits on the amount of external debt permitted and include both loans and financial leases.

27. With the exception of the slippage of build phase expenditure relating to the Operational Training Centre project into 2019-20, capital expenditure was broadly in line with anticipated spending levels. Following approval of the 2018-19 Treasury Management Strategy, a further project to build a replacement Chester Fire Station was approved by CFA, however no significant expenditure was incurred during 2018-19 due mainly to planning delays.

Conclusion

28. Interest rates have remained low throughout the year and are forecast to do so for the upcoming financial year. Opportunities for seeking improved returns will continue to be pursued within the approved confines of the Investment Strategy.

29. Borrowing levels remain sustainable. Up to £11m of new borrowing has been approved by the Authority to finance the Operational Training Centre project. The timing of this new borrowing will be kept under close review throughout 2019-20 and the borrowing will be secured at the optimum point taking into account prevailing and forecast market rates.

Financial Implications

30. The report is in its nature financial and the implications are covered in the body of the report.

Legal implications

31. All transactions between the Authority and counterparties are governed by the agreements between the two parties, and overseen by our Treasury Management partner Link Asset Services.

Equality and Diversity and Environmental Implications

32. There are none.

CONTACT: DONNA LINTON, FIRE SERVICE HQ, WINSFORD
TEL [01606] 868804

BACKGROUND PAPERS : NONE