NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT ANNUAL REPORT 2018/19

Report of the Treasurer to the Fire Authority

Date: 27 September 2019

Purpose of Report:

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

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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 2018/19. 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 2018/19;

- A review of Capital Activity during 2018/19 and the impact of this on the Authority's Capital Financing Requirement;

- A review of the Investment and Cash Management Strategy during 2018/19;

- Investment and cash activity during 2018/19;
- A review of the year end Investments and cash position and usable reserves;
- A review of the Borrowing Strategy and borrowing activity during 2018/19;
- A summary of compliance with treasury and prudential limits for 2018/19.

1.5 The Authority has appointed Link Asset Services (formerly Capita) as its external treasury management adviser.

2. REPORT

ECONOMIC REVIEW

2.1 After weak economic growth of 0.2% in quarter 1 of 2018, growth picked up to 0.4% in quarter 2, and strengthened to 0.7% in quarter 3 before cooling off to 0.2% in the final quarter. This reduction in quarter 4 was to be expected given the uncertainties caused by Brexit. The annual growth at quarter 4 came in at 1.4% year on year, confirming that the UK was the third fastest growing country in the G7 in quarter 4.

2.2 The Monetary Policy Committee (MPC) raised bank rate from 0.5% to 0.75% in August 2018. There is unlikely to be any further action from the MPC until the uncertainties over Brexit clear. If there is a disorderly exit, it is likely that the bank rate would be cut to support growth. However, the MPC has been concerned over trends in wage inflation, which peaked to a post-financial crisis high of 3.5% in the three months to December 2018. British employers hired people at the fastest pace in more than three years in the three months to January 2019, helping to push the unemployment rate to 3.9%, its lowest rate since 1975.

2.3 CPI inflation has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising to 1.9% in February. However, in the February 2019 Bank of England Inflation Report, the forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%.

2.4 The rise in wage inflation and fall in Consumer Price Index (CPI) inflation means that there has been a real terms' increase in consumer spending power. Given that the UK economy is largely driven by the services sector, an increase in household spending power will help to support the overall rate of economic growth.

2.5 Equity markets showed concern about the synchronised general weakening of growth in the major world economies. There were even some fears of a possible recession looming in the US. US Treasury yields and UK gilt yields have therefore fallen sharply. This has also caused Public Works Loans

Board (PWLB) borrowing rates to fall from a peak during October 2018 to the lowest rates seen in 2018/19 during March 2019.

REVIEW OF CAPITAL ACTIVITY IN 2018/19

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.

	2017/18 Actual	**2018/19 Revised Budget**	**2018/19 Actual**
	£000's	**£000's**	**£000's**
Capital Expenditure	**4,060**	**3,277**	**1,075**
Resourced By:			
- Capital Grants	25		0
- Capital Receipts	630		115
- Revenue Contributions			62
- Borrowing	3,405		898
Total Financed Capital Expenditure	**4,060**		**1,075**

2.8 The 2018/19 capital programme has been smaller than in previous years as the service is between building projects. As at 31 March 2019, the Authority's capital financing requirement was £25.738m, which was within the prudential indicator set of £27,306k. 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

2.9 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, building societies (either term deposits or call deposits) and other local authority bodies.

2.10 The Authority aims to limit its investment with any single counterparty to £2m although the strategy noted that this was sometimes difficult to achieve. This £2m limit was breached during 2018/19 when the £2.3m pension grant came in earlier than expected. A total of £3.5m was consequently invested with Barclays during April and May 2018 (excluding current account and Business Premium Account balances). This was due to a lack of suitable counterparties. This limit was increased to £4m in the 2019/20 Treasury Management Strategy approved by Fire Authority in February 2019.

2.11 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 reference to the Treasury Management Advisor, 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 will therefore use counterparties with the following durational colour codes:

- Blue - investments up to 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange – investments up to 1 year
- Red – investments up to 6 months

- Green - investments up to 100 days

The Authority has made all investments with counterparties during the year in accordance with the maximum periods advised by Link.

2.12 The Authority will avoid 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.

2.13 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 current account balances in the Business Premium Account on a daily basis if the interest rate is favourable. The current account was overdrawn on three occasions during 2018/19. As a result, the Authority incurred interest charges of £1,400.

2.14 All aspects of the treasury management strategy outlined for 2018/19 remained in place throughout the year.

INVESTMENT AND CASH ACTIVITY IN 2018/19

2.15 As at 31 March 2019, the Authority held £7.050m of principal as short term investments. This comprised 6 separate investments in call accounts with 5 different counterparties. All of the investments were for £2m or less. These accounts had notice periods ranging from 1 day to 185 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.

2.16 During the course of the year, 2 new investments were made, excluding the overnight sweep to the Business Premium Account.

2.17 Investment returns remained low during 2018/19. The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75%. At the start of 2018/19, after UK GDP growth had proved disappointingly weak in the first few months of 2018, the expectation for the timing of this increase was pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the MPC would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018. Investment rates were little changed during August to October but rose sharply after the MPC meeting of 1 November was unexpectedly hawkish about their perception of building inflationary pressures, particularly from rising wages. However, weak GDP growth data after December, plus increasing concerns generated by Brexit, resulted in investment rates falling back again.

