EAST SUSSEX FIRE AND RESCUE SERVICE

Meeting:	Policy & Resources Panel
Date:	9 November 2023
Title of Report:	Treasury Management-Half Year Review For 2023/24
By:	Duncan Savage, Assistant Director Resources / Treasurer
Lead Officer:	Richard Carcas, Principal Finance Officer, Treasury Centre of Expertise, Orbis

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Background Papers: Fire Authority:
15 June 2023 – Agenda Item 155 Treasury Management – Stewardship report for 2022/23
9 February 2023 – Agenda Item 139: Treasury Management Strategy for 2023/24

CIPFA Treasury Management in the Public Services code of practice and cross sector guidance notes

Local Government Act 2003

CIPFA Prudential Code

Appendices: None

Implications (please tick ✓ and attach to report)

CORPORATE RISK		**LEGAL**	
ENVIRONMENTAL		**POLICY**	
FINANCIAL	✓	**POLITICAL**	
HEALTH & SAFETY		**OTHER (please specify)**	
HUMAN RESOURCES		**CORE BRIEF**	

PURPOSE OF REPORT: The treasury management half yearly report is a requirement of the Fire Authority's reporting procedures and covers the treasury activity for the first six months of 2023/24. The report includes an update on the first half year of Prudential Indicators which relate to treasury activity.

EXECUTIVE SUMMARY: The Fire Authority has complied with its approved Treasury Management Strategy and Prudential Indicators during the first 6 months of the year.

The first six months of the year have been challenging economic times as a result of global events and inflationary factors on the UK economy. The average rate of interest received through Treasury Management activity was 4.66%. This reflected the Fire Authority's continuing prioritisation of security and liquidity over yield. The Bank of England (BoE) base rate during the period was increased on three separate occasions in May, June and August and at 30 September it was 5.25%. The average Bank of England Base Rate during the six months to 30 September was 4.80%.

The Fire Authority has always adopted a prudent approach on its investment strategy, and, in the last few years there have been regular changes to the list of the approved organisations used for investment of short term surpluses. There were no changes proposed to the Investment Strategy for 2023/24.

CIPFA published the revised Treasury and Prudential codes in December 2021. Full adoption of the new Codes is incorporated within this Strategy.

No new borrowing has been undertaken in 2023/24 to date. On the 30 September 2023 total Public Works Loan Board (PWLB) loan debt outstanding was £9.58m, at an average interest rate of 4.49%. In the period two PWLB loans matured on the 30 September, totalling £236k and were at an average rate of 5.50%. The next loan repayment is due on the 31 December 2023 (£164k). There have been no beneficial opportunities to reschedule debt so far during the year to date. However, opportunities will be considered if they are both prudent and affordable.

A training session led by Officers was delivered at the Members Seminar on the 18 September. The session covered Treasury Management issues in the context of the Authority's financial position and introduced management tools, such as the Liability Benchmark, used by Officers to manage Treasury related risks.

The projected outturn of the Fire Authority's Capital Financing Requirement (CFR), a measure of the underlying need to borrow is £9,417m.

RECOMMENDATION: The Panel is recommended to:

(i) Note the treasury management performance for the first half year of 2023/24.

(ii) Identify any further reassurance the Panel requires in relation to the delivery of the Treasury Management Strategy.

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1. INTRODUCTION

1.1 The Fire Authority's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

a) The Local Government Act 2003 (the Act) and supporting regulations require the Authority to "have regard to" the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice when setting Prudential and Treasury Indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

b) The Act therefore requires the Authority to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act) which sets out the Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.

c) Under the Act the Department for Levelling Up, Housing & Communities (DLUHC) has issued Investment Guidance to structure and regulate the Authority's investment activities.

1.2 The Fire Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken on a prudent, affordable and sustainable basis and its treasury management practices demonstrate a low risk approach.

1.3 The Code requires the regular reporting of treasury management activities to:

a) Forecast the likely activity for the forthcoming year (in the Annual Treasury Strategy Report);
b) Review actual activity for the preceding year;
c) Review mid-year activity (this report); and
d) Report changes to our Strategy (when required)

1.4 This report sets out information on:

a) A summary of the strategy agreed for 2023/24 and the economic factors affecting the strategy in the first six months of this year;
b) The Fire Authority's treasury activity during the first six months on borrowing and short term investments.

