CHESHIRE FIRE AUTHORITY

MEETING OF:	**CHESHIRE FIRE AUTHORITY**
DATE:	**8 DECEMBER 2021**
REPORT OF:	**HEAD OF FINANCE**
AUTHOR:	**WENDY BEBBINGTON**

SUBJECT: TREASURY MANAGEMENT – MID YEAR REPORT 2021/22

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 a Capital Strategy and an annual Treasury Management Strategy for 2021/22 at its meeting in February 2021.

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 2021/22 financial year;
- A review of the Treasury Management Strategy Statement (including the Annual Investment Strategy);
- The capital programme and borrowing position;
- A review of the investment portfolio for 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22.

ECONOMIC BACKGROUND

9. The Coronavirus Pandemic has done huge economic damage to the UK economy and economies around the world. After the Bank of England took emergency action in March 2020 to cut the Bank Rate to 0.25% initially, and then to 0.10%, it left the Bank Rate unchanged at its subsequent meetings. At its latest meeting on 4 November 2021, the Monetary Policy Committee (MPC) voted 7-2 to leave the Bank Rate unchanged at 0.10% with two members voting for an increase to 0.25% and made no changes to its programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn by a vote of 6-3.

10. There has been a major shift in the tone of the MPC's minutes at this meeting and its September meeting from the meeting in August that had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In August, the MPC's focus was

on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021.

11. In November, it has now indicated that its primary concern is that underlying price pressures in the economy are likely to be embedded over the next year (the Bank of England is now forecasting inflation to reach 5% in April 2022 when the next round of capped gas prices will go up) and elevate future inflation to stay significantly above its 2% target for longer.

12. The MPC therefore commented that the Bank Rate would have to go up in the short term. It is now relatively evenly balanced as to whether the Bank Rate will be increased in December, February or May. Much will depend on how the statistical releases for the labour market after the end of furlough on 30th September 2021 turn out. Information available at the December MPC meeting will be helpful in forming a picture but not conclusive, so this could cause a delay until the February meeting.

13. At the MPC's meeting in February 2022, it will only have available the employment figures for November 2021. To get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation. If the statistics show the labour market coping well during the next six months, then it is likely there will be two increases in these three meetings.

14. Covid-19 vaccines have been the game changer, which have enormously boosted confidence that life in the UK could largely return to normal after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, or whether vaccines can be modified quickly to deal with them and along with enhanced testing programmes could help to contain their spread.

15. As the interest forecast table for PWLB certainty rates, below, shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US. There is, however, likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates over the coming months.

16. The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid-19 and its variants, both domestically and their potential effects worldwide. There is a balance of upside risks to forecasts for medium to long-term PWLB rates.

17. A summary of projected interest rates is provided in the table below. As shown in the forecast table, one increase in the Bank Rate from 0.10% to 0.25% has now been included in December 2021, a second increase to 0.5% in quarter 2 of 2022, a third increase to 0.75% in quarter 1 of 2023 and a fourth one to 1.00% in quarter 1 of 2024.

Link Group Interest Rate View	8.11.21									
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00
3 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.80	0.90	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.10	1.10
12 month ave earnings	0.50	0.60	0.70	0.70	0.80	0.90	1.00	1.10	1.20	1.20
5 yr PWLB	1.50	1.50	1.60	1.60	1.70	1.70	1.70	1.80	1.80	1.80
10 yr PWLB	1.80	1.90	1.90	2.00	2.00	2.10	2.10	2.20	2.20	2.20
25 yr PWLB	2.10	2.20	2.30	2.40	2.40	2.40	2.50	2.50	2.60	2.60
50 yr PWLB	1.90	2.00	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40

TREASURY MANAGEMENT STRATEGY STATEMENT UPDATE

18. The Treasury Management Strategy Statement (TMSS) was approved by the Authority on 10 February 2021. 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

19. 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.

20. 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	**2021/22 £000**	**2022/23 £000**	**2023/24 £000**	**2024/25 £000**
Forecast Capital Programme	6,559	16,754	5,378	1,610
To be funded by new borrowing (estimate)	4,000	9,000	1,000	0
Estimated associated revenue cost of existing plus new borrowing (MRP & Interest Payable)	860	1,117	1,378	1,486

21. The Authority currently has a loan portfolio of £12.012m in line with the approved Treasury Management Strategy. This includes new external borrowing of £11m to finance the Training Centre project, secured from PWLB at favourably low fixed rates in March 2021 (£4m at 1.99%), July 2021 (£4m at 1.65%) and November 2021 (£3m at 1.63%).

22. 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 have now been fully committed to the existing programme for some time.

23. 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 in addition to the borrowing already approved.

24. 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 increase revenue funding of the programme and/or to enter into new external borrowing.

25. In view of a 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. This borrowing has now been secured at low fixed interest rates as outlined in paragraph 21 above.

