NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT ANNUAL REPORT 2020/21

Report of the Treasurer

Date: 24 September 2021

Purpose of Report:

To provide Members with an update on treasury management activity during the 2020/21 financial year.

Recommendations:

That Members note the update on treasury management activity during the 2020/21 financial year as required under the Local Government Act 2003.

CONTACT OFFICER	
Name :	Becky Smeathers Head of Finance/Treasurer to the Authority
Tel :	0115 967 0880
Email :	becky.smeathers@notts-fire.gov.uk
Media Enquiries Contact :	Simon Cotton (0115) 967 0880 simon.cotton@notts-fire.gov.uk

1. BACKGROUND

1.1 Treasury management is defined as:

"The management of the organisation's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with these activities; and the pursuit of optimum performance consistent with those risks."

1.2 The Fire Authority is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2020/21. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised in 2017) was adopted by the Fire Authority on 9 April 2010.

1.3 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.

5. 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.

1.4 This annual report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic review of 2020/21;
- A review of Capital Activity during 2020/21 and the impact of this on the Authority's Capital Financing Requirement;
- A review of the Investment and Cash Management Strategy during 2020/21;
- Investment and cash activity during 2020/21;
- A review of the year end Investments and cash position and usable reserves;
- A review of the Borrowing Strategy and borrowing activity during 2020/21;

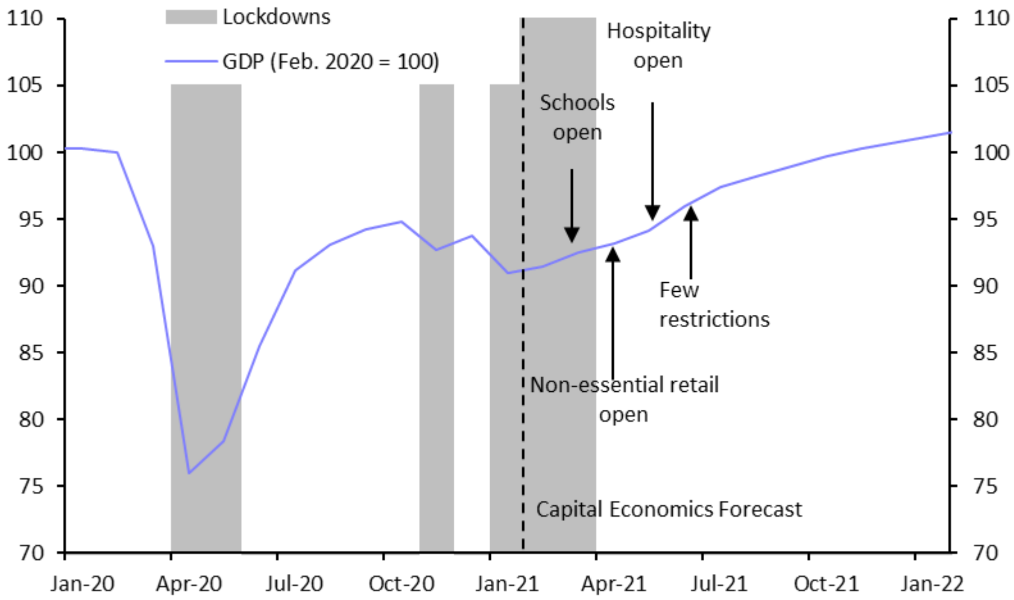
- A summary of compliance with treasury and prudential limits for 2020/21.

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

2. REPORT

ECONOMIC REVIEW

2.1 The financial year 2020/21 will go down in history as being the year of the Covid-19 pandemic. The first national lockdown in March 2020 did huge damage to an economy that was unprepared for such an eventuality. This caused an economic downturn that exceeded the one caused by the financial crisis of 2008/09. A second shorter lockdown in November 2020 had a lesser economic impact as both businesses and individuals had become more resilient in adapting to working in new ways, and the third lockdown in January 2021 was less damaging still.



2.2 The Bank of England took rapid action in March 2020 at the height of the crisis, cutting bank rate from 0.75% to 0.25% and then to 0.10%. It also embarked on a £200bn programme of quantitative easing (the purchase of gilts to reduce borrowing costs throughout the economy by lowering gilt yields). The Monetary Policy Committee (MPC) then increased quantitative easing QE by £100bn in June and by £150bn in November, whilst keeping bank rate at 0.10%.