2.18 The 3 Month London Interbank Bid Rate (LIBID) benchmark rate for the year was 0.6753%. The Authority's investments earned an average rate of

0.7652% during the year resulting in total investment (including overnight savings interest on the current account) income earned of £80k, against a budgeted sum for investment income of £66k.

REVIEW OF INVESTMENTS / CASH POSITION AND USABLE RESERVES

2.19 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. However, the Authority's year end cash balances were higher than usual as at 31st March 2019 as a £2m PWLB loan was taken on 26th March in order to take advantage of falling interest rates.

2.20 At 31 March 2019 the value of the Authority's usable reserves totalled £10,686m. The balance sheet as at the same date shows that short term investments were valued at £5,442m and cash and cash equivalents held totalled £7,020m. This means that reserves were fully cash-backed at year end, compared with a cash deficit of £3.015m at the end of the previous financial year. The 2018/19 Treasury Management Strategy set out the Authority's aim to reduce the level of internal borrowing and build up cash balances to ensure that usable reserves are cash-backed to an appropriate level, however the Strategy also made it clear that the timing and rate at which cash balances increased would very much depend on the prevailing economic conditions. Opportunities have arisen during the year for the Authority to borrow from the PWLB at relatively low interest rates, and this has allowed the level of internal borrowing to be reduced whilst minimising the "cost of carry" that arises due the differential between borrowing and investment rates.

REVIEW OF THE BORROWING STRATEGY AND BORROWING ACTIVITY IN 2018/19

2.21 The strategy recommended that a combination of capital receipts, internal funds and borrowing would be used to finance capital expenditure during 2018/19. Capital receipts of £115k, borrowing of £898 and Revenue Contributions of £62k were applied to finance expenditure.

2.22 The Authority has taken out three short term loans throughout the year. Interest rates ranged between 0.65% and 1.1% depending on duration of the loan. The total interest cost of these loans was £20.7k including administration and brokerage fees. These loans were taken to fill short term gaps in the Authority's cash flow.

2.23 The Authority took out four new PWLB Loans in 2018/19: £1m on 31st May at a rate of 2.25% for 50 years, £1m on 18th December at a rate of 2.51% for 50 years, a further £1m on 18th December at a rate of 2.02% for 10 years, and £2m on 26th March at a rate of 2.33% for 20 years. These loans reduced the Authority's average long term borrowing rate from 3.52% to 2.83%, and reduced the Authority's level of internal borrowing.

2.24 The treasury management limits to loan maturity were set in 2018/19 and are shown below:

Loan Maturity		
	Upper Limit	**Lower Limit**
Under 12 months	20%	0%
12 months to 5 years	30%	0%
5 years to 10 years	75%	0%
10 years to 20 years	100%	0%
Over 20 years	100%	30%

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

2.26 The Authorised Limit is the affordable borrowing limit above which the Authority does not have the power to borrow. This was set at £32.695m for 2018/19. Total external debt as at 31 March 2019 was £29.599m, which was well within the Authorised limit.

2.27 The Operational Boundary is the expected borrowing position of the Authority within the year. This was set at £29,723m for 2018/19, and was not exceeded at any point during the year.

SUMMARY OF COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

2.28 The following indicators were approved by Members for the 2018/19 financial year. Actual performance is shown in the final column of the table below:

Treasury or Prudential Indicator or Limit	Approved for 2018/19	Actual for 2018/19
Estimate of Ratio of Financing Costs to Net Revenue Stream	5.7%	5.2%
Estimate of Total Capital Expenditure to be Incurred	£3,191,000	£1,075,000
Estimate of Capital Financing Requirement	£27,306,000	£25,738,000
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%

Loan Maturity:	Limits:	Limits:
Under 12 months	Upper 20% Lower 0%	17.9%
12 months to 5 years	Upper 30% Lower 0%	19.0%
5 years to 10 years	Upper 75% Lower 0%	4.0%
10 years to 20 years	Upper 100% Lower 0%	0.0%
Over 20 years	Upper 100% Lower 30%	59.2%
Upper Limit for Principal Sums Invested for Periods Longer than 365 Days	£2,000,000	£2,000,000

2.29 The indicator for the Ratio of Financing Costs to Net Revenue Stream shows an actual result of 5.2% compared to an estimated ratio of 5.7%. This is partly due to the actual financing costs being £201k lower than estimated, and partly due to the net revenue stream being £266k higher than estimated. Interest costs underspent by £131k due to a combination of borrowing later than planned, as well as borrowing at a lower rate than budgeted. The minimum revenue provision (MRP) charge underspent by £70k, which was due to capital expenditure for 2017/18 (on which the 2018/19 charge is based) being lower than originally anticipated due some capital expenditure being slipped into 2018/19. The higher revenue stream is due to that fact that the calculation of the indicator was based on provisional tax base figures which were lower than the actual figures, and budgeted grant figures that were lower than the actual amount received.

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 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 contents of this report.

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

None.

Charlotte Radford
TREASURER TO THE FIRE AUTHORITY