# CHESHIRE FIRE AUTHORITY

**MEETING OF:** CHESHIRE FIRE AUTHORITY
**DATE:** 10TH DECEMBER 2019
**REPORT OF:** HEAD OF FINANCE
**AUTHOR:** WENDY BEBBINGTON

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## SUBJECT: TREASURY MANAGEMENT – MID YEAR REPORT 2019/20

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## 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 to support the 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. 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 have been 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 2019/20 on 13 February 2019.

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 2019/20 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 2019/20;
   - A review of compliance with Treasury and Prudential Limits for 2019/20.

**ECONOMIC BACKGROUND**

9. The first half of 2019/20 has seen UK economic growth fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The Monetary Policy Committee (MPC) meeting of 19 September re-emphasised their concern about the downturn in world growth and also expressed concern that the prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor confidence around the world which is now expecting a significant downturn or possibly even a recession in some developed economies. It is therefore no surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit.

10. As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time.

11. With regard to the labour market, despite a contraction in quarterly GDP growth, in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself. The latter figure, in particular, suggests there could be a return to positive growth in quarter 3. Unemployment has continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July; however, that was caused by a rise in the participation rate to an all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%.

12. As 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. The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

13. In the political arena, the announcement of a December general election could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

14. A summary of projected interest rates is provided in the table below. These forecasts have been based on an assumption that there is some sort of an agreed deal on Brexit. Given the current level of uncertainties, this is a significant assumption and so forecasts may need to be materially reassessed in the light of events over the next few weeks or months.

| Link Asset Services Interest Rate View | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank Rate View | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 |
| 3 Month LIBID | 0.70 | 0.70 | 0.70 | 0.70 | 0.80 | 0.90 | 1.00 | 1.00 | 1.00 | 1.10 | 1.20 |
| 6 Month LIBID | 0.80 | 0.80 | 0.80 | 0.80 | 0.90 | 1.00 | 1.10 | 1.10 | 1.20 | 1.30 | 1.40 |
| 12 Month LIBID | 1.00 | 1.00 | 1.00 | 1.00 | 1.10 | 1.20 | 1.30 | 1.30 | 1.40 | 1.50 | 1.60 |
| 5yr PWLB Rate | 2.20 | 2.30 | 2.50 | 2.60 | 2.70 | 2.70 | 2.80 | 2.90 | 3.00 | 3.00 | 3.10 |
| 10yr PWLB Rate | 2.50 | 2.60 | 2.80 | 2.90 | 3.00 | 3.00 | 3.10 | 3.20 | 3.30 | 3.30 | 3.40 |
| 25yr PWLB Rate | 3.10 | 3.30 | 3.40 | 3.50 | 3.60 | 3.70 | 3.70 | 3.80 | 3.90 | 4.00 | 4.00 |
| 50yr PWLB Rate | 3.00 | 3.20 | 3.30 | 3.40 | 3.50 | 3.60 | 3.60 | 3.70 | 3.80 | 3.90 | 3.90 |

## TREASURY MANAGEMENT STRATEGY STATEMENT UPDATE

15. The Treasury Management Strategy Statement (TMSS) was approved by the Authority on 13 February 2019. 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

16. 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.

17. 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** | **2019/20 £000** | **2020/21 £000** | **2021/22 £000** | **2022/23 £000** |
|---|---|---|---|---|
| Forecast Capital Programme | 14,188 | 11,223 | 8,318 | 1,925 |
| To be funded by new borrowing (estimate) | 0 | 6,402 | 4,000 | 0 |
| Estimated associated revenue cost of existing plus new borrowing (MRP & Interest Payable) | 332 | 363 | 875 | 1,179 |

18. 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 substantially 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 enter into new external borrowing (as estimated in the above table) and make suitable revenue budget provision for the borrowing charges.

19. 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 2020 is anticipated to be c£5m-£6m under-borrowed.

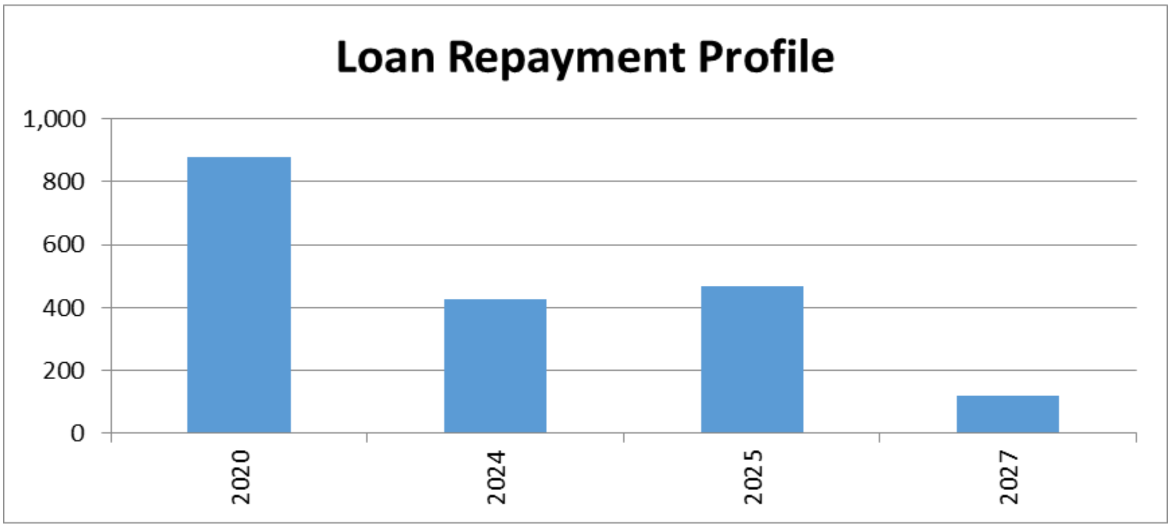
20. At this point maintaining under-borrowing at this level going forward is considered to be manageable and a sensible position in view of poor returns that can be achieved on cash balances invested versus the cost of borrowing. The cashflow impact will however be kept under continual review and it 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 major build and modernisation projects.