2.3 The Government introduced various schemes to subsidise jobs while some sectors of the economy were locked down. It also put in place a raft of other measures to help businesses access loans from their banks, (with the Government providing guarantees to the banks against losses), to tide them over the lock down period when some firms had little or no income. This support has come at a huge cost in terms of the Government's budget deficit, which has ballooned to the point that the GDP to debt ratio has reached around 100%. The Budget on 3 March 2021 increased fiscal support to the economy in 2021 and 2022, followed by substantial tax rises in the following three years to help to help reduce the deficit. This will help further to strengthen the economic recovery from the pandemic and to return the government's finances to a balanced budget on a current expenditure and income basis in 2025/26. This will stop the Debt to GDP ratio rising further from 100%. An area of concern, though, is that the government's debt is now twice as sensitive to interest rate rises as before the pandemic due to quantitative easing operations substituting fixed long-term debt for floating rate debt; there is, therefore, much incentive for the Government to promote Bank Rate staying low e.g. by using fiscal policy in conjunction with the monetary policy action by the Bank of England to keep inflation from rising too high, and / or by amending the Bank's policy mandate to allow for a higher target for inflation.

2.4 The UK's vaccination programme has been instrumental in speeding economic recovery and the reopening of the economy. In addition, the household saving rate has been exceptionally high since the first lockdown in March 2020 and so there is plenty of pent-up demand and purchasing power stored up for services in the still-depressed sectors like restaurants, travel and hotels now they are reopening. It is therefore expected that the UK economy could recover to its pre-pandemic level of economic activity during quarter 1 of 2022.

2.5 A major change has been adopted by the Bank of England in terms of implementing its inflation target of 2%. The key addition to the Bank's forward guidance in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time the MPC will not increase bank rate until they can clearly see that level of inflation is going to be persistently above target if no action is taken. This sets a high bar for raising bank rate and no increase is expected by March 2024, and possibly for as long as five years. Inflation has been well under 2% during 2020/21. It is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short-lived factor and so not currently a concern to the MPC.

2.6 The final Brexit agreement on 24th December 2020 eliminated a significant downside risk for the UK economy. However, the initial agreement only covered trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. There was much disruption to trade in January as form filling has proved to be a formidable barrier to trade. This appears to have eased somewhat since then but is an area that needs further work to ease difficulties, which are still acute in some areas. The implementation of the Northern Ireland Protocol is proving particularly problematic.

2.7 Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last 30 years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. In March 2021, western democracies implemented limited sanctions against a few officials in charge of government policy on the Uighurs in Xinjiang; this led to a much bigger retaliation by China and is likely to mean that the China / EU investment deal then being negotiated, will be torn up. After the pandemic exposed how frail extended supply lines were around the world, both factors are now likely to lead to a sharp retrenchment of economies into two blocs of western democracies v. autocracies. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products and vice versa. This is likely to reduce world growth rates.

REVIEW OF CAPITAL ACTIVITY IN 2020/21

2.8 The Authority undertakes capital expenditure on long term assets. These activities may either be:

- Financed immediately by way of capital or revenue resources (capital receipts, capital grants, revenue contributions), which does not give rise to a requirement to borrow; or

- If insufficient financing is available, or if a decision is taken not to apply resources, the capital expenditure will need to be financed by borrowing.

2.9 Actual capital expenditure forms one of the required prudential indicators. The table below shows actual capital expenditure in the year and how this was financed.

	2019/20 Actual	**2020/21 Revised Budget**	**2020/21 Actual**
	£000's	**£000's**	**£000's**
Capital Expenditure	**1,858**	**6,002**	**3,249**
Resourced By:			
- Capital Grants		0	0
- Capital Receipts	15	0	235
- Revenue Contributions/Earmarked Reserves	22	1,037	691
- Borrowing	1,821	4,965	2,323
Total Financed Capital Expenditure	**1,858**	**6,002**	**3,249**

2.10 The 2020/21 capital budget underspent by £2.753m. Significant variances include £313k relating to the purchase of light vehicles, £404k relating to the new station at Worksop and £1.155m relating to the new Joint Headquarters. Further details of these and other variances can be found in the 2020/21 Revenue and Capital Outturn Report, which was presented to members of the Finance and Resources Committee on 2 July 2021.

