NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT MID YEAR REVIEW 2018/19

Report of the Treasurer to the Fire Authority

Date: 14 December 2018

Purpose of Report:

To provide Members with an update on treasury management activity during the first half of the 2018/19 financial year.

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1. BACKGROUND

1.1. The purpose of the treasury management function is to effectively manage the day to day cashflow of the organisation and to manage the borrowing required to finance the capital programme.

1.2 Accordingly, treasury management is defined as:

> "The management of the local 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."

1.3 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice on Treasury Management was adopted by the Fire Authority on 9 April 2010. The primary requirements of the Code are as follows:

1. The creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities.

2. The creation and maintenance of Treasury Management Practices which set out the manner in which the Authority will seek to achieve those policies and objectives.

3. Receipt by the Fire Authority of an annual Treasury Management Strategy Statement for the year ahead, a mid-year review report and an annual report covering activities during the previous year.

4. Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.4 The CIPFA Delegation by the Authority of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Authority, the delegated body is the Finance and Resources Committee.

1.5 This mid-year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first part of the 2018/19 financial year;
- The Authority's capital expenditure and prudential indicators;
- A review of the Treasury Management Strategy Statement;
- A review of the Authority's investment portfolio for 2018/19;
- A review of the Authority's borrowing strategy for 2018/19;
- A review of any debt rescheduling undertaken during 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19.

1.6 The Authority has appointed Link Asset Services as its external treasury management adviser.

1.7 In December 2017 CIPFA issued revised Prudential and Treasury Management Codes From 2019/20, all fire authorities will be 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.

1.8 A report setting out the Authority's Capital Strategy can be found elsewhere on the agenda for the December 2018 Fire Authority meeting.

2. REPORT

ECONOMIC UPDATE

2.1 The first half of 2018/19 has seen the UK economy grow modestly (0.1% in quarter 1, 0.4% in quarter 2 and 0.6% in quarter 3), although growth was sufficiently robust for the Monetary Policy Committee (MPC) to unanimously vote to increase bank rate on 2 August from 0.5% to 0.75%.

2.2 At their November meeting the MPC unanimously voted for the bank rate to remain unchanged at 0.75%. The MPC stated that future bank rate increases would be gradual and would rise to a much lower equilibrium rate (where monetary policy is neither expansionary nor contractionary) than before the financial crash of 2008. With so much uncertainty around Brexit the MPC warned that the next move in bank rate could be up or down, even if there was a disorderly Brexit. While it could be expected that bank rate might be cut in order to stimulate growth if there was a significant fall in GDP growth as a result of a disorderly Brexit, it is also possible that bank rate could be increased in order to combat rising inflation. It is possible that inflation could rise as a result of Brexit as a result of a devaluation of sterling, increases in import prices, and more expensive goods produced in the UK replacing cheaper goods that had previously been imported.

2.3 It is unlikely that the MPC will change the bank rate in February 2019 ahead of the March deadline for Brexit, however financial markets are currently pricing in a 56% chance of a rate increase in May 2019 and a 68% chance of an increase in August 2019.

2.4 A more detailed economic update, including longer term estimates of bank rates and GDP, can be found in Appendix A.

REVIEW OF THE TREASURY MANAGEMENT STRATEGY

2.5 The Treasury Management Strategy approved by the Authority sets out the policies for managing investments and for giving priority to the security and liquidity of those investments. The risk appetite of this Authority is low in order to give priority to security of its investments. Accordingly, the following types of low risk investments may be made:

- Deposits with the Debt Management Office (Government);
- Term deposits with Banks and Building Societies;
- Call deposits with Banks and Building Societies;
- Term Deposits with uncapped English and Welsh local authority bodies;
- Triple-A rated Money Market Funds (CNAV, LVNAV and VNAV);
- UK Treasury Bills;
- Certificates of Deposit.