2. ORIGINAL STRATEGY FOR 2023/24

2.1 At its meeting on 9 February 2023, the Fire Authority agreed its treasury management strategy for 2023/24 taking into account the economic scene, including forecast levels of interest rates. At the same time, the Treasury Management Policy Statement was agreed for 2023/24 as set out below.

2.2 East Sussex Fire Authority defines its treasury management activities as:

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

2.3 The Fire Authority regards the successful identification, monitoring and management of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

2.4 This Authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

3. BORROWING

3.1 The net borrowing requirement shows that, based on current estimates, the Authority will need to consider recommencing borrowing in the short to medium term in order to fund its Capital Strategy. However, any future new borrowing taken out will be completed with regard to the limits, indicators, the economic environment, the cost of carrying this debt ahead of need, and interest rate forecasts set out above. Given the expected peak in interest rates over the next 12 months, it may be beneficial for the Authority to take short term borrowing during 2023/24 and 2024/25 before moving to longer term borrowing once rates have dropped. The Assistant Director Resources / Treasurer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

3.2 The Authority will not borrow purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Authority can ensure the security of such funds.

3.3 Treasury staff regularly review opportunity for debt rescheduling. Debt rescheduling opportunities have been very limited in the current economic climate and following the various increases in the margins added to gilt yields which have impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year. However, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

3.4 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

3.5 All debt rescheduling will be agreed by the Assistant Director Resources / Treasurer.

4. <u>INVESTMENT</u>

4.1 When the strategy was agreed in February 2023, it emphasised the continued importance of taking account of the current and predicted future state of the financial sector. The Treasury Management advisors (Link Asset Services) commented on short term interest rates, the UK economy, inflation, the outlook for long term interest rates and these factors were taken into account when setting the strategy.

4.2 No Changes are proposed to the Investment Strategy for 2023/24.

4.3 The Authority where possible is actively seeking to support Environmental, Social and Governance (ESG) investment products and institutions that satisfy all the underlying key principals of Security, Liquidity and Yield in that order.

4.4 The market for green and broader ESG investments is still relatively immature. However, research and the consideration of the suitability of ESG investment products will continue into 2023/24. Fixed term investments of up to £3m have been placed in a Standard Chartered ESG product during 2023/24.

4.5 The strategy continued with the policy of pursuing minimum risk but was also intended to deliver secure investment income of at least bank rate on the Fire Authority's cash balances.

4.6 The Strategy aimed to ensure that in the economic climate that a prudent approach was maintained. This would be achieved through investing with selected banks and funds which met the Authority's rating criteria. The emphasis would continue on security (protection of the capital sum invested) and liquidity (keeping money readily available for expenditure when needed) rather than yield. The strategy continued with this prudent approach.

5. INVESTMENT PERFORMANCE TO 30 SEPTEMBER 2023

5.1 The average Bank of England Base Rate during the period was 4.80%.

5.2 Base Rate increased three times during the six months by 1%, on the 30 September the rate was 5.25%.

5.3 The strategy for 2023/24 continued the prudent approach and ensured that all investments were only to the highest quality rated banks and only up to a period of one year.

5.4 The total amount received in short term interest for the six months to 30 September 2023 was £433,693. The performance is summarised in the table below and monitored quarterly.

Average Investment Balances £'000	Average Investment return	Average Bank rate	Difference
18,569	4.66%	4.80%	(0.14%)

5.5 Performance was slightly below the benchmark average bank rate in the same period. This is typical in a rising interest rate environment as a result of the time lag between changes in base rate and investments maturing and being able to re-invest at more favourable rates.

5.6 Investments held in liquidity accounts, e.g. Money Market Funds (MMF) have seen an uplift in return in conjunction with a rising Base Rate. This has helped overall performance in the first 6 months of the year. Funds are held in MMF's to meet the need of future cashflow requirements, on 30 September the average rate earned on those balances was 5.28%.

5.7 During the period the Authority placed a number of fixed term deposits with UK Banks, on a laddered maturity approach, to roll up the yield curve in a rising interest rate environment. Fixed term deposits have been placed with Goldman Sachs, NatWest and Standard Chartered Bank (ESG). For durations between 6 – 12 months, at rates between 4.82% - 5.91%.

