Staffordshire Commissioner Fire and Rescue Authority

Ethics, Transparency and Audit Panel (Fire)

11 December 2019

TREASURY MANAGEMENT REPORT FOR THE HALF YEAR ENDED 30 SEPTEMBER 2019

Report of the Director of Finance / S151 Officer

Background

1. In addition to his existing role overseeing Staffordshire Police, the Staffordshire Commissioner became responsible for the governance of the Staffordshire Fire and Rescue Service from August 2018. However, both remain separate organisations, with separate budgets, staff and governance processes.

2. This report reviews the treasury management activities for the Staffordshire Commissioner Fire and Rescue Authority only; a separate report has been prepared for Staffordshire Police. Therefore, reference is made only to the Staffordshire Commissioner Fire and Rescue Authority ('the Authority') as part of this report.

Summary

3. The Authority has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), which requires the Authority to approve treasury management semi-annual and annual reports.

4. The Authority's treasury management strategy for 2019/20 was approved on 15 February 2019. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

5. This report provides a summary of the Authority's treasury management activities for the half-year ended 30 September 2019. It considers both borrowing and investment decisions taken so far in the light of the interest rates and economic conditions prevailing at the time.

6. During the first 6 months of the year the Authority continued to invest cautiously. No long-term loans were taken out and the Authority repaid a £0.5m Public Works Loan

Board (PWLB) loan in August 2019. The total amount of loans outstanding as at 30 September 2019 was £17.550m.

Recommendations

7. That the treasury management activities for the half-year ended 30 September 2019 are reviewed, and the Prudential Indicators for treasury management shown at **Appendix 2** be noted.

External Context

8. The UK's political and economic environment during the first half of 2019/20 continued to be dominated by the tensions associated with leaving the European Union (EU). Boris Johnson won the Conservative Party leadership contest to become Prime Minister in July 2019 and committed to leaving the EU regardless of whether a deal is reached. However, his extended prorogation of Parliament was deemed unlawful by the Supreme Court whilst Parliament also voted for a bill requiring a Brexit extension, if a deal was not in place by 19th October.

9. Brexit uncertainties impacted the UK economy as it contracted by 0.2% in Q2 2019 with business investment falling by 0.4%; in this period, UK production registered its largest drop since Q4 2012. Although the employment rate remained high at 76.1%, UK Consumer Price Inflation (CPIH) fell to 1.7% in August 2019, weaker than the consensus forecast of 1.9% and below the Bank of England's target of 2%.

10. On an international setting, concerns over a weaker economic environment in the US alongside trade tensions with China prompted fears over a global economic slowdown. The US Federal Reserve responded by cutting rates in September with market expectations for further rate cuts in the financial year. The Eurozone also showed signs of a slowdown as Germany, its largest economy, contracted for the second time in a year. The European Central Bank (ECB) reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1 November 2019.

11. The uncertain economic environment was reflected in financial markets; equities experienced increased volatility and bonds rallied as investors sought greater security. Gilt yields remained volatile during this period with the 10-year gilt falling from 0.83% in June to 0.55% in September. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills; history has shown that a recession can often follow a yield curve inversion.

Borrowing strategy update

12. The Treasury Management Strategy Report for 2019/20, outlined the long-term borrowing strategy for the year and a number of Prudential Indicators as set out in **Appendix 2**. The strategy was;

    "…to use cash as far as is practical with the option to borrow up to £3m long-term where the Director of Finance, Assets and Resources (the Director) considers this appropriate in 2019/20."

13. In accordance with this, cash was used in lieu of borrowing and no new loans were taken in the first half of the financial year.

