# CHESHIRE FIRE AUTHORITY

**MEETING OF:** CHESHIRE FIRE AUTHORITY
**DATE:** 9TH DECEMBER 2020
**REPORT OF:** HEAD OF FINANCE
**AUTHOR:** WENDY BEBBINGTON

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## SUBJECT: TREASURY MANAGEMENT – MID YEAR REPORT 2020-21

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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 2020/21 on 12 February 2020.

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 2020/21 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 2020/21;
- A review of compliance with Treasury and Prudential Limits for 2020/21.

**ECONOMIC BACKGROUND**

9. The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August (and at the subsequent September and November meetings), although some forecasters had suggested that a cut into negative territory could happen.

10. The Governor of the Bank of England, however, has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table below, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

11. As for inflation itself, the Bank of England forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

12. The fall in GDP in the first half of 2020 was revised from 28% to 23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily influenced by consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown and Brexit uncertainties.

13. The peak in the unemployment rate was revised down from 9% in Q2 to 7½% by Q4 2020.

14. The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the Covid-19 virus. There is relatively little UK domestic risk of increases or decreases in Bank Rate or of significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

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

| Link Group Interest Rate View 11.8.20 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 |
| Bank Rate View | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 3 month average earnings | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | - | - | - | - | - |
| 6 month average earnings | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | - | - | - | - | - |
| 12 month average earnings | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | - | - | - | - | - |
| 5yr PWLB Rate | 1.90 | 1.90 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.10 | 2.10 | 2.10 | 2.10 |
| 10yr PWLB Rate | 2.10 | 2.10 | 2.10 | 2.10 | 2.10 | 2.20 | 2.20 | 2.20 | 2.30 | 2.30 | 2.30 |
| 25yr PWLB Rate | 2.50 | 2.50 | 2.50 | 2.50 | 2.60 | 2.60 | 2.60 | 2.70 | 2.70 | 2.70 | 2.70 |
| 50yr PWLB Rate | 2.30 | 2.30 | 2.30 | 2.30 | 2.40 | 2.40 | 2.40 | 2.50 | 2.50 | 2.50 | 2.50 |

16. The Treasury Management Strategy Statement (TMSS) was approved by the Authority on 12 February 2020. 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**

17. 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.

18. 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** | **2020/21 £000** | **2021/22 £000** | **2022/23 £000** | **2023/24 £000** |
|---|---|---|---|---|
| Forecast Capital Programme | 14,784 | 5,588 | 6,354 | 1,378 |
| To be funded by new borrowing (estimate) | 6,403 | 4,000 | 0 | 0 |
| Estimated associated revenue cost of existing plus new borrowing (MRP & Interest Payable) | 408 | 975 | 1,169 | 1,145 |

19. The Authority had a loan portfolio of £1.012m at 31 October 2020, with plans to borrow a further £11m early in 2021/22.

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 are now fully committed to the existing programme.

21. As a result, any future new or additional approval of capital expenditure over and above the currently planned programme, will need to be funded by further new borrowing. This will be in addition to the £11m already approved.

22. In addition, the ongoing requirement to fund an annual capital programme for essential vehicle, equipment and technology replacements beyond the current financial planning period will also require the Authority to enter into new external borrowing and to make suitable revenue budget provision.

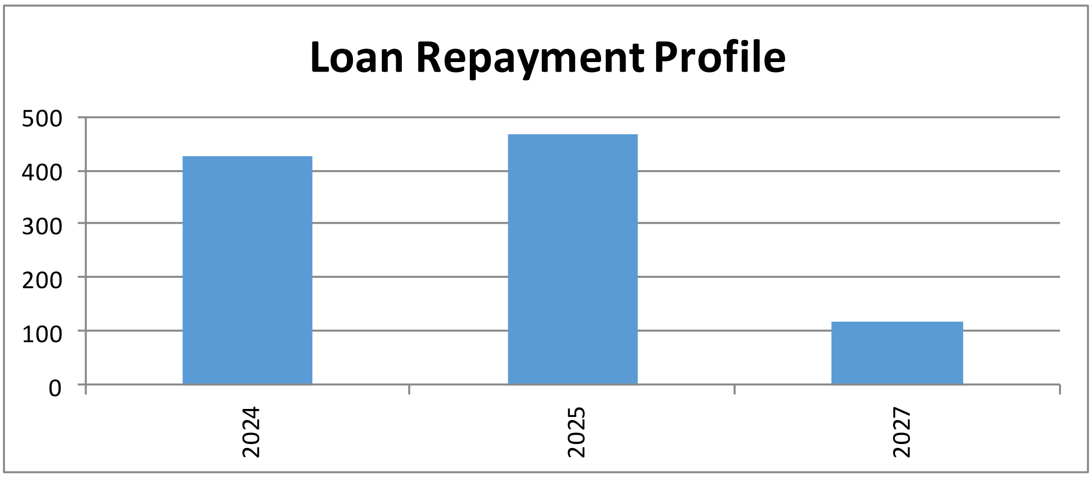
23. In view of the temporarily high level of reserves, the approved Treasury Management Strategy deferred placing the actual £11m borrowing required for the Training Centre project until 2021/22 as a prudent approach given that limited investment return on in-year surplus cash flow and counter-party risk are still issues that need to be considered.