5.8 Non specified longer duration investment options such as pooled property funds, short dated bond funds and mixed asset funds were not utilised in the period. The Fire Authority's strategy is monitored closely and has the flexibility to move into alternatives in the correct financial climate.

5.9 The investments held comply with our Treasury Management Strategy and the Fire Authority has continued to follow a prudent approach with security and liquidity as the main criteria before yield.

6. CURRENT BORROWING

6.1 No new PWLB borrowing has taken place since January 2008 and is unlikely in the immediate future, however in the short to medium term external borrowing will be required to fund the current capital programme.

6.2 The average interest rate of all debt on the 30 September 2023 (£9.6m) was 4.49%. Two PWLB loans matured in the period totalling £236k both on the 30 September, at rates of 4.875% and 5.75%. There is one further loan maturity for £164k on 31 December 2023 at an average rate of 4.875%.

6.3 Opportunities for cost effective repayment of existing debt and restructuring opportunities were constantly monitored but none emerged in the first six months of the year. However, now that the whole of the yield curve has shifted higher there may be better opportunities in the future, although only prudent and affordable debt rescheduling will be considered.

7. ECONOMIC PERFORMANCE TO DATE AND OUTLOOK (COMMENTARY SUPPLIED BY OUR ADVISORS LINK ASSET SERVICES). SEPTEMBER 2023.

7.1 The second quarter of 2023/24 saw:

- Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
- Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
- A 0.5% month on month decline in real GDP in July, mainly due to more industrial action across certain sectors.
- CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
- Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 year high.
- Cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).

7.2 As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.

7.3 In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.

7.4 Link Asset Services, has provided the following forecast as at 30 September 2023.

	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.

7.5 The latest forecast sets out a view that short, medium and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

8. PRUDENTIAL INDICATORS AND LIMITS RELATING TO TREASURY MANAGEMENT ACTIVITIES

8.1 The limits set for 2023/24

The Strategy Report for 2023/24 set self-imposed prudential indicators and limits. There are on an annual basis and monitored. They comprise:

None of the limits has been exceeded in 2023/24 to date.

Prudential Indicator	Compliant
Capital Expenditure	Yes
Ratio of Financing Costs to Net Revenue Stream	Yes
Capital Financing Requirement (CFR)	Yes
Net external Borrowing compared to the medium term CFR	Yes
Upper limits for fixed interest rate exposure and variable interest rate exposure	Yes
Upper limit for total principal sums invested over 365 days	Yes
Actual External Debt	Yes
Authorised Limit for External Debt (see 8.3)	Yes
Operational Boundary for External Debt (see 8.3)	Yes
Maturity Structure of Fixed Rate Borrowing (see 8.8)	Yes
Maturity Structure of Investments (see 8.10)	Yes
Incremental Impact of Capital Investment Decisions	Yes
Adoption of the CIPFA Treasury Management Code (see 8.9)	Yes
Interest rate exposures (see 8.7)	Yes
Interest rate on long term borrowing	Yes
Interest on investments	Yes
Minimum Revenue Provision (see 8.11)	Yes

8.2 Authorised limit for borrowing

8.3 The table below sets out the actual 2022/23, original estimate and projected outturn in 2023/24 for borrowing.

	2022/23 Actual	2023/24 Original Estimate	2023/24 Projected Outturn
	£000	£000	£000
Opening CFR	**10,298**	**9,887**	**9,817**
Capital Investment	3,633	8,421	4,528
Sources of Finance	(3,702)	(5,432)	(4,535)
MRP	(412)	(514)	(393)
Movement in year	**(481)**	**2,475**	**(400)**
Closing CFR	**9,817**	**12,362**	**9,417**
less Finance Lease Liability	-	-	-
Underlying Borrowing Requirement	**9,817**	**12,362**	**9,417**
Actual Long Term Borrowing	**9,817**	**12,362**	**9,417**
Over / (Under) Borrowing	-	-	-
Operational Boundary	**11,166**	**13,600**	**13,600**
Authorised Limit	**13,555**	**15,000**	**15,000**

8.4 The Operational boundary for borrowing was based on the same estimates as the Authorised limit. It reflected directly the authorised borrowing limit estimate without the additional amount for short term borrowing included to allow, for example, for unusual cash movements. The Operational boundary represents a key management tool for in year monitoring and long term borrowing control.