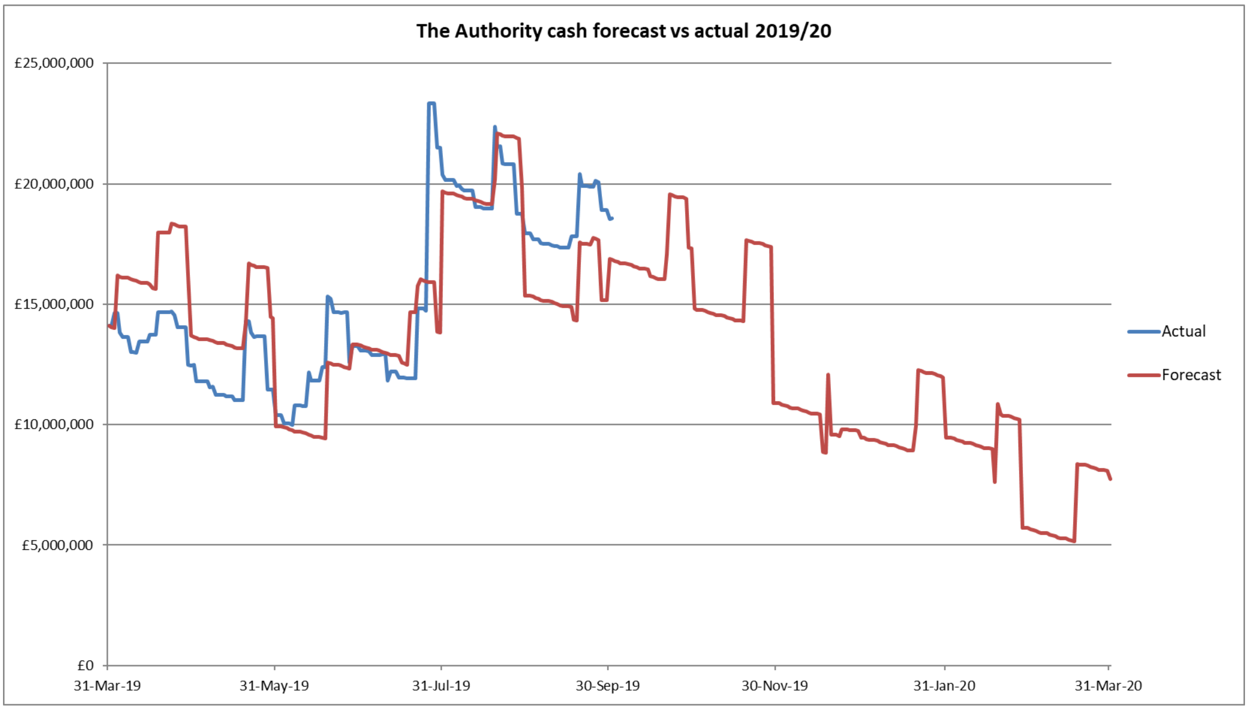
14. The implementation of this strategy relied upon two main factors:
    - The Bank of England 'Bank rate' remaining low; and
    - Cash balances being sufficient to allow the Authority's daily cash flow needs to be met.

15. The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment. The Bank confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31 October 2019.

16. In terms of the future, the County Council provide a Bank Rate forecast, based on advice from their treasury advisor. The Council expect Bank Rate to remain at 0.75% for the foreseeable future although there are significant downside risks to the interest rate forecast, dependent on Brexit and global economic outcomes.

17. Interest rates remain just above historic lows; low rates mean that the strategy of using cash is still important, as it represents a cheap way of financing the capital programme. Overall, the short-term interest rate environment now and the forecast continue to support the borrowing strategy adopted in 2019/20.

