For Publication

Bedfordshire Fire and Rescue Authority
Corporate Service Policy and Challenge Group
27 November 2018
Item No. 9

REPORT AUTHORS: **CHIEF FIRE OFFICER AND TREASURER**

SUBJECT: **TREASURY MANAGEMENT – MID-YEAR REVIEW REPORT TO 30 SEPTEMBER 2018**

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Background Papers:

Treasury Management Strategy 2018/19, as detailed in the Budget Book 2018/19.

Implications (tick ✓):

LEGAL		FINANCIAL	✓
HUMAN RESOURCES		EQUALITY IMPACT	
ENVIRONMENTAL		POLICY	
ORGANISATIONAL RISK		CORE BRIEF	
		OTHER (please specify)	

Any implications affecting this report are noted at the end of the report.

PURPOSE:

To provide an update on the Authority’s Treasury Management to 30 September 2018.

RECOMMENDATION:

That the Corporate Services Policy and Challenge Group consider the report.

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1. Introduction

1.1 Since 1 April 2006, the management of the Fire and Rescue Authority’s (FRA) Treasury operations has been undertaken by the Authority's Finance staff. Treasury management activities are undertaken with the objective of maximising return/minimising cost, consistent with minimising risk. When investing, the over-riding principle is the maintenance of the capital sum.

In order to support this function, the Authority also employs Link Asset Services (was Capita Asset Services) to provide independent, professional treasury advice.

1.2 The FRA’s banking facilities are also arranged and monitored by the Finance staff.

1.3 The FRA adopted the Code of Practice for Treasury Management in the Public Services published by the Chartered Institute of Public Finance and Accountancy (CIPFA), revised in 2017. One of the requirements of the CIPFA Code is for there to be regular reports on Treasury Management to be presented to the appropriate 'committee'. This is the mid-year Review Report for 2018/19 to 30 September 2018.

1.4 The Policy and Challenge Group is asked to note the report, as there are no changes requested to the Prudential Indicators, approval is not required by the FRA.

2. Treasury Management Reports

2.1 This mid-year review report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management and covers the following:

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Authority's capital expenditure (prudential indicators);
- A review of the Authority's investment portfolio for 2018/19;
- A review of the Authority's borrowing strategy for 2018/19;
- A review of any debt rescheduling undertaken (if applicable) during 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19; and
- An economic update for the first six months of 2018/19.

3. Treasury Management Training

3.1 The Responsible Officer (the Section 151 Officer) must ensure that Group/FRA Members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

3.2 Training is to be provided to Members by our Treasury Advisor's, Link Asset Services, in 2019 following the FRA's Annual General Meeting in June 2019.

4. Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy Update

For the current year, these were recommended for approval by the CSP&CG on 12 March 2018 and approved by the FRA on 26 April 2018. There are no policy changes to the TMSS, the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5. Authorities Capital Position (Prudential Indicators)

This part of the report is structured to update:

- Capital expenditure plans

- How these plans are being financed
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

The Prudential Indicators have now been updated in accordance with the revised Code. Members had previously requested further information on one of the specific indicators, this indicator is no longer used and has therefore been removed.

5.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure by Service	2018/19 Original Estimate £'000	Current Position £'000	2018/19 Revised Estimate £'000
As per Budget Book	1,253	799	1,253

5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Authority by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	**2018/19 Original Estimate £'000**	**2018/19 Revised Estimate £'000**
Total Capital Expenditure	1,253	1,253
Financed by:		
Capital receipts	134	134
Capital grants	0	0
Capital reserves	1,119	1,119
Revenue	0	0
Total financing	**1,253**	1,253
Borrowing Requirement	0	0

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the operational Boundary.

Prudential Indicator – Capital Financing Requirement

We are on target to achieve the original forecast Capital Financing Requirement.

Prudential Indicator – the Operational Boundary for external debt

	2018/19 Original Estimate £'000	Current Position £'000	2018/19 Revised Estimate £'000
Prudential Indicator – Capital Financing Requirement			
TOTAL CFR	**8,892**	**8,892**	**8,892**
Net movement in CFR	**(491)**	**(491)**	**(491)**
Prudential Indicator – the Operational Boundary for external debt			
Borrowing	9,987	9,987	9,987
Other long term liabilities*	6	6	6
Total debt (year end position)	**9,993**	**9,993**	**9,993**

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing, (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Authority has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2018/19 Original Estimate £’000	Current Position £’000	2018/19 Revised Estimate £’000
Borrowing	9,987	9,987	9,987
Other long term liabilities	6	6	6
Total debt	**9,993**	9,993	9,993
CFR* (year end position)	**8,401**	**8,401**	**8,401**

The Head of Finance reports that no difficulties are envisaged for the current future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3(1) of the Local Government Act 2003.

Authorised limit for external debt	2018/19 Original Indicator £’000	Current Position £’000	2018/19 Revised Indicator £’000
Borrowing	9,987	9,987	9,987
Other long term liabilities	1,900	1,900	1,900
Total	**11,893**	**11,893**	**11,893**

6. Borrowing/Investment Strategy for 2018/19

6.1 It was anticipated at the beginning of 2018/19 that the Authority would have surplus funds available for short-term investment, either within its Special Interest Bearing Account (SIBA) at its bankers or through the money market. As at the 30 September 2018 the SIBA account is paying a rate of 0.20% up to £999,999 and 0.30% for funds over £1M.