8.5 The Authorised limit was consistent with the Fire Authority's current commitments, existing plans and the proposals for capital expenditure and financing, and with its approved treasury management policy statement and practices. It was based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom (short term borrowing) over and above this to allow for day to day operational management, for example unusual cash movements or late receipt of income. Risk analysis and risk management strategies were taken into account, as were plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements for all purposes.

8.6 The Authorised limit is the "Affordable Borrowing Limit" required by S3 of the Local Government Act 2003 and must not be breached. The estimated long term borrowing at 31 March 2024 of £9,417,000 is under the Authorised limit set for 2023/24 of £15,000,000.

8.7 **Interest rate exposure**

The Fire Authority's Prudential Indicator continued the practice of seeking competitive fixed interest rate exposure for borrowing, lending and a combined figure of borrowing and lending. No new borrowing undertaken and all lending at fixed rates.

Interest Rate Exposure	2023/24 Upper Limit	2024/25 Upper Limit	2025/26 Upper Limit
Limits on fixed interest rates based on net debt*	100%	100%	100%
Limits on variable interest rates based on net debt*	0%	0%	0%

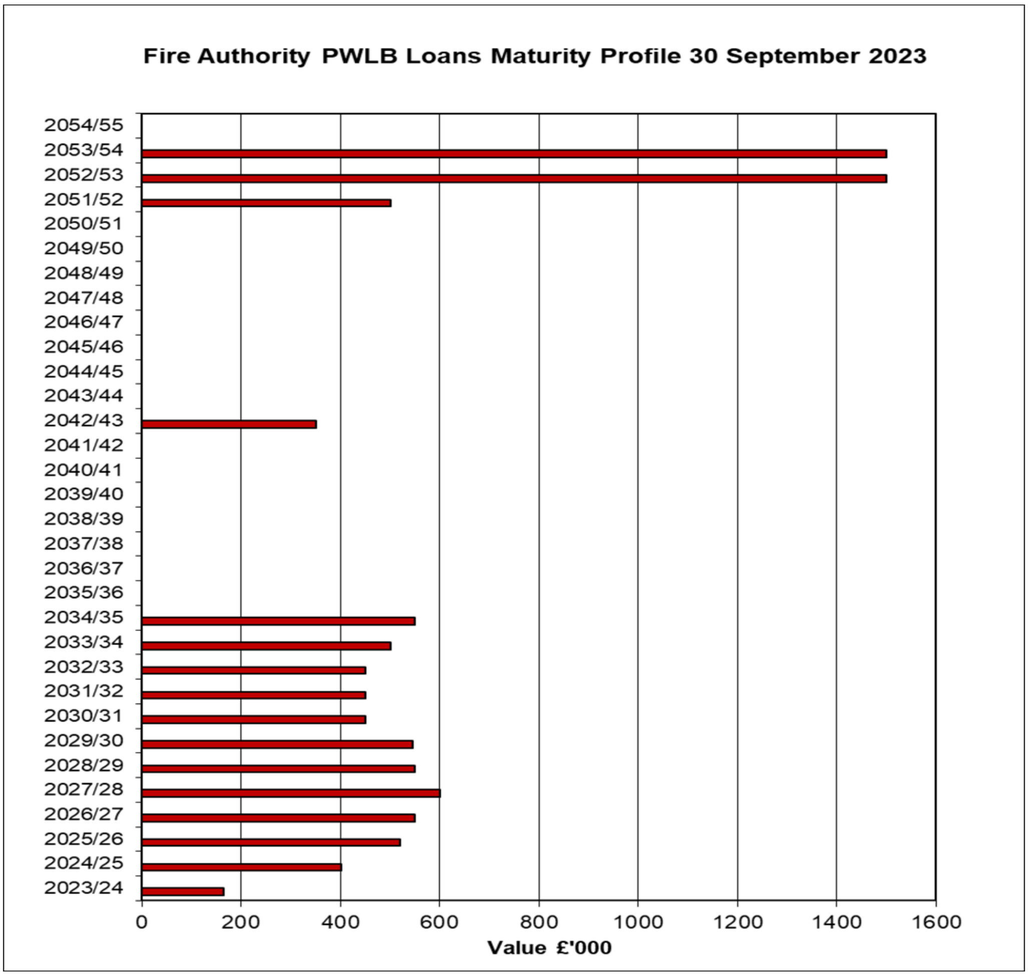
*Net debt is borrowings less investments

8.8 **Maturity structure of debt**

The Fire Authority set upper and lower limits for the maturity structure of its borrowings as follows.