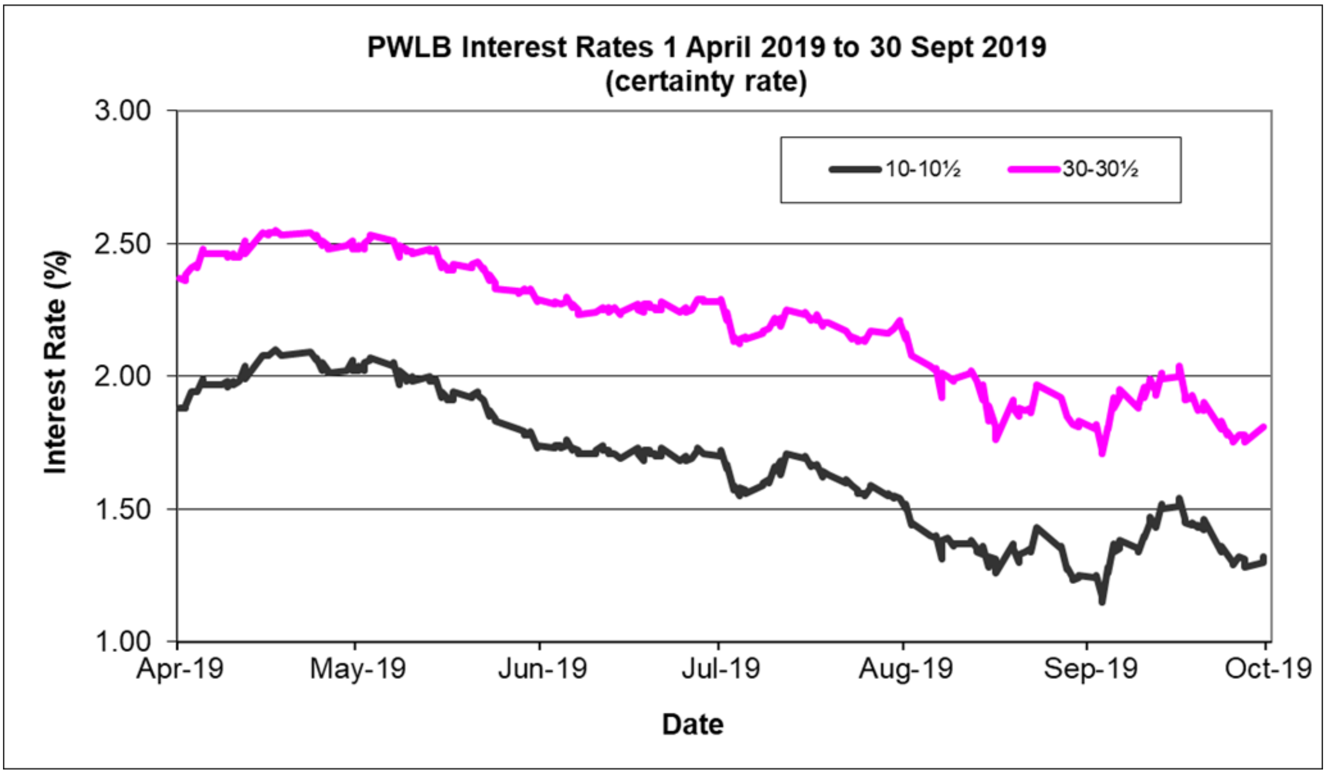
18. Secondly, cash balances have been sufficient to allow day to day cash management in the first half of the year. The following graph shows total actual cash balances for the first half of the year (in blue) against the forecast for the full year (red).



19. The graph indicates actual cash balances have by and large followed the forecast at the start of the year, although they are currently higher than forecast. The graph shows a sharp increase in cash balances following the receipt of the pension "top-up" grant of around £8m at the end of July. Cash balances are also around £8m lower than they would be without the strategy of using cash in lieu of borrowing.

20. Forecasts indicate the Authority should have sufficient balances to fund its debt for 2019/20 without the need to take out further long-term loans. When loans are taken-up these are mainly sourced from the Public Works Loan Board (PWLB) whose loan

interest rates reflect changes in Gilt yields in the UK Government bond market - Gilt yields are effectively longer-term interest rates. The following chart shows two typical loan periods where rates have been adjusted to reflect the “certainty-rate” reduction of 0.20% that is available to all local authorities (including Fire authorities) who register with the Government.



21. Gilt yields are very sensitive to the risk appetite of international investors and the current low yields reflect the uncertain global financial environment. Gilt yields decreased throughout the first half of 2019/20 and reached a record low in early September – the 10-year gilt was at 0.382% on 3 September 2019. Investors sought the safety of bond markets in the face of global economic slowdown concerns and a no-deal Brexit and this has been reflected in a similar downturn in PWLB interest rates.

22. On 9 October 2019, HM Treasury, the government department responsible for the PWLB, increased the margin over gilt yields from 80bps to 180bps for certainty rate loans. The government reasoned that the cost of borrowing had fallen to record lows in recent months and some local authorities have substantially increased their use of PWLB borrowing. This new shift in policy was aimed to restore PWLB lending rates to ‘normal’ levels.

23. The following table compares the certainty rates for standard new maturity 10-year and 30-year PWLB loans under the old and new policy.

PWLB loan period	**Certainty rate 8 Oct 2019 (80 bps above gilt yields)**	**Certainty rate 9 Oct 2019 (180 bps above gilt yields)**
10-10 ½	1.22%	2.25%
30-30 ½	1.76%	2.78%

The new rates are substantially higher than the rates under the old policy although they are still low when compared to historical PWLB rates.

24. The following table shows the interest rates incurred on the Authority's debt portfolio for 2018/19 and for this half year, including an adjustment reflecting the use of cash.