26. The Authority currently remains in an under-borrowed position, which means that historically decisions have been made to internally finance expenditure as opposed to entering into new external borrowing. The forecast position at 31 March 2022 remains unchanged at c£4m, which is considered to be manageable and a sensible position in view of available cash reserves and almost non-existent returns that can be achieved on cash balances invested. However, as cash reserves are utilised to finance planned capital expenditure this may no longer be sustainable and a level of c£3m is currently considered more appropriate going forward.

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

28. The following tables show the actual debt maturity profile of current borrowing as at 31 October 2021 and a comparison with approved Upper and Lower Limits.

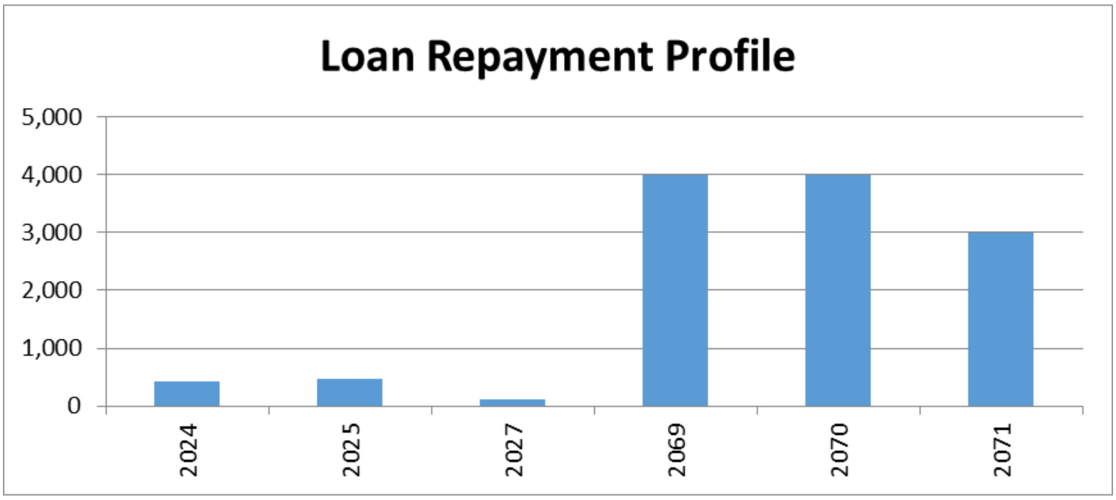

Table 2 Maturity Structure of Borrowing				
	Upper Limit %	**Lower Limit %**	**Actual 31/10/21 %**	**Amount £000**
Under 12 months	25	0	0	0
12 months and within 24 months	25	0	0	0
24 months and within 5 years	50	0	7	893
5 years and 10 years	75	0	1	119
10 years and above	100	5	92	11,000
Total			100	12,012

29. 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.

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 2021/22

31. The Annual Investment Strategy has the priorities of security, liquidity and yield. The aim is 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. In the current climate, it remains impossible to generate significant levels of investment income due to the 0.1% base rate, leading to available short-term investment rates with suitable counterparties being barely above zero. Through proactive cashflow management, the Authority has however been able to secure rates of up to 0.5% for medium term periods on some investments. Interest on balances earned to date is £17k to 31 October, with final 2021/22 outturn currently forecast to be around £30k (£49k 2020/21) compared with the annual budget (£10k) for investment income in 2021/22.

33. The Authority has continued with a cautious approach to its choice of counterparties. As at 31 October 2021, the Authority's investments were with Goldman Sachs, Santander, and NatWest, all of which are used regularly along with Bank of Scotland and Aberdeen Standard Liquidity Money Market Fund to manage day to day cashflows.

Investments 31/10/2021	£'000
Goldman Sachs	4,000
Santander UK	10,000
NatWest	5,980
Total	**19,980**

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

REVIEW OF COMPLIANCE WITH PRUDENTIAL INDICATORS

35. 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 2021/22 against those approved by the Authority in February 2021.

Table 3: Prudential and Treasury Indicators			
Prudential Indicators	2021/22 Indicator £000	2021/22 Revised Estimate £000	Comment
Capital expenditure	8,228	6,559	Re-profiling of Station Modernisation project spend offset by vehicle replacement slippage from 2020/21.
Capital Financing Requirement	16,126	16,126	
Annual change in capital financing requirement	3,332	3,332	
Gross borrowing requirement: (Under) / Over borrowing	(4,114)	(4,114)	
Ratio of financing costs to net revenue stream	1.97%	1.84%	Lower than anticipated cost of new borrowing

Treasury Indicators	2021/22 Indicator £000	2021/22 Revised Estimate £000	
Authorised limit for external debt	14,212	14,212	Set 10/2/21, no change planned during 2021/22.
Operational boundary for external debt	12,212	12,212	
Actual external debt			Approved borrowing now secured.
- Borrowing	12,012	12,012	
- Other long term liabilities	0	0	
Total	12,012	12,012	
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

36. The subject of this report is financial.

Legal Implications

37. 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

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

Environmental Implications

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

CONTACT: DEMOCRATIC SERVICES, CLEMONDS HEY, WINSFORD

TEL [01606] 868804

BACKGROUND PAPERS: None