	Estimated Lower Limit	Estimated Upper Limit	Current 30/09/23
Under 12 months	0%	25%	2%
12 months and within 24 months	0%	40%	8%
24 months and within 5 years	0%	60%	13%
5 years and within 10 years	0%	80%	26%
10 years and within 20 years	0%	80%	15%
20 years and within 30 years	0%	80%	21%
30 years and within 40 years	0%	80%	16%
Over 40 years	0%	80%	0%

Any new borrowing undertaken would give due consideration to the debt maturity profile, ensuring that an acceptable amount of debt is due to mature in any one financial year. This helps to minimise the authority's exposure to the risk of having to replace a large amount of debt in any future years when interest rates may be unfavourable. No new borrowing has been undertaken in 2023/24 to date. The following graph shows when the debt will mature.



8.9 **Compliance with the treasury management code of practice**

East Sussex Fire Authority has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. CIPFA published the revised Treasury and Prudential codes in December 2021. Full adoption of the new Codes is incorporated within this Strategy.

8.10 **Maturity structure of investments**

The Authority held investments from overnight to a 12 month fixed maturity profile. As of the 30 September the longest dated deposit held was with NatWest, this will mature in August 2024.

8.11 **Minimum Revenue Provision Statement**

<u>The Fire Authority's Borrowing Need (the Capital Financing Requirement)</u>

8.12 The prudential indicator is the Authority's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the underlying borrowing need.

8.13 The Fire Authority approved the Capital Finance Requirement projections for 2023/24 in its Strategy approved in February. These are in the original estimate below:

	2022/23 Actual	2023/24 Original Estimate	2023/24 Projected Outturn
	£000	**£000**	**£000**
Opening CFR	10,298	9,887	9,817
Closing CFR	9,817	12,362	9,417
Movement in CFR	**(481)**	**2,475**	**(400)**
Movement in CFR represented by:			
Net financing	(69)	2,989	(7)
MRP	(412)	(514)	(393)
Movement in year	**(481)**	**2,475**	**(400)**

8.14 The Fire Authority is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge called the Minimum Revenue Provision (MRP), although it is also allowed to undertake additional voluntary payments.

8.15 The Authority sets aside a Minimum Revenue Provision based on basic MRP of 4% each year to pay for past capital expenditure and to reduce its CFR. For any new borrowing the Asset Life Method will be used to calculate MRP.

8.16 The government are currently consulting Local Authorities on proposed changes to the MRP guidance. Whilst the changes are not expected to impact on the Fire Authority, officers will be reviewing the Authority's MRP policy during 2023/24 in light of these changes and the increase in the Authority's borrowing need to ensure the MRP policy remains appropriate.

9. TREASURY MANAGEMENT ADVISORS

9.1 The Strategy for 2023/24 explained that the Fire Authority uses Link Asset Services as its treasury management consultant through the contract that exists with East Sussex County Council. The company has provided a range of services which have included:

a) Technical support on treasury matters, capital finance issues and advice on reporting;
b) Economic and interest rate analysis;
c) Debt services which includes advice on the timing of borrowing;
d) Debt rescheduling advice surrounding the existing portfolio;
e) Generic investment advice on interest rates, timing and investme instruments;
f) Credit ratings from the three main credit rating agencies and other mark information;
g) Assistance with training on treasury matters.

9.2 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice, the final decision on treasury matters remains with the Authority. This service remains subject to regular review.

9.3 Link is the largest provider of Treasury Management advice services to local authorities in the UK and they claim to be the market-leading treasury management service to their clients. The advice will continue to be monitored regularly to ensure an excellent level of service provided to the Authority.

10. <u>CONCLUSION</u>

10.1 The prime objective of Treasury Management is the effective management of risk and that its activities are undertaken in a prudent affordable and sustainable basis.

10.2 This report confirms the Authority has continued to follow a prudent approach with the main criteria of security and liquidity before yield. The current emphasis must continue to be able to react quickly if market conditions change.