CHESHIRE FIRE AUTHORITY

MEETING OF: CHESHIRE FIRE AUTHORITY
DATE: 1 JULY 2020
REPORT OF: HEAD OF FINANCE
AUTHOR: WENDY BEBBINGTON

SUBJECT: TREASURY MANAGEMENT ANNUAL REPORT 2019-20

Purpose of Report

1. To present a review of the Authority's treasury management activities undertaken during 2019-20.

Recommended that Members note:

[1] the report on treasury management activity for 2019-20; and

[2] the performance against the prudential and treasury management indicators.

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 report provides Members with details of the treasury management activities undertaken in 2019-20. 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 2020;
   b) the Authority's investment portfolio position at 31 March 2020;
   c) a summary of performance for the year 2019-20;
   d) the Authority's performance in 2019-20 set against the key Prudential Indicators;

6. Members should be aware that all the 2019-20 figures in the report remain subject to audit.

The Economy and Interest Rates

7. Investment returns remained low during 2019-20. The expectation for interest rates within the Treasury Management Strategy for 2019-20 was that the Bank Rate would stay at 0.75% during 2019-20 as it was not expected that the Monetary Policy Committee (MPC) would be able to deliver on an increase in the Bank Rate until Brexit was finally settled. However, there was an expectation that the Bank Rate would rise after Brexit was delivered, but would only rise to 1.0% during 2020. Shorter term investment interest rates were fairly flat during most of the year until two cuts in the Bank Rate from 0.75% to 0.25% on 11th March 2020 and then to the current 0.10% on 19th March 2020 which caused short term investment rates to fall sharply.

8. Rising concerns over the possibility that the UK could leave the EU at the end of October 2019 caused longer term investment rates to be on a falling trend for most of April to September 2019. They then rose after the end of October deadline was rejected by the Commons but fell back again in January before recovering again after the 31 January departure of the UK from the EU. When the Coronavirus outbreak hit the UK in February/March, longer term rates initially plunged but then rose sharply back up again due to a shortage of liquidity in financial markets. As longer term rates were significantly higher than shorter term rates during the year, value was therefore sought by placing longer term investments where cash balances were sufficient to allow this during the year. However, towards the end of the year the Authority was unable to continue this approach due to caution around the financial impact of Coronavirus on its short to medium term cashflows.

9. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support current capital programme expenditure which was significant in 2019-20, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates. This approach has also provided benefits in terms of reducing counterparty risk exposure, by having fewer investments placed in the financial markets.

10. Table 1 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.

Table 1

	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2019	1.46%	1.52%	1.84%	2.41%	2.24%
31/03/2020	1.90%	1.95%	2.14%	2.65%	2.39%
Low	1.17%	1.00%	1.13%	1.73%	1.57%
Date	03/09/2019	08/10/2019	03/09/2019	03/09/2019	03/09/2019
High	2.47%	2.45%	2.76%	3.25%	3.05%
Date	21/10/2019	19/03/2020	19/03/2020	19/03/2020	31/12/2019
Average	1.83%	1.77%	2.00%	2.56%	2.40%

Outlook for 2020-21

11. The Coronavirus outbreak has inflicted an unprecedented shock on financial markets and economic activity, with policymakers struggling to avert a longer-lasting downturn. In common with other advanced countries, the UK has shut down parts of its economy to slow the spread of the disease, which will cause a deep contraction centred on the second quarter of 2020. On 23 March, the Prime Minister announced more significant measures to contain the spread of COVID-19. Consequently, the deep near-term damage to the UK economy caused by the Coronavirus outbreak and the lingering uncertainty regarding the post-Brexit UK-EU trade relationship is significant. The commensurate and necessary policy response to contain the COVID-19 outbreak will result in a sharp rise in general government deficit and debt ratios, leading to an acceleration in the deterioration of public finances over the medium term.

12. The Government's furlough scheme has prevented the UK economy from being engulfed by a tsunami-like first wave of unemployment. But a second wave may come once the reduction in the generosity of the scheme in August forces businesses to decide if they can then retain their employees. That introduces a major risk of the economic recovery from the Coronavirus crisis deepening. As the lockdown is eased and firms reopen, in an ideal world workers would move off the furlough scheme and back to work, meaning that unemployment never rises. But even in that situation, there would still be an economic cost as lots of the 10m furloughed workers are having to cope with reduced pay.

13. Markets now estimate that GDP could fall by close to 4% in 2020. In the baseline, there is an assumption that containment measures can be unwound in the second half of 2020, allowing for recovery in sequential growth and the broader economy, leading to a sharp recovery in growth to around 3% in 2021. However, with so much depending on the extent and duration of the Coronavirus outbreak, there is material downside risk to these economic forecasts. A plausible downside case, including a second wave of infections and a longer lockdown period, would see an even larger decline in output in 2020 and a weaker recovery in 2021.

14. The strength of the recovery is also subject to lingering Brexit uncertainty, as the final shape of any future trade deal with the EU remains unknown and the risk of the transition period ending without a deal persists.

Portfolio Position at 31 March 2020

15. A summary of the Authority's long term borrowing and investments at 31 March 2020 is shown in Table 2, including the equivalent position at 31 March 2019 for reference.

