CHESHIRE FIRE AUTHORITY

MEETING OF: CHESHIRE FIRE AUTHORITY
DATE: 23 JUNE 2021
REPORT OF: HEAD OF FINANCE
AUTHOR: WENDY BEBBINGTON

SUBJECT: TREASURY MANAGEMENT ANNUAL REPORT 2020-21

Purpose of Report

1. To present a review of the Authority's treasury management activities undertaken during 2020-21.

Recommended that Members note**:**

[1] the report on treasury management activity for 2020-21; 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 2020-21. 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 2021;
   b) the Authority's investment portfolio position at 31 March 2021;
   c) a summary of performance for the year 2020-21;
   d) the Authority's performance in 2020-21 set against the key Prudential Indicators;

6. Members should be aware that all the 2020-21 figures in the report remain subject to audit.

The Economy and Interest Rates

7. Investment returns, which had already been low during 2019-20, plunged during 2020-21 to near zero or even into negative territory. The expectation for interest rates within the treasury management strategy for 2020-21 was that the Bank Rate would continue at the start of the year at 0.75% before rising to end 2022-23 at 1.25%. This forecast was invalidated by the Covid-19 pandemic in March 2020 which caused the Monetary Policy Committee to cut the Bank Rate in March, first to 0.25% and then to 0.10%, in order to counter the hugely negative impact of the national lockdown on large swathes of the economy. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.

8. While the Authority has maintained a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

9. Investment balances have been kept to a minimum through the agreed strategy of initially using reserves and balances where possible to support current capital programme expenditure, which was significant in 2020-21, rather than immediately borrowing externally from the financial markets. Earlier or additional 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) maturity loan 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
01/04/2020	1.89%	1.92%	2.10%	2.58%	2.32%
31/03/2021	0.79%	1.18%	1.71%	2.19%	1.99%
Low	0.65%	0.72%	1.00%	1.53%	1.32%
Date	04/01/2021	11/12/2020	11/12/2020	11/12/2020	11/12/2020
High	1.94%	1.99%	2.28%	2.86%	2.71%
Date	08/04/2020	08/04/2020	11/11/2020	11/11/2020	11/11/2020
Average	1.43%	1.50%	1.81%	2.33%	2.14%

Outlook for 2021-22

11. 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 2020 to cut the Bank Rate to first 0.25%, and then to 0.10%, it subsequently left the Bank Rate unchanged at its subsequent meetings, including its last meeting in May 2021, although some forecasters had suggested that a cut into negative territory could happen. However, at that last meeting, it was stated that financial institutions were not prepared for implementing negative rates.

12. The new economic forecasts by the Bank of England imply that the date at which the conditions for tighter monetary policy might be in place, e.g. a 4.5% unemployment rate and 2.0% inflation rate, has come forward by at least a year, from the end of 2023 to the end of 2022. The Bank's forecast for CPI inflation stays above 2.0% for the next two years. That suggests at least one rate hike will be needed to keep inflation at the 2.0% target. The Monetary Policy Committee will be keen to implement a series of increases in Bank Rate as soon as possible in order for it to become a usable tool when the next economic downturn comes along.

13. The vaccination programme is well underway in the UK and further easing of social distancing restrictions is expected late in June. A combination of excess savings, pent-up demand and a range of government incentives should see for a positive summer in the UK. Markets expect the economy to grow between 6% and 7.5% this year and by 5.4% in 2022, with a potential deceleration in growth thereafter. This will allow the economy to reach its pre-COVID level by the first quarter of next year.

14. The furlough scheme continues to support the labour market, keeping unemployment relatively low, while a fall in the participation rate also means that the labour market may be less tight at present. Markets expect unemployment to peak at 5.7% by the end of the year, as the furlough scheme ends and the majority of workers are re-absorbed by the labour market.

Portfolio Position at 31 March 2021

15. A summary of the Authority's long term borrowing and investments at 31 March 2021 is shown in Table 2, including the equivalent position at 31 March 2020 for reference.

Table 2 – Portfolio Position

	31 March 2020 £000	31 March 2021 £000
Long Term Borrowing	1,012	5,012
Investments	(18,795)	(13,804)
Net Borrowing / (Investments)	(17,783)	(8,792)

16. Long term borrowing as at 31 March 2021 is made up entirely of maturity loans from the Public Works Loans Board (PWLB). A new PWLB loan of £4m towards the approved Capital Programme requirement was secured on 26 February 2021.