2.6 The Authority will aim to limit its investment with any single counterparty to £2m although the strategy noted that this was sometimes difficult to achieve. No term deposits will be made for more than 1 year without the prior approval of the Treasurer and the Chair of Finance and Resources Committee. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Link's weekly credit list of potential counterparties. The Authority will therefore use counterparties within the following durational bands:

- Blue 1 year (only applies to nationalised or semi nationalised UK Banks);
- Orange 1 year;
- Red 6 months;
- Green 100 days.

2.7 The Authority will avoid locking into longer term deals whilst investment rates are down at such low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

2.8 In terms of cash resources, the strategy is to maintain a bank overdraft facility of £200,000, to continue to use cash flow forecasting to predict cash surpluses and shortfalls so that these can be managed and to invest small bank account balances in the Business Premium Account on a daily basis if the interest rate is favourable.

2.9 In the first half of the year, the current account was overdrawn on two occasions. As a result, the Authority incurred interest charges of £1.4k.

REVIEW OF THE INVESTMENT PORTFOLIO

2.10 During the first half of the year, two investments were made (excluding the overnight sweep to the Business Premium Account). A £950k fixed term deposit was placed with the Bank of Scotland at a rate of 0.77%. The deposit was placed on 3 August for 3 months, and it took the total amount invested with this institution to £2m. £2m was placed in a 95-day fixed term deposit on

16 August for 3 months, at a rate of 1.11%. An analysis of investments as at 30 September 2018 revealed that the Authority had £10m invested with 6 different institutions at an average interest rate of 0.85%. £8m was placed with banks or building societies incorporated in the UK, and £2m was placed with a bank incorporated outside the EEA authorised to accept deposits through a branch in the UK (as defined by the Bank of England Prudential Regulation Authority).

2.11 Investment income received as at 30 September 2018 totalled £8k. The forecasted outturn for total interest earned in 2018/19 is £67k, compared with a budget of £66k.

2.12 The Authority is finding it more difficult to find suitable counterparties for investments. This is partly due to the £2m limit per counterparty, and partly because the time it takes to establish new banking relationships and set up new accounts can be prohibitive when looking to place investments for a relatively short period of time. As a result, the balance held in the Business Premium Account has been higher than usual since the £9.9m Pension Top Up grant was received at the end of July.

REVIEW OF THE BORROWING STRATEGY

2.13 The strategy for 2018/19 is to use a combination of capital receipts, borrowing and internal funds to finance capital expenditure.

2.14 In the Treasury Management Strategy, it was predicted that the Authority would need to borrow up to £8m during the 3-year period from 2018/19 to finance the capital programme and replace £4m of maturing loans. A £1m maturity loan was taken from the PWLB in May 2018 to refinance a £1m PWLB loan that matured the following month. The new loan matures in March 2068 and has a rate of 2.25%, compared with a rate of 3.91% on the loan that matured. A £1.5m PWLB loan is due to mature in December 2018.

2.15 PWLB rates have fluctuated during the year, but have generally increased. The 25-year rate has increased from 2.55% at the beginning of April 2018 to 2.74% at the end of September. The rate as at 13 November is 2.73%. Given the high levels of uncertainty around the likely impact of the UK's withdrawal from the EU it is difficult to predict if this upward trend will continue until the end of the financial year.

2.16 As borrowing rates are currently higher than investment rates the Authority can avoid carrying costs by not borrowing too far in advance of expenditure, however a balance needs to be struck between avoiding unnecessary carrying costs and managing the interest rate risk which arises from delaying borrowing while interest rates are at relatively low levels. The Authority is currently maintaining an under-borrowed position, which means that the capital financing requirement is being partly funded by the Authority's reserves and balances rather than by loan debt. This strategy, known as "internal borrowing" is prudent at the moment as investment returns are low and counterparty risk is relatively high. However, this strategy is not sustainable in the longer term and borrowing will have to be taken at some

point in the future to ensure that reserves and balances are “cash-backed” to an appropriate level. The timing of this borrowing will very much depend on prevailing economic conditions and the Authority’s ability to ensure the security of funds and demonstrate value for money in its investment returns. Current cash flow forecasts show that the Authority is likely to require further borrowing of £2.5m in the final quarter of the financial year. Officers will work with treasury advisors to decide if this borrowing should be short or long term, and if it is appropriate to borrow more than this amount in order to reduce the Authority’s under-borrowed position.

