NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT MID-YEAR REVIEW 2022/23

Report of the Treasurer to the Fire Authority

Date: 16 December 2022

Purpose of Report:

To provide Members with an update on treasury management activity during first half of the 2022/23 financial year,

Recommendations:

That Members note the contents of this report.

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1. BACKGROUND

1.1 The Fire Authority operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low-risk counterparties, providing adequate liquidity initially before considering optimising investment return. The second main function of the treasury management service is the funding of the Fire Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning to ensure the Authority can meet its capital spending operations. This management of longer-term cash may involve arranging long or short-term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Authority risk or cost objectives.

1.2 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."

1.3 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice on Treasury Management (the Code) was adopted by the Fire Authority on 9 April 2010. The Code was revised in December 2017 and again in December 2021, however the 2021 revisions are not due to be formally adopted until the 2023/24 financial year. The primary requirements of the Code are as follows:

- The creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities;
- 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;
- 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;
- 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. This Authority delegates the role of scrutinising the treasury management strategy and policies to the Finance and Resources Committee.

1.4 This mid-year report has been prepared in accordance with the Code, and covers the following:

- An economic update for the first half of the 2022/23 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Authority's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Authority's investment portfolio for 2022/23;
- A review of the Authority's borrowing strategy for 2022/23;
- A review of any debt rescheduling undertaken in 2022/23;
- A review of compliance with Treasury and Prudential Limits for 2022/23.

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

1.6 The Code also requires that the Authority has a Capital Strategy – this forms part of the Medium-Term Financial Strategy which is a separate item on this meeting's agenda.

2. REPORT

ECONOMIC UPDATE

2.1 The quarterly estimate of Gross Domestic Product (GDP) fell by 0.2% in Quarter 3 (July to September) 2022. With the drag on economic activity from high inflation having grown in recent months, GDP is at risk of contracting further through the autumn and winter. There are already signs that economic activity is losing momentum as production fell due to rising energy prices, and the Bank of England has warned that the UK could be in recession from Q4 2022 until the first half of 2024.

2.2 Bank rate has increased from 0.75% in April 2022 to 3.00% in October, its highest level since November 2008. There are further increases to come, and markets are currently expecting rates to peak between 4.5% and 4.75% next year.

2.3 Interest rate forecasts provided by Link Asset Services can be found at Appendix A.

2.4 Inflation continues to be high, largely due to post-pandemic supply-chain shortages and increased demand, and the war in Ukraine. CPI inflation stands at 11.1% in October 2022 (10.1% in September), up from 9.0% in April. It was expected to peak at close to 11% in Q4 2022, but this projection may now be updated by the Bank of England given that the October figure was higher than expected. Domestic price pressures show little sign of abating in the near-term and are largely driven by a tight labour market, strong wage growth and increasing energy costs. If the Russian invasion of

Ukraine remains unresolved this will continue to put pressure on global energy process and the prices of staple foods such as wheat.

2.5 On 17 November, the Chancellor of the Exchequer Jeremy Hunt announced the Autumn Statement 2022. The Statement was Mr Hunt's first major fiscal event as Chancellor, and unlike the September so-called "mini-Budget", set out by his predecessor, was accompanied by the Office of Budget Responsibility's Economic and Fiscal Outlook.

2.6 The Autumn Statement followed a series of fiscal announcements in the last few months under the stewardship of the previous Prime Minister, Liz Truss. Many of the measures originally announced have since been either cancelled or scaled back. These changes had a calming effect on markets.

2.7 The Statement estimated a spending gap of approximately £55bn which would be met from a mixture of tax rises (£20bn) and spending cuts (£35bn).

REVIEW OF THE TREASURY MANAGEMENT STRATEGY

2.8 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;
- UK Treasury Bills;
- Certificates of Deposit.

2.9 The Treasury Management Strategy includes a limit of £4m to be invested with any single counterparty, although this limit is only used in exceptional circumstances and a maximum of £2m is normally adhered to. 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:

- Purple band – 24 months;
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks);
- Orange 1 year;
- Red 6 months;
- Green 100 days.

2.10 The Authority will avoid locking into longer term deals unless attractive rates are available which make longer term deals worthwhile.

2.11 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.

2.12 The current account has been overdrawn once during the first half of the year.

REVIEW OF THE INVESTMENT PORTFOLIO

2.13 The Authority's priority is to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with its risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs.

2.14 Following the Government's fiscal event on 23 September the main ratings agencies (Moody's, Fitch and S&P) have placed the UK sovereign rating on Negative Outlook, reflecting a downside bias to the current ratings in light of expectations of weaker finances and the economic outlook. The Authority's Annual Investment Strategy allows for the continued use of UK counterparties in the event that the UK's sovereign credit rating is downgraded, subject to other creditworthiness criteria. The Authority's investments are therefore unaffected at this stage, although the UK's Negative Outlook has had an impact on the underlying Outlooks of some "systemically important" UK banks.

2.15 Investments at 30 September 2022 totalled £16.0m and are all held with UK banks or building societies. Investment rates are monitored within the benchmarking group supported by Link Asset Services. The group consists of 13 members, including NFRS. The latest report (June 2022) showed NFRS's weighted average rate of return to be 0.27% compared with a group average of 0.97%. As at 30 September NFRS's weighted average rate of return was 1.62% and the weighted average life (WAL) of its investments was 69 days.