17. Investment balances (including cash on deposit in Money Market Funds) have reduced significantly during 2020-21. This is due to the use of cash reserves to fund major capital expenditure during the year, along with the deferral of the majority of borrowing approved towards the Operational Training Centre project as discussed in paragraph 9 above and in line with the currently approved Treasury Management Strategy.

Treasury Management Performance 2020-21

Investments

18. In the current climate it is impossible to generate significant levels of investment income. Investment income in 2020-21 is £49k, reduced from the £244k generated in 2019-20. This year-on-year decrease is mainly due to the 0.10% base rate throughout the whole of 2020-21 leading to available investment rates with suitable counterparties being barely above zero. In addition, higher cash balances were available for investment in the early part of 2019-20 before significant capital expenditure has since reduced cash balances, most notably in respect of the new Operational Training Centre and replacement Chester Fire Station projects both of which were completed during the year along with a number of further Fire Station modernisations.

19. The Authority has continued with a cautious approach to its choice of counterparties. As at 31 March 2021, the Authority's investments are with Santander UK and in its National Westminster Bank Liquidity account, which the Authority continues to use regularly to manage day to day cashflows. Other investment counterparties used during 2020-21 were Aberdeen Standard Liquidity Money Market Fund and Bank of Scotland.

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

Borrowing

21. The amount of borrowing as at 31 March 2021 is £5.012m. During 2020-21 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 £11m of new borrowing to finance the Capital programme (including the Operational Training Centre project) by the end of 2021-22, 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 was deferred due to the temporarily high levels of reserves held and in order to enable greater flexibility about the appropriate timing, which needs to be balanced carefully to take account of the levels of cash reserves held and prevailing and forecast market interest rates.

24. This borrowing was provisionally planned for early in 2021-22, however, due to an upward risk to borrowing rates towards the end of 2020-21 along with reducing cash balances, the Treasurer considered it prudent to secure the first £4m of this borrowing on 26 February 2021 from PWLB at a favourable fixed long term interest rate of 1.99%. The situation will continue to be kept under close review so that the remaining £7m approved 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 £7.8m under-borrowed, compared to the £11.8m originally forecast as a result of securing this £4m in 2020-21 rather than early in 2021-22. The forecast position at the end of 2021-22 remains unchanged at c£4m.

26. The actual maturity structure for borrowing 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. There are currently no potential issues.

Table 3 Maturity Structure of Borrowing

	Upper Limit %	**Lower Limit %**	**Actual %**	**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	18	893
5 years and 10 years	75	0	2	119
10 years and above	100	5	80	4,000
Total			100	5,012

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 2020-21 against the indicators, which were approved by the Authority in February 2020.

Table 4: Prudential and Treasury Indicators			
Prudential Indicators	2020-21 Indicator £000	2020-21 Outturn £000	Comment
Capital expenditure	14,095	12,123	Re-profiling of Crewe FS replacement and some delays to planned specialist vehicle/equipment purchases.
Capital financing requirement Annual change in capital financing requirement	12,793 5,986	12,794 5,987	
Gross borrowing requirement: (Under) / Over borrowing	(11,781)	(7,782)	£4m borrowing secured on 26/2/21. Paragraph 25 refers.
Ratio of financing costs to net revenue stream	0.77%	0.94%	Lower than forecast interest earned on investments increases net financing costs
Treasury Indicators	2020-21 Indicator £000	2020-21 Outturn £000	
Authorised limit for external debt Operational boundary for external debt	3,212 1,162	14,212 12,212	Revised limits approved 10 Feb 21 to enable the approved £11m borrowing planned for early 2021/22.
Actual external debt - Borrowing - Other long term liabilities Total	 1,012 0 1,012	 5,012 0 5,012	Original 2020-21 Strategy forecast £11m approved borrowing to finance Capital Programme commitments early in 2021-22. £4m of this was secured on 26 Feb 21 due to favourable market conditions.
Upper limit of fixed interest rate exposure	100%	100%	
Upper limit of variable interest rate exposure	25%	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 Crewe replacement station and a number of specialist vehicle/equipment purchases, capital expenditure was broadly in line with anticipated spending levels.

Conclusion

30. Investment interest rates have remained very low throughout the year and are forecast to remain low 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. £11m of new borrowing has been approved by the end of 2021-22 to finance the approved Capital Programme. £4m of this was secured on 26 Feb 2021 and the balance is currently planned for later in 2021-22 but the timing will be kept under close review. 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