6.2 The Authority's call-account with Barclays Bank has been used during 2018/19. As at the 30 September 2018 the Barclays account is paying a rate of 0.55%.

6.3 This Authority had also placed surplus funds into a 120-Day Interest account with Santander at a rate of 0.70%. This rate increased to 0.95% as of 1 September.

6.4 This Authority had also placed surplus funds into a 180-Day Interest account with Santander at a rate of 0.90%. This rate increased to 1.00% as of 1 September.

6.5 The Authority has invested funds with two foreign banks, Sumitomo Mitsui BC Europe and Goldman Sachs during the first half of 2018/19, via our Treasury Agents, Link Asset Services. The Sumitomo Mitsui BC Europe investment was a fixed term investment for six months at a rate of 0.85% and has since matured in October 2018 (£3M). The Goldman Sachs Bank investments are fixed term investments for six months at a rate of 0.85% and 0.845%. Goldman Sachs investments will both mature (£2M and £1M) in February 2019.

6.6 During the second half of 2018/19 this Authority will be considering using Money Market Funds for short-term investments. Operators use the credit ratings agencies which lay down investment restrictions to enable the funds to maintain its AAA status. Money Market Funds may also be governed by the Institutional Money Market Fund Association (IMMFA) which is a voluntary code of practice issued in 1992 by a trade body for Money Market Funds. This ensures all members offer a consistently high quality product by promoting best practice, transparency of fund values and a standardised format for published data.

6.7 Borrowing has not been undertaken in 2018/19 to finance the Capital Programme. The funding for the 2018/19 Capital Programme was through grant and revenue contributions.

7. Interest Rate Movements During 2018/19

7.1 Bank base rate was 0.50% at the beginning of the year but increased to 0.75% as at 2 August. The rate still remained the same as of 30 September 2018.

7.2 Interest rates applicable to temporary investments were short-term money market rates. These investments were fixed for a set period (between one month and one year), at a greater interest rate than bank base rate. During the first six months of 2018/19, four investments reached maturity, new investments were then placed, one in April of £3M, one in July for £3M, and four in August for £5.7M. When placing these, a number of factors were considered, including cashflow, security, return etc in order to meet our Policies and at the same time get the best return.

8. Investment/Borrowing Operations

8.1 Investments:

Surplus cash is invested on a temporary basis through the money market. Levels of investment have varied from £8.5M at the start of 2018/19 to £11.7M as at 30 September 2018. In the year 2018/19 to 30 September 2018, £32,166 interest has been generated through these investments and through the local SIBA account, Barclays Account and Santander Accounts. Interest on PWLB borrowings totals of £210,817 was paid on 1 October but was for the period up to end of September. This will give a net interest paid position of £178,651 as at 2 October 2018.

8.2 The FRA’s budgeted investment return (interest receivable) for 2018/19 is £90,400.

8.3 Long-Term Borrowing:

No debt rescheduling was undertaken during the first six months of 2018/19.

8.4 **Borrowing and Investments Outstanding:**

	Temporary Investments £000s	Long-Term Borrowing £000s
Outstanding at 1 April 2018	8,500	9,987
Raised	11,750	0
Repaid	(8,500)	0
Outstanding at 30 September 2018	**11,750**	**9,987**

9. Performance Measurement

9.1 The success of cash flow management, and hence the Fire Authority's temporary investment and borrowing activity, is measured by comparing the actual rates of interest achieved and borne against a benchmark of the average Local Authority 7 Day Rate.

9.2 For the period ending 30 September 2018, the average interest rate achieved from temporary investments, the SIBA Account, Barclays and Santander Accounts was 0.68%, higher than the average Local Authority 7 Day Rate over the same period of 0.407%.

9.3 At a recent meeting with our Treasury Consultants, Link Asset Services, it was commented that our Treasury Team had produced a very good average investment rate despite the current economic climate, resulting in limited counterparty flexibility.

9.4 To note, the Authority was the best performing in terms of investment rates achieved, out of the nine Fire and Rescue Services that Link Asset Services support.

10. General Economic Conditions

10.1 In brief, the first six months of this financial year has seen:

- Inflation – Target Inflation (CPI) was at 2.50% on 1 April 2018 and at 2.70% by 30 September 2018 (0.20% change). Headline Inflation (RPI) was at 3.30% on 1 April 2018 and at 3.40% by 30 September 2018 (0.10% change).

10.2 Economic Update**:**

UK. The first half of 2018/19 has seen UK **economic growth** post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase **Bank Rate** on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

Some MPC members have expressed concerns about a build-up of **inflationary pressures**, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

As for the **labour market,** unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009. (The previous high point was in July 2015.) Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2, but also an upturn in inflationary pressures. With inflation moving towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

EUROZONE. Growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

11. Economic Forecast – (October Link Asset Services update)

The Authority's Treasury Advisers, Link Asset Services, have provided the following forecast:

	End Q4 2018	**End Q1 2019**	**End Q2 2019**	**End Q3 2019**	**End Q4 2019**	**End Q1 2020**	**End Q2 2020**	**End Q3 2020**
Bank Rate	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
5yr PWLB rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%
10yr PWLB rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%
25yr PWLB rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%

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