NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT ANNUAL REPORT 2021/22

Report of the Treasurer

Date: 23 September 2022

Purpose of Report:

To provide Members with an update on treasury management activity during the 2021/22 financial year.

Recommendations:

That Members note the update on treasury management activity during the 2021/22 financial year as required under the Local Government Act 2003.

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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 2021/22. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised in 2021) 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 2021/22
- A review of Capital Activity during 2021/22 and the impact of this on the Authority's Capital Financing Requirement
- A review of the Investment and Cash Management Strategy during 2021/22
- Investment and cash activity during 2021/22
- A review of the year end Investments and cash position and usable reserves
- A review of the Borrowing Strategy and borrowing activity during 2021/22

- A summary of compliance with treasury and prudential limits for 2021/22

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

2. REPORT

ECONOMIC REVIEW

2.1 Over the last two years the Covid-19 pandemic has done huge damage to the UK economy and economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021, 0.50% at its meeting of 4th February 2022 and then to 0.75% in March 2022.

2.2 The UK economy continued its post-Covid recovery during 2021/22 and was almost back to business as usual, with a relatively robust GDP figure of 9% y/y for Q2 2022. The Monetary Policy Committee therefore turned its attention to tackling the effects of inflation, as the CPI measure rose to 6.2% by March 2022.

2.3 Gilt yields fell towards the back end of 2021, but despite the war in Ukraine yields shot higher in early 2022. At 1.38%, 2-year yields remained close to their 11 year high and 10-year yields of 1.65% were close to their 6 year high. These rises have been part of a global trend as central banks have indicated that they will continue to raise interest rates to combat inflation.

2.4 Household utilities prices leapt up by 54% in April 2022. This, together with supply side shortages, labour shortages, commodity price inflation, the impact of the war in Ukraine and the subsequent Western sanctions on Russia all point to inflation being at elevated levels until well into 2023. Consequently, inflation will be a bigger drag on real incomes in 2022 than in any year since records began in 1955.

2.5 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 18% of total world GDP (the USA accounts for 24%), and Russia's recent invasion of Ukraine, has unbalanced the world economy. In addition, 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 (and to a much lesser extent Russia) to supply products and vice versa. This is likely to reduce world growth rates.

REVIEW OF CAPITAL ACTIVITY IN 2021/22

2.6 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.

2.7 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.

	2020/21 Actual	**2021/22 Revised Budget**	**2021/22 Actual**
	£000's	**£000's**	**£000's**
Capital Expenditure	**3,249**	**8,681**	**6,499**
Resourced By:			
- Capital Grants	0		0
- Capital Receipts	235		473
- Revenue Contributions/Earmarked Reserves	691		527
- Borrowing	2,323		5,499
Total Financed Capital Expenditure	**3,249**		**6,499**

2.8 The 2021/22 capital budget underspent by £2.182m. Significant variances include £179k relating to the purchase of light vehicles, £106k relating to water rescue equipment, £78k relating to the new station at Hucknall, £394k relating to Worksop station and £671k relating to the Joint Headquarters. Further details of these and other variances can be found in the 2021/22 Revenue and Capital Outturn Report, which was presented to members of the Finance and Resources Committee on 24 June 2022.

2.9 As at 31 March 2022 the Authority's capital financing requirement was £30,594k, which was within the prudential indicator set of £31,971k. 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.

2.10 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.

2.11 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.

2.12 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.

2.13 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.

2.14 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.

2.15 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 not overdrawn at any point during 2021/22.

2.16 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.

2.17 All aspects of the Annual Investment Strategy outlined for 2021/22 remained in place throughout the year.

INVESTMENT AND CASH ACTIVITY IN 2021/22

2.18 As at 31 March 2022, the Authority held £2.0m of principal as short-term investments on the Balance Sheet and £4.0m of principal as shorter dated “cash equivalent” investments.

2.19 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 or European banks and building societies.

2.20 Of the five call accounts held at 31 March 2022, four had been held for more than 1 year. These accounts had notice periods ranging from 1 day to 95 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.

