For Publication

Bedfordshire Fire and Rescue Authority
7 October 2019
Item No. 7

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

SUBJECT: **TREASURY MANAGEMENT – MID-YEAR REVIEW REPORT TO 30 SEPTEMBER 2019**

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Background Papers:

Treasury Management Strategy 2019/20, as detailed in the Budget Book 2019/20.

Implications (tick ✓):

LEGAL		FINANCIAL	✓
HUMAN RESOURCES		EQUALITY IMPACT	
ENVIRONMENTAL		POLICY	
ORGANISATIONAL RISK		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 2019.

RECOMMENDATION:

That the Fire and Rescue Authority consider and comment on 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 2019/20 to 30 September 2019.

1.4 The FRA 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 2019/20;
- A review of the Authority's borrowing strategy for 2019/20;
- A review of any debt rescheduling undertaken (if applicable) during 2019/20;
- A review of compliance with Treasury and Prudential Limits for 2019/20; and
- An economic update for the first six months of 2019/20.

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 has previously been provided to Members by our Treasury Advisor's, Link Asset Services. This can again be arranged at the Members request.

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 27th February 2019 and approved by the FRA on 28th March 2019. 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. The increase is due to the wi-fi refresh that the FRA has previously agreed. The low spend as at the mid-year point is detailed in the Budget Monitoring report to the FRA, also on the meeting's agenda. In summary there will be slippage of vehicles and equipment into 2020/21.

Capital Expenditure by Service	**2019/20 Original Estimate £'000**	**Current Position £'000**	**2019/20 Revised Estimate £'000**
As per Budget Book	1,736	71	1,811

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	**2019/20 Original Estimate £'000**	**2019/20 Revised Estimate £'000**
Total Capital Expenditure	1,736	1,736
Financed by:		
Capital receipts	140	140
Capital grants	0	0
Capital reserves	200	200
Revenue	1,396	1,396
Total financing	**1,736**	**1,736**
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

	2019/20 Original Estimate £'000	Current Position £'000	2019/20 Revised Estimate £'000
Prudential Indicator – Capital Financing Requirement			
TOTAL CFR	**8,038**	**8,038**	**8,038**
Net movement in CFR	**(424)**	**(424)**	**(424)**
Prudential Indicator – the Operational Boundary for external debt			
Borrowing	9,987	9,987	9,987
Other long term liabilities*	0	0	0
Total debt (year end position)	**9,987**	**9,987**	**9,987**

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.

	2019/20 Original Estimate £'000	**Current Position £'000**	**2019/20 Revised Estimate £'000**
Borrowing	9,987	9,987	9,987
Other long term liabilities	0	0	0
Total debt	**9,987**	**9,987**	**9,987**
CFR* (year end position)	**7,614**	**7,614**	**7,614**

The Treasurer 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	2019/20 Original Indicator £'000	Current Position £'000	2019/20 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 2019/20

6.1 It was anticipated at the beginning of 2019/20 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 30th September 2019 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 2019/20. As at the 30th September 2019 the Barclays account is paying a rate of 0.45%.

6.3 This Authority's 120-Day Interest account with Santander has been used during 2019/20. As at the 30th September 2019 this account is paying a rate of 0.95%.

6.4 This Authority's 180-Day Interest account with Santander has been used during 2019/10. As at the 30th September 2019 this account is paying a rate at a rate of 1.00%.

6.5 The Authority has invested funds with two foreign banks, Qatar National Bank and Goldman Sachs during the first half of 2019/20, via our Treasury Agents, Link Asset Services. The Qatar National Bank fixed term investments are for six months at a rate of 1.13% and 1.08% and will mature October 2019 and January 2020 (£2.75M and £2.25M). The Goldman Sachs Bank investment is a fixed term investments for three months at a rate of 0.79% and will mature in November 2019 (£2.5M).

6.6 This Authority has also placed surplus funds into a 95-Day Interest account with Lloyds Bank at a variable rate of 1.10% (Bank Rate 0.75% (variable) plus 0.35% fixed) as from August 2019.

6.7 During the second half of 2019/20 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.

6.8 Borrowing has not been undertaken in 2019/20 to finance the Capital Programme. The funding for the 2019/20 Capital Programme was through Grant and revenue contributions.

7. Interest Rate Movements During 2019/20

7.1 Bank base rate has remained at 0.75% from the beginning of the year.

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 2019/20, four investments reached maturity, new investments were then placed, two in April of £3.5M, two in July for £5.25M, and one in August for £2.5M. 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 £9.5M at the start of 2019/20 to £12.5M as at 30th September 2019. In the year 2019/20 to 30 September 2019, £47,300 interest will have been generated through these investments and through the local SIBA account, Barclays Account, Santander Accounts and Lloyds Account. Interest on PWLB borrowings totals of £210,817 was paid on 1st October but was for the period up to end of September. This will give a net interest paid position of £163,517 as at 2 October 2019.

8.2 The FRA's budgeted investment return (interest receivable) for 2019/20 is £90,400.

8.3 Long-Term Borrowing:

Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

8.4 **Borrowing and Investments Outstanding:**

	Temporary Investments £000s	**Long-Term Borrowing £000s**
Outstanding at 1 April 2019	9,500	9,987
Raised	11,250	0
Repaid	(8,250)	0
Outstanding at 30 September 2019	**12,500**	**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 2019, the average interest rate achieved from temporary investments, the SIBA Account, Barclays, Lloyds and Santander Accounts was 1.13%, higher than the average Local Authority 7 Day Rate over the same period of 0.57%.