	2018/19 Full Year %	**2019/20 Half Year %**
Weighted average rate of interest for external loans *	4.35	4.39
* adjusted for the use of cash	3.74	3.58

25. The weighted average rate of interest has increased slightly in 2019/20 as the Authority had repaid a PWLB loan for £0.5 million in February 2019, originally taken out at a lower rate than the average. Once the use of cash is taken into account the rate falls considerably. Furthermore, the adjusted rate decreased from that in 2018/19 because of an increase in the use of cash available. This illustrates the policy of using cash instead of borrowing continues to generate significant savings, helping reduce the average interest the Authority pays on its debt.

26. As an indication and on average, internally funding from cash in lieu of borrowing has saved the Authority about £0.064 million in interest payments so far this financial year. A full year figure will be reported in the 2019/20 outturn report but is expected to be a saving of about £0.128 million.

27. A graph illustrating the maturity profile of the long-term debt at 30 September 2019 is provided at **Appendix 3**.

Investment Strategy update

28. The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. As shown in the chart at **paragraph 18**, the Authority's investment balances during the year have ranged between £10 million and £23 million due to timing differences between income and expenditure.

29. The Annual Investment Strategy (AIS) forms part of the Treasury Management Strategy and sets out those parties the Authority will lend its money to. The AIS details the requirements of government guidance and the CIPFA Code; both documents require the Authority to invest its funds prudently and to have regard to the following two prime risk issues over return:
    - The security of capital.
    - The liquidity of investments.

30. The latest AIS is included as part of the Treasury Management Strategy for 2019/20. This identifies that investments can be being placed with:
    - UK Government Debt Management Account Deposit Facility (DMADF) – £ Unlimited (6 months is the maximum period permitted).
    - Local Authorities / Parish Councils (per regulations) – £ Unlimited (12 months).
    - 3 x "AAA" rated Money Market Funds (MMF) – Up to £2.5m (same day liquidity).
    - "AAA" rated Enhanced MMF – Up to £1.5m (3-day notice)
    - Lloyds Bank as banking services provider - up to £1m (Instant Access).

31. As shown in **paragraph 18**, cash balances at the Authority have been relatively high, especially from the point the pensions top up grant was received in July. Once MMF limits are reached, it can be difficult to invest the higher cash balances when there is insufficient demand for local authority borrowing and with returns from DMADF deposits being relatively low.

32. As part of the Treasury Management Strategy for 2019/20, a hard MMF investment limit of £2.5m was set with a soft limit of £1.5m, in order to maintain flexibility within the investment strategy. In addition the amendment of the AIS has been delegated to the Director of Finance, Assets and Resources, with the outcome reported in the regular treasury management reports.

Short-term money-market transactions

33. Approved investments at 30 September 2019, stood at £18.546 million. They can be analysed by counterparty, amount, term and credit rating as follows.

Regulation Investments	**£m**	**Term**	**Credit rating**
Thurrock Council	5.000	6 months	Unrated
Wirral Metropolitan Borough Council	3.000	3 months	Unrated
London Borough of Barking & Dagenham	3.000	3 months	Unrated
Banks and building societies			
Lloyds Bank Plc	0.146	Instant	A+
Money Market Funds			
Federated	2.500	Instant	AAA

Morgan Stanley	0.900	Instant	AAA
Aberdeen	2.500	Instant	AAA
Collective Investment Scheme			
Royal London Cash Plus Fund	1.500	3 day notice	AAA
TOTAL	**18.546**		

34. Whilst most local authorities are unrated by credit agencies, both regulations (which list local authorities as acceptable bodies to invest in) and their status as tax raising bodies make them highly creditworthy.

35. The table below shows the return in 2018/19 and 2019/20 to date.

	2018/19 Full Year	**2019/20 Half Year**
Average return on investments	0.68%	0.75%
Average 7-day LIBID*	0.51%	0.53%

** The 7 Day LIBID is the average rate of interest at which banks are prepared to lend to each other for up to a week.*

36. The average return on investments so far this year (and in 2018/19) has been higher than the benchmark, reflecting the higher returns from investments made with local authorities and MMFs. The average return this year has been higher than last year as the Bank rate has remained at 0.75%; in 2018/19, the 0.25% Bank Rate increase had come in mid-year.