2.11 As at 31 March 2021 the Authority's capital financing requirement was £26,667k, which was within the prudential indicator set of £29,073k. The Capital Financing Requirement (CFR) figure represents the Authority's underlying need to borrow to fund capital expenditure and equates to un-financed capital expenditure which has not yet been paid for by revenue funding or other resources such as capital grants or receipts. The CFR is reduced over time by way of a statutory Minimum Revenue Provision charge to revenue which effectively charges the revenue budget for the use of capital assets over their asset lives.

REVIEW OF THE INVESTMENT AND CASH MANAGEMENT STRATEGY

2.12 The Treasury Management Strategy approved by the Authority set 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 specified investments may be made:

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

During the year, all investments were made with banks or building societies (term deposits or call deposits) or with English local authorities.

2.13 The Authority has a maximum limit of investments with any single counterparty of £4m. The maximum investment placed with any single counterparty during the year was £4m.

2.14 No term deposits are made for more than 1 year without the prior approval of the Treasurer and the Chair of Finance and Resources Committee. There have been no term deposits made during the year due to the low interest rates.

2.15 The selection of counterparties with a high level of creditworthiness is achieved by reference to Link's weekly credit list of potential counterparties. The Link weekly credit list shows potential investment counterparties, which are colour-coded to indicate the maximum period it is recommended that investments are made for. The Authority has made all investments with counterparties during the year in accordance with the maximum periods advised by Link.

2.16 The Authority avoids locking into longer term deals while investment rates are at such low levels unless exceptionally attractive rates are available which make longer term deals seem worthwhile.

2.17 In terms of cash resources, the strategy is to maintain a bank overdraft facility of £200,000 and to continue to use cash flow forecasting to predict cash surpluses and shortfalls. These surpluses and shortfalls are managed, and current account balances are transferred to the Business Premium Account on a daily basis if the interest rate is favourable. The current account was overdrawn on four occasions during 2020/21.

2.18 The Treasury Management Strategy stated that the Authority will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch ratings. An exception to this policy can be made for the UK in the event that its sovereign credit rating is downgraded to AA-, in which case the Authority can continue to use counterparties from the UK. The UK was downgraded to AA- by Fitch on 27th March 2020.

2.19 All aspects of the Annual Investment Strategy outlined for 2020/21 remained in place throughout the year.

INVESTMENT AND CASH ACTIVITY IN 2020/21

2.20 As at 31 March 2021, the Authority held £3.5m of principal as short term investments on the Balance Sheet and £3.0m of principal as shorter dated "cash equivalent" investments. The Authority holds a total of £12.5m in short term investments and cash equivalent investments as at 31 August 2021.

2.21 The investment activity during the year conformed to the approved strategy, and the Authority had no liquidity difficulties. All investments during the year were made with UK banks and building societies or local authorities.

2.22 Of the six call accounts held at 31 March 2021, four had been held for more than 1 year. These accounts had notice periods ranging from 1 day to 125 days. All counterparties have their creditworthiness continually monitored against Link's credit listings, and had it looked likely that the maximum recommended investment term for these institutions would have fallen below the call account notice period then the funds would have been withdrawn.

2.23 Investment returns remained low during 2020/21. The expectation for interest rates within the treasury management strategy for 2020/21 was that bank rate would rise from 0.75% to 1.00% during the year. However, the Covid-19 pandemic led to the Bank of England cutting bank rate to 0.25% on 11 March 2020 and then again to 0.10% on 19 March, where it has remained.

2.24 The average 3 Month LIBID benchmark rate for the year was 0.01%. The Authority's investments earned an average rate of 0.21% during the year resulting in total investment (including overnight savings interest on the current account) income earned of £19.8k, against a budgeted sum for investment income of £100k.

2.25 The Treasury Management Strategy set a Weighted Average Life (WAL) benchmark for liquidity of approximately 3 months for the Authority's investment portfolio. The actual WAL during 2020/21 was 45.2 days. The Strategy also set a security benchmark of 0.08% historic risk of default. The historic risk of default as at 31/03/21 was 0.05%.

REVIEW OF INVESTMENTS / CASH POSITION AND USABLE RESERVES

2.26 Members will be aware that the Authority's "usable" reserves i.e. the General Fund and Earmarked Reserves have not been fully cash backed in the past due to the use of cash balances to support capital expenditure in previous years. This strategy of using internally borrowed funds is considered prudent as investment returns are low and counterparty risk is still an issue.