2.21 Investment returns remained relatively low during 2021/22, although they were higher than in 2020/21. The expectation for interest rates within the treasury management strategy for 2020/21 was that bank rate would rise from remain at 0.10% during the year. However, the Bank of England raised rates three times between December 2021 and March 2022 in response to rising inflation. Bank rate at 31 March 2022 was 0.75%.

2.22 The average 3 Month LIBID benchmark rate for the year was 0.1707%. The Authority’s investments earned an average rate of 0.1443% during the year resulting in total investment (including overnight savings interest on the current account) income earned of £14.3k, against a budgeted sum for investment income of £20k. This means that the investment returns achieved by the Authority were below the benchmark set in the Treasury Management Strategy. The main reason for this is that the weighted average life of the investments was below 3 months (see below), therefore the returns tended to be lower.

2.23 The Treasury Management Strategy set a Weighted Average Life (WAL) benchmark for liquidity of approximately 0.4 years for the Authority’s investment portfolio. The actual WAL during 2021/22 was 47 days. The Strategy also set a security benchmark of 0.08% historic risk of default. The historic risk of default as at 31/03/22 was 0.005%.

REVIEW OF INVESTMENTS / CASH POSITION AND USABLE RESERVES

2.24 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.

2.25 At 31 March 2022 the value of the Authority's usable reserves (including Capital Grants Unapplied) totalled £10.375m. The balance sheet as at the same date shows that short term investments were valued at £2.061m and cash and cash equivalents held totalled £7.687m. This means that reserves were not fully cash-backed at year end, as £627k of cash balances were being used to support capital expenditure. The 2021/22 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 2022, the internal borrowing of £627k was 2.0% of the underlying borrowing requirement.

REVIEW OF THE BORROWING STRATEGY AND BORROWING ACTIVITY IN 2021/22

2.26 The strategy recommended that a combination of capital receipts, internal funds and borrowing would be used to finance capital expenditure during 2021/22. Capital receipts of £473k, borrowing of £5,499k and revenue contributions of £527k were applied to finance expenditure.

2.27 The Authority did not take any short-term borrowing during 2021/22.

2.28 The Authority repaid £52.5k in principle on PWLB annuity loans during 2021/22. Three new long term loans totalling £6m were taken between October 2021 January 2022. This was done in order to secure borrowing at reasonably low rates, as PWLB rates had begun to rise in response to the rising gilt yields which resulted from the changing economic situation. A £2m PWLB maturity loan was taken in October 2021 for 50 years at a rate of 2.00%. Two further PWLB maturity loans totalling £4m were taken in January 2022 (£2m for 12 years at a rate of 2.11% and £2m for 24.5 years at a rate of 2.22%).

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

2.30 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 2022 was £32.952m, which was well within the Authorised Limit.

2.31 The Operational Boundary is the expected borrowing position of the Authority within the year. This was set at £33.959m for 2021/22. The Operational Boundary was not exceeded at any point during the year.

SUMMARY OF COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

2.32 The following indicators were approved by Members for the 2021/22 financial year. Actual performance is shown in the final column of the table below:

Treasury or Prudential Indicator or Limit	**Approved for 2021/22**	**Actual for 2021/22**
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.4%	4.93%
Estimate of Total Capital Expenditure to be Incurred	£5,835,000	£6,499,000
Estimate of Capital Financing Requirement	£31,971,000	£30,594,000
Operational Boundary	£33,959,000	Not exceeded
Authorised Limit	£38,255,000	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%	0.0%
12 months to 5 years	Upper 30% Lower 0%	9.1%
5 years to 10 years	Upper 75% Lower 0%	10.6%
10 years to 20 years	Upper 100% Lower 0%	12.2%
Over 20 years	Upper 100% Lower 30%	68.1%
Upper Limit for Principal Sums Invested for Periods Longer than 365 Days	£2,000,000	£0

Local Indicator or Limit	**Approved for 2021/22**	**Actual for 2021/22**
Upper limit for internal borrowing as a % of the Capital Financing Requirement	20%	2.0%
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%	0.005%
Investment liquidity benchmark: maximum weighted average life of investment portfolio	0.40 years	0.13 years
Investment yield benchmark	Internal returns to be above 3-month LIBID rate	0.1443% (below the 3-month LIBID rate)

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 2021/22. 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