2.17 The Authority took a short-term loan for 3 months from Middlesbrough Council in April 2018, borrowing £3m at a rate of 0.65%. A short-term loan of £2m was repaid in April 2018. This was a £2m loan which had been borrowed for 1 month from Nottinghamshire County Council at a rate of 0.75%.

2.18 No rescheduling of debt has taken place to date, as the interest rate climate has not resulted in an advantageous environment for rescheduling.

2.19 All aspects of the borrowing strategy remain in place at this mid-point in the year.

REVIEW OF COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

2.20 The following indicators were approved by Members for the 2018/19 financial year. As at 30 September, the actual performance was as shown in the final column of the table below.

Treasury or Prudential Indicator or Limit	Approved for 2018/19	Actual as at 30/09/18
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.7%	Not available until year end
Estimate of Total Capital Expenditure to be Incurred	£3,191,000	£2,388,000
Estimate of Capital Financing Requirement	£27,306,000	Not exceeded
Operational Boundary	£29,723,000	Not exceeded
Authorised Limit	£32,695,000	Not exceeded
Upper limit for fixed rate interest exposures	100%	100%
Upper limit for variable rate interest exposures	30%	0%

Treasury or Prudential Indicator or Limit	Approved for 2018/19	Actual as at 30/09/18
Loan Maturity:	Limits:	
Under 12 months	Upper 20% Lower 0%	13.5%
12 months to 5 years	Upper 30% Lower 0%	8.9%
5 years to 10 years	Upper 75% Lower 0%	20.9%
10 years to 20 years	Upper 100% Lower 0%	0%
Over 20 years	Upper 100% Lower 30%	56.7%
Upper Limit for Principal Sums Invested for Periods Longer than 364 Days	£2,000,000	Not applicable

3. FINANCIAL IMPLICATIONS

The financial implications are set out in full within the body of the report.

4. HUMAN RESOURCES AND LEARNING AND DEVELOPMENT IMPLICATIONS

There are no human resources or learning and development implications arising from this report.

5. EQUALITIES IMPLICATIONS

An equality impact assessment has not been undertaken because this report gives a review of activities rather than introducing a new policy.

6. CRIME AND DISORDER IMPLICATIONS

There are no crime and disorder implications arising directly from this report.

7. LEGAL IMPLICATIONS

There are no legal implications arising directly from this report, other than the requirement to act within the Authority's powers when undertaking treasury management borrowings and investments.

8. RISK MANAGEMENT IMPLICATIONS

The investment of local authority funds cannot be achieved without some element of risk. Careful choice of borrowers using creditworthiness indices will minimise this risk. This prudent approach will undoubtedly result in some interest rate loss but the principles of security and liquidity are paramount.

9. COLLABORATION IMPLICATIONS

There are no collaboration implications arising from this report.

10. RECOMMENDATIONS

That Members note the contents of this report.

11. BACKGROUND PAPERS FOR INSPECTION (OTHER THAN PUBLISHED DOCUMENTS)

None.

Charlotte Radford
TREASURER TO THE FIRE AUTHORITY

APPENDIX A

ECONOMIC UPDATE

1 The Bank of England's November Inflation Report forecast summary contained the following projections:

	2018 Q4	**2019 Q4**	**2020 Q4**	**2021 Q4**
GDP	1.5%	1.7%	1.7%	1.7%
CPI inflation	2.5%	2.1%	2.1%	2.0%
Bank rate	0.7%	1.0%	1.2%	1.4%

2 However, this inflation report was produced prior to the Chancellor's announcement of a significant fiscal stimulus in the budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy. The Bank's inflation forecast is therefore likely to be amended upwards.