2.27 At 31 March 2021 the value of the Authority's usable reserves totalled £11.048m. The balance sheet as at the same date shows that short term investments were valued at £3.553m and cash and cash equivalents held totalled £4.922m. This means that reserves were not fully cash-backed at year end, as £2.573m of cash balances were being used to support capital expenditure. The 2020/21 Treasury Management Strategy recognised that the use of cash balances in this way, known as "internal borrowing", is prudent. However, it also recognised that internal borrowing brings a different kind of risk, as it is effectively variable rate debt. The Authority therefore has a local indicator that limits the level of internal borrowing to 20% of the underlying borrowing requirement. At 31 March 2021, the internal borrowing of £2.573m was 8.9% of the underlying borrowing requirement.

REVIEW OF THE BORROWING STRATEGY AND BORROWING ACTIVITY IN 2020/21

2.28 The strategy recommended that a combination of capital receipts, internal funds and borrowing would be used to finance capital expenditure during 2020/21. Capital receipts of £235k, borrowing of £2,323k and revenue contributions of £691k were applied to finance expenditure.

2.29 The Authority did not take any short term borrowing during 2020/21.

2.30 The Authority repaid £53.3k in principal on PWLB annuity loans during 2020/21. No maturity loans were repaid and no new long term borrowing was taken.

2.31 No rescheduling of debt took place, as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

2.32 On 1st May 2020 members of the Policy and Strategy Committee approved the following changes to the original 2020/21 Treasury Management Strategy and Prudential Indicators in light of the potential challenges presented by the Covid-19 pandemic:

- Increasing the operational boundary from £31.85m to £33.85m
- Increasing the authorised limit from £35.035m to £37.035m
- Increase the loan maturity profile limit for borrowing under 12 months from 20% to 30%

2.33 The Authorised Limit is the affordable borrowing limit above which the Authority does not have the power to borrow. Total external debt as at 31 March 2020 was £26.958m, which was well within the Authorised Limit.

2.34 The Operational Boundary is the expected borrowing position of the Authority within the year. This was set at £31.85m for 2020/21 and was subsequently increased to £33.85m. The Operational Boundary was not exceeded at any point during the year.

SUMMARY OF COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

2.35 The following indicators were approved by Members for the 2020/21 financial year. Actual performance is shown in the final column of the table below:

Treasury or Prudential Indicator or Limit	**Approved for 2020/21**	**Actual for 2020/21**
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.3%	5.2%
Estimate of Total Capital Expenditure to be Incurred	£5,576,000	£3,249,000
Estimate of Capital Financing Requirement	£29,073,000	£26,667,000
Operational Boundary	£33,850,000	Not exceeded
Authorised Limit	£37,035,000	Not exceeded
Upper limit for fixed rate interest exposures	100%	100%
Upper limit for variable rate interest exposures	30%	0%
Loan Maturity:		
Under 12 months	Upper 30% Lower 0%	0.2%
12 months to 5 years	Upper 30% Lower 0%	11.1%
5 years to 10 years	Upper 75% Lower 0%	13.0%
10 years to 20 years	Upper 100% Lower 0%	7.4%
Over 20 years	Upper 100% Lower 30%	68.3%
Upper Limit for Principal Sums Invested for Periods Longer than 365 Days	£2,000,000	£0

Local Indicator or Limit	**Approved for 2020/21**	**Actual for 2020/21**
Upper limit for internal borrowing as a % of the Capital Financing Requirement	20%	8.9%

Lower limit for proportion of net debt to gross debt	50%	Not breached
Upper limit for proportion of net debt to gross debt	85%	Not breached
Investment security benchmark: maximum historic default of investment portfolio	0.08%	0.05%

3. FINANCIAL IMPLICATIONS

The financial implications of this report 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

Risk management is a key aspect of treasury management, and the Treasury Management Strategy sets out the parameters within which activities will be carried out with a view to managing credit risk, liquidity risk, re-financing risk and market risk. The Authority has approved a prudent approach to treasury management and this report allows Members to review how well risks have been managed during the year.

9. COLLABORATION IMPLICATIONS

There are no collaboration implications arising from this report.

10. RECOMMENDATIONS

That Members note the update on treasury management activity during the 2020/21 financial year as required under the Local Government Act 2003.

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

None.

Becky Smeathers
TREASURER TO THE FIRE AUTHORITY