NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT ANNUAL REPORT 2023/24

Report of the Treasurer

Date: 20 September 2024

Purpose of Report:

To provide Members with an update on treasury management activity during the 2023/24 financial year.

Recommendations:

That Members note the update on treasury management activity during the 2023/24 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 2023/24. 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 2023/24;
- A review of capital activity during 2023/24;
- A review of borrowing and the capital financing requirement during 2023/24;
- A review of the Investment and Cash Management Strategy during 2023/24;
- Investment and cash activity during 2023/24;
- A review of the year end investments, cash position and usable reserves;
- A summary of compliance with treasury and prudential limits for 2023/24.

1.5 The Authority has appointed Link Assets Services as its external treasury management advisor. It was announced on 16 May 2024 that the Link Group has been acquired by Mitsubishi UFJ Trust & Banking Corporation and will be rebranding as MUFG Pension & Market Services over the coming months.

2. REPORT

ECONOMIC REVIEW

2.1 Against a backdrop of stubborn inflationary pressures and wars in Ukraine and the Middle East, UK interest rates continued to be volatile right across the yield curve during 2023/24. They have also remained stubbornly high, with the Bank of England Base Rate beginning the year at 4.25% and ending at 5.25%. The high, low and average rates for loans from the Public Works Loan Board (PWLB) are shown in the table below. The rates are based on gilt yields plus a margin of 80 basis points.

High/Low/Average PWLB Rates For 2023/24

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06/04/2023	27/12/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06/07/2023	07/07/2023	23/10/2023	23/10/2023	23/10/2023
Average	5.54%	4.99%	4.97%	5.34%	5.08%

2.2 Inflation has eased throughout 2023/24. The 12-month Consumer Price Index (CPI) rate had fallen to 2.3% by April 2024, largely due to reductions in the gas and electricity price caps. The Bank of England’s communications suggest that the Monetary Policy Committee (MPC) is gaining confidence that inflation will fall sustainably back to the 2.0% target. However, although the MPC noted that “the restrictive stance of monetary policy is weighing on activity in the real economy, and is leading to a looser labour market and is bearing down on inflationary pressures”, conversely it also noted that key indicators of inflation persistence remain elevated and that policy will be “restrictive for sufficiently long” and “restrictive for an extended period”. Core CPI (excluding energy, food, alcohol and tobacco) was 3.9% in April.

2.3 The UK economy performed a little better in Q1 2024, but it is still recovering from a shallow recession through the second half of 2023. UK gross domestic product (GDP) is estimated to have increased by 0.6% in Q1 2024, following declines of 0.3% in Q4 2023 and 0.1% in Q3 2023. Unemployment is still relatively low at less than 4% and annual wage inflation is above 5%.

REVIEW OF CAPITAL ACTIVITY IN 2023/24

2.4 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.

2.5 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:

	2022/23 Actual Expenditure	2023/24 Revised Budget	2023/24 Actual Expenditure
	£'000	£'000	£'000
Capital Expenditure	**2,265**	**9,223**	**7,271**
Resourced by:			
Capital grants	57	12	132
Capital receipts	513	3	0
Revenue contributions/earmarked reserves	298	513	513
Total capital expenditure financed in year	**868**	**528**	**645**
Unfinanced capital expenditure to be funded by borrowing	**1,397**	**8,695**	**6,626**

2.6 The 2023/24 revised capital budget underspent by £1.952m. Details of significant variances can be found in the 2023/24 revenue and capital outturn report, which was reported at the Fire Authority meeting on 26 July 2024.

REVIEW OF BORROWING AND THE CAPITAL FINANCING REQUIREMENT

2.7 The Authority's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). The CFR results from the Authority's capital activity and the resources used to pay for the capital spend. It represents the 2023/24 unfinanced capital expenditure (see above table), and prior years' unfinanced capital expenditure which has not yet been paid for by revenue or other resources. Part of the Authority's treasury activities is to address the funding requirements for this borrowing need. The cash position is managed to ensure that sufficient funds are available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies such as the PWLB, or by utilising temporary cash resources within the Authority.

2.8 The Authority's CFR is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Authority is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR. The total CFR can also be reduced by the application of additional capital financing resources (such as unapplied capital receipts), or by charging more than the statutory revenue charge (MRP) through a Voluntary Revenue Provision (VRP).