21. The Authority had a loan portfolio of £1.892m at 31 October 2019, reducing to £1.012m in March 2020 due to the repayment of a maturing loan and there is currently a further requirement to borrow to finance the capital programme going forward.

22. The table above forecasts a borrowing requirement of around £11m between 2019/20 and 2022/23. This level of borrowing has already been approved to finance the Training Centre project, however in view of the temporarily high level of reserves, this will now be deferred to match the spend profile of all of the current major build projects in order to enable greater flexibility about the appropriate timing of the borrowing. This needs to be balanced carefully to take account of the actual timing of expenditure, levels of reserves held and prevailing and forecast market interest rates, all of which will be kept under close review.

23. As previously approved, borrowing will be secured in line with this forecast requirement at the most advantageous time based on consultation with appointed Treasury Management Advisors and the Authority’s Chief Finance Officer.

24. The following tables show the actual debt maturity profile of current borrowing as at 31 October 2019 and a comparison with approved Upper and Lower Limits.




| Table 2 Maturity Structure of Borrowing | | | | |
|---|---|---|---|---|
| | **Upper Limit %** | **Lower Limit %** | **Actual 31/10/19 %** | **Amount £000** |
| Under 12 months | 50 | 0 | 47 | 880 |
| 12 months and within 24 months | 50 | 0 | 0 | 0 |
| 24 months and within 5 years | 50 | 0 | 23 | 426 |
| 5 years and 10 years | 75 | 0 | 31 | 586 |
| 10 years and above | 100 | 5 | 0 | 0 |
| Total | | | 100 | 1,892 |

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. Over recent years, the Authority has not required any new additional borrowing and has not therefore been easily able to influence the maturity structure.

26. 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 increase in 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 2019/20

27. 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.

28. The Authority continues to maintain high levels of cash at 31 October 2019 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.

29. As a result, interest on balances earned in 2019/20 is £150k to 31 October compared with the annual budget (£100k) for investment income in 2019/20, despite continuing low interest rates throughout 2019/20 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.

30. The Authority has continued with a cautious approach to its choice of counterparties. As at 31 October 2019, the Authority's investments were with Aberdeen Standard Liquidity Money Market Fund, Bank of Scotland, Santander, Goldman Sachs and NatWest.

| **Investments 31/10/2019** | £'000 |
|---|---|
| Aberdeen Standard | 7,820 |
| Bank of Scotland | 7,000 |
| Santander UK | 4,000 |
| Goldman Sachs | 7,000 |
| Natwest | 1,912 |
| **Total** | **27,732** |

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

## REVIEW OF COMPLIANCE WITH PRUDENTIAL INDICATORS

32. 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 2019/20 against those approved by the Authority in February 2019.

| Table 3: Prudential and Treasury Indicators | | | |
|---|---|---|---|
| Prudential Indicators | 2019/20 Indicator £000 | 2019/20 Revised Estimate £000 | Comment |
| Capital expenditure | 17,488 | 14,188 | Re-profiling of Chester FS new build due to Planning issues and Crewe FS replacement due to extended feasibility/options stage. |
| Capital Financing Requirement | 15,655 | 6,807 | Re-profiling / deferral of borrowing required until 2020/21 onwards. Paragraph 22 refers. |
| Annual change in capital financing requirement | 8,354 | (446) | |
| Gross borrowing requirement: (Under) / Over borrowing | (5,198) | (5,795) | |
| Ratio of financing costs to net revenue stream | 1.39% | 0.77% | |
| Treasury Indicators | 2019/20 Indicator £000 | 2019/20 Revised Estimate £000 | |
| Authorised limit for external debt | 12,657 | 4,092 | Set 13/2/19 to include provision for c£8m borrowing towards Training Centre now deferred until 2021/22. |
| Operational boundary for external debt | 10,607 | 2,042 | |
| Actual external debt | | | Approved borrowing not now planned until 2021/22. |
| - Borrowing | 10,457 | 1,012 | |
| - Other long term liabilities | 0 | 0 | |
| Total | 10,457 | 1,012 | |
| 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 |
| Upper limit for principal sums invested for over 365 days | £5m | £nil | No longer term investments held or planned. |

## Financial Implications

33. The subject of this report is financial.

## Legal Implications

34. 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 and Diversity Implications

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

## Environmental Implications

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

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**BACKGROUND PAPERS: None**