Brexit update

37. The Director of Finance is aware of the risks of a no deal Brexit and the potential delays in redeeming cash balances from non-UK domiciled MMFs. As a result, the Director of Finance will ensure that its account with the DMADF remains available for use in an emergency. The Authority will also have its UK domiciled Federated MMF and Lloyds bank account available to hold sufficient liquidity required in the near term.

Compliance with CIPFA Code of Practice

38. It can be certified that for the half-year ended 30 September 2019:

    (i) All transactions were undertaken by authorised officers and within the limits approved by the Authority;

    (ii) All investments were to counterparties on the approved lending list current at the time, and fully met the requirements of relevant legislation;

    (iii) During the financial year the Authority operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Practices and Annual Treasury Strategy Statement. The half year position against the Prudential Indicators is shown in **Appendix 2**.

David Greensmith
Director of Finance / S151 Officer

Report Author
Johirul Alam
Treasury and Pensions
Staffordshire County Council
johirul.alam@staffordshire.gov.uk

Background Documents

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2017)
2. Prudential Code for Capital Finance in Local Authorities (CIPFA) (2017)
3. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. Statutory Guidance on Local Government Investments – Issued under Section 15(1) (a) of the Local Government Act 2003 (2018)

Appendix 1

Financial Implications

All resource implications are covered in the body of this report.

Legal Implications

There are no legal implications.

Equality & Diversity Implications

There are no equalities implications.

Risk Implications

Treasury management operations by their very nature are subject to interest rate risk, credit, counterparty and refinancing risk and these are discussed throughout the report.

Consultation and Engagement undertaken

The County Council's treasury advisors, Arlingclose, have provided some of the information for the report.

Procurement and Social Value Implications

The daily treasury management function is carried out on behalf of the Authority by Staffordshire County Council, under an annually updated Service Level Agreement (SLA).

Protective Security Considerations

Data protection and protective security policies are implemented within Staffordshire County Council and all departments within the Council. Treasury management activities are undertaken in line with these policies and the agreed SLA.