2.9 The Authority's 2023/24 MRP Policy (as required by DLUCH Guidance) was approved as part of the Treasury Management Strategy Report for 2023/24 on 24/02/23. The CFR for the year is shown below and represents a key prudential indicator.

Capital Financing Requirement	**31/03/23 Actual**	**31/03/24 Estimate***	**31/03/24 Actual**
Opening balance	30,735	31,680	30,533
Add unfunded capital expenditure	1,397	685	6,627
Less MRP/VRP	(1,599)	(1,719)	(1,522)
Closing balance	30,533	30,646	35,638

*Figures used when calculating the estimated CFR for the Prudential Code for Capital Finance 2023/24 report

2.10 The difference between the 31/03/24 estimated and actual figures for unfunded capital expenditure arose for two reasons: a significant increase in actual levels of capital expenditure due to slippage of the capital programme, and a delay in securing a capital receipt (budgeted at £3m) for the sale of the former headquarters due to the original offer falling through.

2.11 Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR and the Authorised Limit.

2.12 **Gross borrowing and the CFR** – in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Authority should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years (the cumulative CFR). This essentially means that the Authority is not borrowing to support revenue expenditure. The table below shows the Authority's gross borrowing position against the CFR. The Authority has complied with this prudential indicator (even though the 31/03/23 borrowing figure exceeded the 31/03/23 CFR it was less than the cumulative CFR figure of £41.7m).

Gross Borrowing and the CFR	**31/03/23 Actual**	**31/03/24 Estimate***	**31/03/24 Actual**
Gross borrowing position	32,900	30,901	32,900
CFR	30,533	30,646	35,638
(Under)/over funding of CFR	2,367	255	(2,738)

*Figures used when calculating the estimates for the Prudential Code for Capital Finance 2023/24 report

2.13 The Authority has not borrowed more than, or in advance of its needs purely in order to profit from the investment of the extra sums borrowed.

2.14 **The authorised limit** – this is the "affordable borrowing limit" required by Section 3 of the Local Government Act 2003. Once this has been set, the Authority does not have the power to borrow above this level.

2.15 In addition to the Authorised Limit, the management of external borrowing is aided by two other prudential indicators: the Operational Boundary and Financing Costs as a Proportion of Net Revenue Stream:

- **Operational boundary** – this is the expected borrowing position of the Authority during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the Authorised Limit not being breached;

- **Financing costs as a proportion of net revenue stream** – this identifies the trend in the cost of capital (borrowing and other long term obligations net of investment income), against the net revenue stream

	2023/24 £'000
Authorised limit	41,591
Maximum gross borrowing position during the year	35,900
Operational boundary	36,901
Average gross borrowing position	32,925
Financing costs as a proportion of net revenue stream	3.4%

2.16 The Authority did not take any short-term borrowing for cash flow purposes during 2023/24.

2.17 During 2023/24, the Authority maintained an under-borrowed position. This meant that the capital borrowing need (the CFR) was not fully funded with loan debt. Instead, cash supporting the Authority's reserves, balances and cash flows was used as an interim measure. This strategy was prudent as although near-term investment rates were equal to, and sometimes higher than, long-term borrowing costs, the latter are expected to fall back through 2024 and 2025 as inflation concerns are dampened. The Authority has sought to minimise the taking on of long-term borrowing at elevated levels (>4%) and has focused instead on a policy of internal and short-term borrowing. In line with this strategy, a £3m one year maturity loan with an interest rate of 5.32% was taken from the PWLB for capital funding purposes during the year. Based on current economic forecasts, it is expected that this loan will be refinanced more cheaply when it matures in March 2025.

2.18 The Authority repaid a £3m maturity loan during the year.

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

REVIEW OF INVESTMENT AND CASH MANAGEMENT STRATEGY

2.20 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 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, investments were made with banks or building societies (term deposits or call deposits) and a Police Authority.

2.21 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.

2.22 No deposits are made for more than one year without the prior approval of the Treasurer and the Chair of Finance and Resources Committee. There have been no term deposits for more than one year made during the year.

2.23 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.

2.24 Due to the volatile interest rate environment, the Authority avoids locking into longer term deals unless exceptionally attractive rates are available which make longer term deals seem worthwhile.