Table 2 – Portfolio Position		
	31 March 2019 £000	31 March 2020 £000
Long Term Borrowing	1,892	1,012
Investments	(25,190)	(18,795)
Net Borrowing / (Investments)	(23,298)	(17,783)

16. Long term borrowing as at 31 March 2020 is made up entirely of maturity loans from the Public Works Loans Board (PWLB). A PWLB loan of £880k matured and was repaid on 31 March 2020.

17. Investment balances (including cash on deposit in Money Market Funds) have reduced during 2019-20 due mainly to the use of cash reserves to fund major capital expenditure during the year in line with the currently approved Treasury Management strategy.

Treasury Management Performance 2019-20

Investments

18. The Authority has continued to find it difficult to generate significant rates of return on investments in light of continuing low interest rates throughout 2019-20. Investment income in 2019-20 is £244k, increased from the £216k generated in 2018-19. This year-on-year increase is mainly due to the fact that bank base rate was maintained at 0.75% throughout almost the whole financial year, compared to 2018-19 when it was only 0.5% until August 2018. In addition, higher cash balances were available for investment in the early part of 2019-20 before significant capital expenditure reduced cash balances later in the year, most notably in respect of the new Training Centre and replacement Chester Fire Station projects both of which moved into their build phases during the year.

19. The Authority has continued with a cautious approach to its choice of counterparties. As at 31 March 2020, the Authority's investments are with Lloyds Bank of Scotland, Santander UK and Aberdeen Standard Money Market Liquidity Fund, which the Authority continues to use regularly to manage day to day cashflows. Other investment counterparties used during 2019-20 were Goldman Sachs UK and National Westminster Bank Plc.

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

Borrowing

21. The amount of borrowing as at 31st March 2020 is £1.092m. During 2019-20 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 unwise.

22. The Authority has approved up to £11m of new borrowing to finance the 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 and Capital Strategies.

23. As previously reported to Members and in line with the currently approved Treasury Management Strategy, this borrowing has not yet been secured due to the current temporarily high levels of reserves held. Instead, this borrowing has been deferred in order to enable greater flexibility about the appropriate timing, which 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.

24. This borrowing is currently planned for 2021-22, however, in the event of significant upward risk to borrowing rates over the coming months it may well be prudent to secure the borrowing during 2020-21, accepting that this will result in a temporary increase to the Authority's current cash balances. The situation will continue to be kept under close review so that the borrowing can be secured at the most advantageous time based on consultation with appointed Treasury Management Advisors and the Authority's Treasurer.

25. 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£5.8m under-borrowed which has not changed significantly for a number of years. This position may need to be reduced in the longer term 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.

26. The actual maturity structure for borrowing falls slightly outside the agreed profile, as can be seen in Table 3. This indicator is designed to be a control over an authority having large concentrations of fixed rate debt which need 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. As planned new borrowing is undertaken to finance the currently approved capital programme, the maturity structure will naturally return to be within the agreed target profile and therefore no specific action is considered necessary at this time.

Table 3 Maturity Structure of Borrowing				
	Upper Limit %	Lower Limit %	Actual %	Amount £000
Under 12 months	25	0	0	0
12 months and within 24 months	25	0	0	0
24 months and within 5 years	50	0	88	893
5 years and 10 years	60	0	12	119
10 years and above	100	5	0	0

Prudential and Treasury Indicators

27. The Authority must approve Prudential and Treasury Indicators annually, to reflect the impact of the capital programme on the Authority's financial position. Table 4 below shows performance in 2019-20 against the indicators, which were approved by the Authority in February 2019.

Table 4: Prudential and Treasury Indicators			
Prudential Indicators	2019-20 Indicator £000	2019-20 Outturn £000	Comment
Capital expenditure	17,488	12,844	Re-profiling of both Chester FS new build due to Planning issues and Crewe FS replacement due to extended feasibility/options stage.
Capital financing requirement Annual change in capital financing requirement	15,655 8,354	6,807 (446)	Re-profiling / deferral of borrowing required until 2020-21 onwards.
Gross borrowing requirement: (Under) / Over borrowing	(5,198)	(5,795)	
Ratio of financing costs to net revenue stream	1.39%	0.66%	
Treasury Indicators	2019-20 Indicator £000	2019-20 Outturn £000	
Authorised limit for external debt Operational boundary for external debt	12,657 10,607	12,657 10,607	Set 13/2/19, No change during 2019-20
Actual external debt - Borrowing - Other long term liabilities Total	 10,457 0 10,457	 1,012 0 1,012	Approved borrowing not now planned until 2020-21 onwards.
Upper limit of fixed interest rate exposure	100%	100%	
Upper limit of variable interest rate exposure	40%	Nil	No variable rate loans held or planned
Upper limit for principal sums invested for over 364 days	£5m	£nil	No longer term investments held or planned.

28. The above table 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.

29. With the exception of some re-profiling of expenditure relating to both Chester and Crewe replacement station projects due to unavoidable delays, capital expenditure was broadly in line with anticipated spending levels.

Conclusion

30. Investment interest rates have remained low throughout the year and are forecast to be even lower in the upcoming financial year. Opportunities for seeking improved returns will continue to be pursued within the approved confines of the Investment Strategy.

31. Borrowing levels remain sustainable. Up to £11m of new borrowing has been approved by the Authority to finance the Training Centre project. The timing of this new borrowing is currently planned for 2021-22 but will be kept under close review throughout 2020-21 and the borrowing will be secured at the optimum point taking into account prevailing and forecast market rates.

Financial Implications

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

Legal implications

33. 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

34. There are none.

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BACKGROUND PAPERS : NONE