10. General Economic Conditions

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

- Inflation – Target Inflation (CPI) was at 1.90% on 1 April 2019 and at 2.10% by 31 August 2019 (0.20% change). Headline Inflation (RPI) was at 2.50% on 1 April 2019 and at 2.80% by 31 August 2019 (030% change).

10.2 Economic Update**:**

UK. This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October, with or without a deal. However, so far, there has been no majority of MPs for any one option to move forward on enabling Brexit to be implemented. At the time of writing, (first week in September), the whole political situation in the UK over **Brexit** is highly fluid and could change radically by the day. The vote in the Commons on 3 September looks likely to lead to a delay in the date for Brexit to 31 January 2020, but there is also likelihood that there will be an imminent general election. In such circumstances, any interest rate forecasts are subject to material change as the situation evolves. At present, if the UK does soon achieve an agreed deal on Brexit, including some additional clarification wording on the Irish border backstop, then it is possible that growth could recover quickly. The MPC could then need to address the issue of whether to raise Bank Rate when there is very little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could falter and the MPC would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by way of tax cuts and / or expenditure on infrastructure projects, to boost the economy. However, infrastructure projects generally take a long time to plan and to start up, and so to feed through into impacting the economy; tax cuts would be much quicker in impacting the level of consumption in the economy.

The first half of 2019/20 has seen UK **economic growth** fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. This mirrored investor confidence around the world which is now expecting a significant downturn or possibly even a recession in some developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, (July 2.1%), and is likely to shift only a little upwards over the rest of 2019/20. It does not therefore pose any immediate concern to the MPC at the current time.

With regard to the **labour market,** despite the contraction in quarterly GDP growth of -0.2%q/q, (+1.2% y/y), in quarter 2, employment rose by 115,000 in the same quarter: this suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Unemployment has continued near to a 44 year low, edging up from 3.8% to 3.9% on the Independent Labour Organisation measure in June; however, that was caused by a rise in the participation rate to an all-time high. Job vacancies fell for a sixth consecutive month, hitting record levels, and indicating that employers are having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 1.8%. As 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 could mean that the MPC will need to take action to raise Bank Rate if there is an agreed Brexit deal as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, if there is a general election soon, 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 although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of strong growth to 2.9% y/y. Growth in 2019 has been falling back after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2. Quarter 3 is expected to fall further. The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not to be seen as the start of a series of cuts to ward off a downturn in growth. Financial markets are, however, expecting another cut in September. Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

BOND YIELDS. It is this souring of investor confidence that has largely contributed to the sharp fall in bond yields on government debt in mid-2019 in the major western economies as investors have switched out of risky assets - equities, fearing an impending recession, and buying into bonds, so pushing their prices up and correspondingly, pushing yields down. Investors have little confidence that the US China trade war will have a satisfactory outcome in the near future and both sides look as if they are digging in to entrenched positions. However, most domestic US economic indicators are not currently pointing to a recession in the US, only to a slowing of growth. Provided the major world economies do avoid recession, then it is likely that there will be some reversal of this flow from equities into bonds and, therefore, that bond yields will recover to a limited extent from recent truly exceptional lows. However, the near-term reality is that we have seen 10 year bond yields fall below 2 year yields in the US; this has historically been a prime indicator of impending recession in the

US, though this correlation has been much weaker in the UK. All German bond yields between 2 and 30 years are actually negative while many other EZ countries have bond yields which are also negative, at least in some maturity years.

EUROZONE. Growth has been slowing from +1.9% during 2018 to +0.4% q/q (+1.2% y/y) in quarter 1 and then to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019. German GDP growth fell to -0.1% in quarter 2; industrial production was down 5.2% y/y in June with car production especially being hit. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars. The ECB meeting in July expressed concern as to the weak outlook for growth and how low inflation was despite all the monetary stimulus the bank still has in place. The ECB is therefore expected to take action to cut its main rate of -0.4% further, but only marginally, and to look at the potential for more quantitative easing and/or other instruments of monetary policy to provide further stimulus to economic growth. On the political front, Spain and Italy are in the throes of trying to form coalition governments while the very recent results of two German state elections will put further pressure on the frail German CDU/SDP coalition government.

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. The trade war with the US does not appear to have had a significant effect on GDP growth as yet as some of the impact of tariffs has been offset by falls in the exchange rate and by transhipping exports through other countries, rather than directly to the US.

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 – (August Link Asset Services update)

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

	End Q3 2019	**End Q4 2019**	**End Q1 2020**	**End Q2 2020**	**End Q3 2020**	**End Q4 2020**	**End Q1 2021**
Bank Rate	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%
5yr PWLB rate	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%	1.80%
10yr PWLB rate	1.50%	1.60%	1.80%	1.90%	2.00%	2.00%	2.10%
25yr PWLB rate	2.10%	2.30%	2.40%	2.50%	2.60%	2.70%	2.70%
50yr PWLB rate	2.00%	2.20%	2.30%	2.40%	2.50%	2.60%	2.60%

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