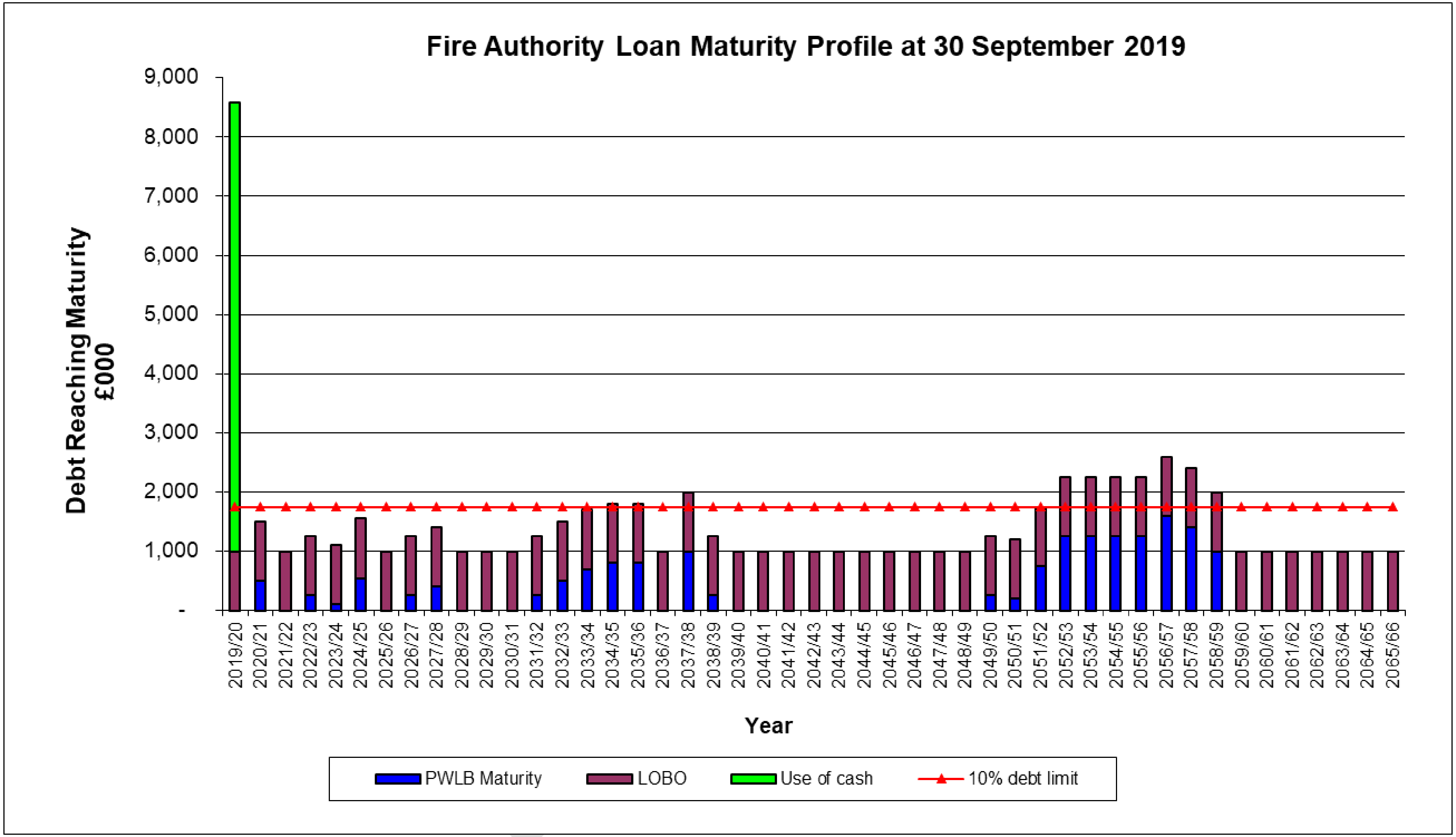
Appendix 2

Staffordshire Commissioner Fire and Rescue Authority

Ethics, Transparency and Audit Panel (Fire)
23 October 2019

Prudential Indicators for Treasury Management

Indicator	Estimated 2019/20		Position at 30/09/19
1. External Debt			
Authorised Limit	£34.1m		£17.6m
Authorised Limit for other liabilities	£84.5m		£84.5m
TOTAL	£118.6m		£102.1m
Operational Boundary	£30.0m		£17.6m
Operational Boundary for other liabilities	£84.5m		£84.5m
TOTAL	£114.5m		£102.1m
External Loans	£17.6m		£17.6m
The Authorised Limit is the maximum level of external borrowing which should not be exceeded. It is linked to the estimated level of borrowing assumed in the capital programme. *The Operational Boundary represents the Director's estimate of the day to day limit for treasury management activity based on the most likely i.e. prudent but not worst case scenario.* *Other liabilities relate to PFI schemes on the balance sheet.*			
2. Interest Rate Exposures			
a. Upper Limit (Fixed)	£26.6m		£17.6m
b. Upper Limit (Variable)	(£25.0m)		(£18.1m)
The Authority sets upper limits of fixed and variable borrowing and investments. This limits the Authority's exposure to both fixed and variable interest rate movements as part of the overall risk management strategy for Treasury Management activities. Negative figures are shown in brackets; these relate to investments at a variable rate which are not offset by variable borrowings.			
3. Maturity Structure of Borrowing	Upper Limit	Lower Limit	
Under 12 months	10%	0%	2.9%
12 months and within 24 months	10%	0%	0.0%
24 months and within 5 years	30%	0%	3.4%
5 years and within 10 years	50%	0%	5.4%
10 years and above	100%	25%	88.3%
This indicator identifies the amount of loans maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time. *The Authority currently applies the prudent practice of ensuring that no more than 10% of its total gross fixed rate loans mature in any one financial year.*			
4. Total principal sums invested for periods longer than a year	£		£
Any investments made for longer than a year will be in accordance with the Authority's limits on non-specified investments.	Nil		Nil


Fire Authority Loan Maturity Profile at 30 September 2019
Debt Reaching Maturity £000
9,000
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
-
2019/20
2020/21
2021/22
2022/23
2023/24
2024/25
2025/26
2026/27
2027/28
2028/29
2029/30
2030/31
2031/32
2032/33
2033/34
2034/35
2035/36
2036/37
2037/38
2038/39
2039/40
2040/41
2041/42
2042/43
2043/44
2044/45
2045/46
2046/47
2047/48
2048/49
2049/50
2050/51
2051/52
2052/53
2053/54
2054/55
2055/56
2056/57
2057/58
2058/59
2059/60
2060/61
2061/62
2062/63
2063/64
2064/65
2065/66
Year
PWLB Maturity
LOBO
Use of cash
10% debt limit