2.16 The Authority has adopted a liquidity benchmark, which is a WAL of approximately 3 months and recommended maximum WAL limit of 0.40 years. The current WAL of 69 days is around 2.3 months, meaning that the portfolio has a higher level of liquidity.

2.17 The Authority's yield benchmark is for investment returns to be above the 3-month SONIA compounded rate. The current 3-month SONIA compounded rate is currently 1.82% The Authority's weighted average rate of return is below this largely because the WAL of its portfolio is less than 3 months.

2.18 The approved limits within the Authority's Annual Investment Strategy have not been breached during the period from 1 April 2022 to 30 September 2022.

2.19 The Authority's budget for investment interest for 2022/23 is £20k. The forecast outturn for the 2022/23 financial year is £104k. Returns have increased significantly due to the increases in bank rate.

REVIEW OF THE BORROWING STRATEGY

2.20 The strategy for 2022/23 is to use a combination of capital receipts, borrowing and internal funds to finance capital expenditure.

2.21 In the Treasury Management Strategy, it was predicted that the Authority would need to borrow up to £9m during the 4-year period from 1 April 2022 to finance the capital programme and replace £3m of maturing loans. The Authority has repaid £3k of principal relating to annuity loans and has not repaid any maturity loans in the period to 30 September.

2.22 PWLB rates have been on a rising trend throughout 2022/23 and rose sharply following the fiscal event on 23 September. During October they have fallen back to rates seen before the mini budget. Link's 50-year PWLB target certainty rate for new long-term borrowing started 2022/23 at 2.20% before increasing to 4.80% in September. Rates are expected to fall back to 3.10% by the end of September 2025. These rates are higher than those used in the calculations for the medium-term budget covering the period 2022/23 to 2024/25 and will add to budgetary pressures going forward.

2.23 The Authority's capital financing requirement (CFR) as at 31 March 2022 was £30.59m, and the estimate for 2022/23 is £34.53m. The CFR denotes the Authority's underlying need to borrow for capital purposes. Current borrowing stands at £32.90m. 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. Based on current cashflow forecasts the Authority is unlikely to undertake any new borrowing during 2022/23 except to refinance a LOBO loan if required (see paragraph 2.25).

2.24 No rescheduling of debt has taken place to date, as the interest rate climate has not resulted in an advantageous environment for rescheduling. However, now that the whole yield curve has shifted higher there may be better opportunities in the future. Only prudent and affordable debt rescheduling will be considered.

2.25 The Authority holds a £4m Lender Option Borrower Option (LOBO) loan. This means that on 7 March 2013 and on that anniversary every five years, the lender may revise the interest rate, which is currently 4.13%. The Authority may choose to repay the loan without penalty if the amended interest rate is not advantageous. The next opportunity for a revision of the interest rate is 7 March 2023, and the recent rise in the cost of borrowing has increased the likelihood that the rate may be revised. Should this occur then officers would consider the implications of accepting the revised rate and assess whether to

repay the loan. Given the current interest rate forecasts if the loan is repaid it is likely to be initially refinanced by short-term borrowing until longer-term rates return to more affordable levels. This can be accommodated within current loan maturity limits.

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

REVIEW OF COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

2.27 The following indicators were approved by Members for the 2022/23 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 2022/23**	**Actual as at 30/10/22**
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.6%	Not available until year end
Estimate of Total Capital Expenditure to be Incurred	£3,909,000	£3,718,000
Estimate of Capital Financing Requirement	£34,526,000	Not available until year end
Operational Boundary	£36,907,000	Not exceeded
Authorised Limit	£40,598,000	Not exceeded
Upper limit for fixed rate interest exposures	100%	100%
Upper limit for variable rate interest exposures	30%	0%
Loan Maturity:	Limits:	
Under 12 months	Upper 20% Lower 0%	0.1%
12 months to 5 years	Upper 30% Lower 0%	10.4%
5 years to 10 years	Upper 75% Lower 0%	12.1%
10 years to 20 years	Upper 100% Lower 0%	6.9%
Over 20 years	Upper 100% Lower 30%	70.5%
Upper Limit for Principal Sums Invested for Periods Longer than 364 Days	£2,000,000	Not applicable

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 2022/23 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

APPENDIX A

Interest Rate Forecasts 2022-2025

PWLB forecasts shown below have taken into account the 20 basis point certainty rate reduction

Source: Link Asset Services 08/11/22

	Dec 2022	Mar 2023	Jun 2023	Sep 2023	Dec 2023	Mar 2024	Jun 2024	Sep 2024	Dec 2024	Mar 2025	Jun 2025	Sep 2025	Dec 2025
Bank Rate	3.50%	4.25%	4.50%	4.50%	4.50%	4.00%	3.75%	3.50%	3.25%	3.00%	2.75%	2.50%	2.50%
5Y PWLB Rate	4.30%	4.30%	4.20%	4.10%	4.00%	3.90%	3.80%	3.60%	3.50%	3.40%	3.30%	3.20%	3.10%
10Y PWLB Rate	4.50%	4.50%	4.40%	4.30%	4.20%	4.00%	3.90%	3.70%	3.60%	3.50%	3.40%	3.30%	3.20%
25Y PWLB Rate	4.70%	4.70%	4.60%	4.50%	4.40%	4.30%	4.10%	4.00%	3.90%	3.70%	3.60%	3.50%	3.50%
50Y PWLB Rate	4.30%	4.40%	4.30%	4.20%	4.10%	4.00%	3.80%	3.70%	3.60%	3.40%	3.30%	3.20%	3.20%