2.25 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 the year.

2.26 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 27 March 2020 and has remained at this rating to date.

2.27 All aspects of the Annual Investment Strategy outlined for 2023/24 remained in place throughout the year.

INVESTMENT AND CASH ACTIVITY IN 2023/24

2.28 At 31 March 2024, the Authority held £1.5m of principal as short-term investments on the Balance Sheet and £5.0m of principal as shorter dated “cash equivalent” investments.

2.29 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 or local authorities.

2.30 All of the call accounts held at 31 March 2024 had been held for more than one 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.

2.31 Investment returns increased steadily during 2023/24. The weighted average rate of return for the Authority’s investments went from 3.76% in April 2023 to 4.75% in March 2024. Bank rate increased from 4.25% to 4.50% in May 2023, then increased to 5.00% in June and to 5.25% in August 2023. It remained at 5.25% for the rest of the year.

2.32 The average 90 days backward looking Sterling Overnight Index Average (SONIA) compounded benchmark rate for the year was 4.74%. The SONIA is a risk-free sterling interest rate that is identified as the investment yield benchmark in the Treasury Management Strategy. The Authority's investments earned an average rate of 4.74% during the year. This is in line with the SONIA benchmark. This resulted in investment income of £637k, against a budget of £374k.

2.33 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 2023/24 was 0.16 years, which means that the majority of investments were relatively short dated, and the portfolio was more liquid. Shorter dated investments offered better rates of return during the period, so the Authority was able to reduce its liquidity risk whilst increasing its investment income. The Strategy also set a security benchmark of 0.08% historic risk of default. The historic risk of default as at 31 March 2024 was 0.003%.

REVIEW OF YEAR END INVESTMENTS, CASH POSITION AND USEABLE RESERVES

2.34 The Authority's usable reserves, which include the general fund and earmarked reserves, are not fully cash backed due to the use of cash balances to support capital expenditure. This strategy of using internally borrowed funds is considered prudent for the reasons set out in paragraph 2.17.

2.35 At 31 March 2024, the value of the Authority's useable reserves totalled £11.072m. The balance sheet at the same date shows that the Authority held short-term investments totalling £1.745m and £7.394m in cash and cash equivalents. This means that £1.9m of cash balances were being used to support capital expenditure. The Treasury Management Strategy recognises that whilst the use of cash balances in this way (known as "internal borrowing") can be prudent, it is not without risk. This is because internal borrowing 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 2024, internal borrowing was 5.4% of the underlying borrowing requirement.

SUMMARY OF COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

2.36 The following indicators were approved by Members for the 2023/24 financial year. Actual performance is shown in the final column of the table below:

Treasury or Prudential Indicator or Limit	Approved for 2023/24	Actual for 2023/24
Maximum ratio of financing costs to net revenue stream	8.0%	Not exceeded
Estimate of ratio of financing costs to net revenue stream	5.0%	3.4%
Estimate of total capital expenditure to be incurred		£7,272,000
Estimate of capital financing requirement	£30,646,000	£35,638,000
Operational boundary	£36,901,000	Not exceeded
Authorised limit	£41,591,000	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 30% Lower 0%	9.1%
12 months to 5 years	Upper 30% Lower 0%	10.6%
5 years to 10 years	Upper 75% Lower 0%	6.1%
10 years to 20 years	Upper 100% Lower 0%	6.1%
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
Upper limit for internal borrowing as a % of the capital financing requirement	20%	5.4%
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%	0.003%
Investment liquidity benchmark: maximum weighted average life of investment portfolio	0.40 years	
Investment yield benchmark	Internal returns to be above 3 month compounded SONIA rate	Average rate of return: 4.74% SONIA rate: 4.74%

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 AND ETHICAL IMPLICATIONS

An equality impact assessment has not been undertaken because this is not a new policy or service.

6. ENVIRONMENTAL AND SUSTAINABILITY IMPLICATIONS

There are no environmental or sustainability implications arising directly from this report.

7. LEGAL IMPLICATIONS

There are no legal implications arising 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 2023/24 financial year as required under the Local Government Act 2003.

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

None.

Bev Bull
TREASURER TO THE FIRE AUTHORITY