3 In the US, President Trump's easing of fiscal policy is fuelling a boost in consumption which has generated a strong upturn in the rate of growth, but also an upturn in inflationary pressures. With CPI inflation over the target rate of 2%, the Federal Reserve increased rates in September, the fourth increase in 2018. Further rate increases are expected in 2019. This boost in consumption is likely to be temporary, particularly as the recent imposition of trade tariffs on a number of countries' exports to the US could see a switch to the US production of some of these goods, but at higher prices.

4 Growth in the Eurozone is expected to be in the region of 2% for 2018. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank (ECB) has indicated it is likely to end all further purchases in December 2018. Inflationary pressures are starting to build gently so it is expected that the ECB will start to increase rates towards the end of 2019.

INTEREST RATE FORECASTS

5 The Authority's treasury advisor, Link Asset Services, has provided the following forecast:

	Dec 2018	Mar 2019	Jun 2019	Sep 2019	Dec 2019	Mar 2020	Jun 2020	Sep 2020	Dec 2020	Mar 2021	Mar 2022
Bank rate	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	2.00%
5yr PWLB	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.80%
10yr PWLB	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.20%
25yr PWLB	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.60%
50yr PWLB	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.40%

6 These forecasts are predicated on the assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly

non-agreement exit from the EU, economists at Link believe it is likely that the Bank of England would take action to cut bank rate from 0.75% in order stimulate growth and help the economy deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly exit from the EU, then any cut in bank rates would be likely to last for a longer period and also depress short and medium term gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

7 The overall balance of risks to economic growth in the UK is probably neutral. The balance of risks to increases in bank rate and shorter term PWLB rates are probably also neutral, and are broadly dependant on how strong GDP growth turns out to be, how slowly inflation pressures subside, and how quickly and positively the Brexit negotiations move forward.

8 Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Brexit - if it were to cause significant economic disruption and a major downturn in the rate of growth.

- Bank of England monetary policy: if action is taken too quickly or bank rates are raised too much in the next three years this will cause UK growth and increases in inflation to be weaker than currently anticipated.

- A resurgence of the Eurozone sovereign debt crisis. This is possible in Italy due to its high level of government debt, low rate of economic growth and vulnerable banking system, and the election in March of an anti-austerity government. At the time of writing, the EU has rejected the proposed Italian budget and has demanded cuts in government spending, which the Italian government has refused. The rating agencies have started downgrading Italian debt to one notch above junk level, and if it falls below investment grade many investors would be unable to hold it.

- Weak capitalisation of some European banks. Banks that hold a high level of Italian government debt are particularly vulnerable as that debt is falling in value. This is undermining the banks' capital ratios and raising the possibility that they will require fresh capital to plug the gap.

- Further increases in US interest rates could see a transfer of investment funds from more risky assets such as shares into bonds which have a much-improved yield. This could lead to a fall in equity markets and create the risk of investors switching to safe havens such as UK gilts. This would increase demand, pushing up UK gilt prices and therefore decreasing yields. Emerging countries which have borrowed heavily in US dollar denominated debt could also be exposed to the risk of investor flight to safe havens e.g. UK gilts.

9 Potential upside risks to current forecasts for UK gilt yields and PWLB rates include:

- Brexit - if all sides were to agree a compromise that removed threats of economic and political disruption.

- The pace and timing of increases in the Federal Funds Rate in the US could cause investors to reassess the relative risks of holding bonds as opposed to equities, leading to a major flight from bonds to equities.

- If the Bank of England is too slow in its pace and strength of increases in bank rate, inflation pressures could build up too strongly within the UK economy. This could necessitate a later rapid series of increases in bank rate faster than currently expected.

- UK inflation returning to significantly high levels, causing an increase in the inflation premium inherent to gilt yields.

Source: Link Asset Services