24. The Authority therefore currently remains in an under-borrowed position, which means that expenditure has been temporarily internally financed as opposed to externally borrowed. The position at 31 March 2021 is temporarily anticipated to be c£12m under-borrowed until the new planned external borrowing is taken.

25. At this point maintaining longer term under-borrowing at a target level of c£3m 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 target 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.

26. As previously approved, borrowing will be secured in line with this requirement at the most advantageous time based on consultation with appointed Treasury Management Advisors and the Authority's Treasurer.

27. The following tables show the actual debt maturity profile of current borrowing as at 31 October 2020 and a comparison with approved Upper and Lower Limits.




| Table 2 Maturity Structure of Borrowing | | | | |
|---|---|---|---|---|
| | Upper Limit % | Lower Limit % | Actual 31/10/20 % | Amount £000 |
| Under 12 months | 50 | 0 | 0 | 0 |
| 12 months and within 24 months | 50 | 0 | 0 | 0 |
| 24 months and within 5 years | 50 | 0 | 88 | 893 |
| 5 years and 10 years | 75 | 0 | 12 | 119 |
| 10 years and above | 100 | 5 | 0 | 0 |
| Total | | | 100 | 1,012 |

28. 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.

29. The actual maturity structure for borrowing falls temporarily 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.

30. 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 2020/21**

31. 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.

32. The Authority's cash balances are reducing significantly, despite the temporary positive cash flow implications of receiving annual Firefighters Pension Government Grant in July each year, as progress is made towards delivery of the currently approved strategic building projects. Clearly this results in reduced investment income received.

33. Alongside this, in the current climate it is impossible to generate significant levels of investment income due to the 0.10% base rate leading to available investment rates with suitable counterparties being barely above zero. Interest on balances earned to date is however £42k to 31 October, with final 2020/21 outturn currently forecast to be around £55k (£244k 2019/20) compared with the annual budget (£60k) for investment income in 2020/21.

34. This is in part due to the current under-borrowing position discussed above which has resulted in savings on loan interest payable that more than offsets lower interest earned on cash balances.

35. The Authority has continued with a cautious approach to its choice of counterparties. As at 31 October 2020, the Authority's investments were with Aberdeen Standard Liquidity Money Market Fund,

Santander, and NatWest, all of which are used regularly along with Bank of Scotland to manage day to day cashflows.

| **Investments 31/10/2020** | £'000 |
|---|---|
| Aberdeen Standard | 8,190 |
| Santander UK | 4,000 |
| Natwest | 1,639 |
| **Total** | **13,829** |

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

**REVIEW OF COMPLIANCE WITH PRUDENTIAL INDICATORS**

37. 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 2020/21 against those approved by the Authority in February 2020.

| Table 3: Prudential and Treasury Indicators | | | |
|---|---|---|---|
| Prudential Indicators | 2020/21 Indicator £000 | 2020/21 Revised Estimate £000 | Comment |
| Capital expenditure | 14,095 | 14,784 | Re-profiling/timing of major estate projects expenditure. |
| Capital Financing Requirement | 12,793 | 12,794 | |
| Annual change in capital financing requirement | 5,986 | 5,987 | |
| Gross borrowing requirement: (Under) / Over borrowing | (11,781) | (11,782) | |
| Ratio of financing costs to net revenue stream | 0.77% | 0.91% | |
| Treasury Indicators | 2020/21 Indicator £000 | 2020/21 Revised Estimate £000 | |
| Authorised limit for external debt | 3,212 | 3,212 | Set 12/2/20, no change planned during 2020/21. |
| Operational boundary for external debt | 1,162 | 1,162 | |
| Actual external debt | | | Approved borrowing remains planned for 2021/22. |
| - Borrowing | 1,012 | 1,012 | |
| - Other long term liabilities | 0 | 0 | |
| Total | 1,012 | 1,012 | |

| Table 3: Prudential and Treasury Indicators | | | |
|---|---|---|---|
| Upper limit of fixed interest rate exposure | 100% | 100% | |
| Upper limit of variable interest rate exposure | 25% | 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

38. The subject of this report is financial.

## Legal Implications

39. 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

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

## Environmental Implications

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

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**BACKGROUND PAPERS: NONE**