

**TREASURY MANAGEMENT STRATEGY 2025/26
AND THIRD QUARTER REVIEW 2024/25****REPORT OF THE TREASURER****For Approval****1. PURPOSE OF REPORT**

- 1.1 The purposes of the report is to:
- i. provide the third quarter update of the 2024/25 Treasury Management activity; and
 - ii. enable the Audit and Governance Committee to scrutinise the recommended Treasury Management Strategy for 2025/26, before it is referred to the Full Fire Authority for approval.

2. RECOMMENDATIONS

It is recommended that Members consider the Treasury Strategy and note that if Members are content the following recommendations will be referred to the Full Authority for approval:

- i) Note the 2024/25 Treasury Management third quarter position detailed in section 5.
- ii) Approve the prudential indicators outlined in Appendix A.
- iii) Borrowing Strategy 2025/26
To approve the recommendation that the Capital Financing Requirement (CFR) i.e. capital borrowing requirement is funded from short-term borrowing until such time as long term interest rates reduce to a sustainable level.

To approve the proposal to use any temporary revenue budget savings arising from temporary borrowing interest being less than budgeted to reduce the CFR, which will help mitigate potential higher longer term interest costs.
- iv) Investment Strategy 2025/26
Approve the Counterparty limits as set out in paragraph 8.7.
- v) Minimum Revenue Provision (MRP) Statement
Approve the following MRP statement:
 - For capital expenditure incurred before 1st April, 2008 the Authority's MRP policy is to calculate MRP in accordance with former DCLG (Department for Communities and Local Government) Regulations. This is 4% of the Capital Financing Requirement except where the Authority makes

Voluntary Revenue Payments (VRP) which is in excess of the amount required by these regulations, based on asset life;

- From 1st April, 2008 the Authority calculates MRP based on asset life for all assets or where prudential borrowing is financed by a specific annuity loan, MRP will be calculated according to the actual annuity loan repayments;
- The Treasurer may determine to make Voluntary Revenue Provision payments to reduce the Authority's overall CFR if it is in the best financial interests of the Authority.

3. BACKGROUND

3.1 The Treasury Management Strategy covers:

- The strategy for the Authority's borrowing requirement arising from historic capital expenditure and the element of the approved Asset Management Plan funded from Prudential Borrowing; and
- The Annual Investment Strategy relating to the Authority's cash flow.

3.2 The Local Government Act 2003 requires the Authority to 'have regard to' the CIPFA (Chartered Institute of Public Finance and Accountancy) Prudential Code and to set prudential indicators for the next three years to ensure the Authority's capital investment plans are affordable, prudent and sustainable.

3.3 The Act requires the Authority to set out a Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy, which sets out the policies for managing investments and for giving priority to the security and liquidity of those investments. The Secretary of State has issued Guidance on Local Government Investments which came into force on 1st April, 2004, and has subsequently been updated, most recently in 2021.

3.4 The Authority is required to nominate a body to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies, before making recommendations to the Full Fire Authority. This responsibility has been allocated to the Audit and Governance Committee.

3.5 This report covers the following areas:

- Economic background and outlook for interest rates
- Treasury Management Strategy 2024/25 third quarter review
- Treasury Management Strategy 2025/26
- Minimum Revenue Provision and Interest Cost and Other Regulatory Information 2025/26.

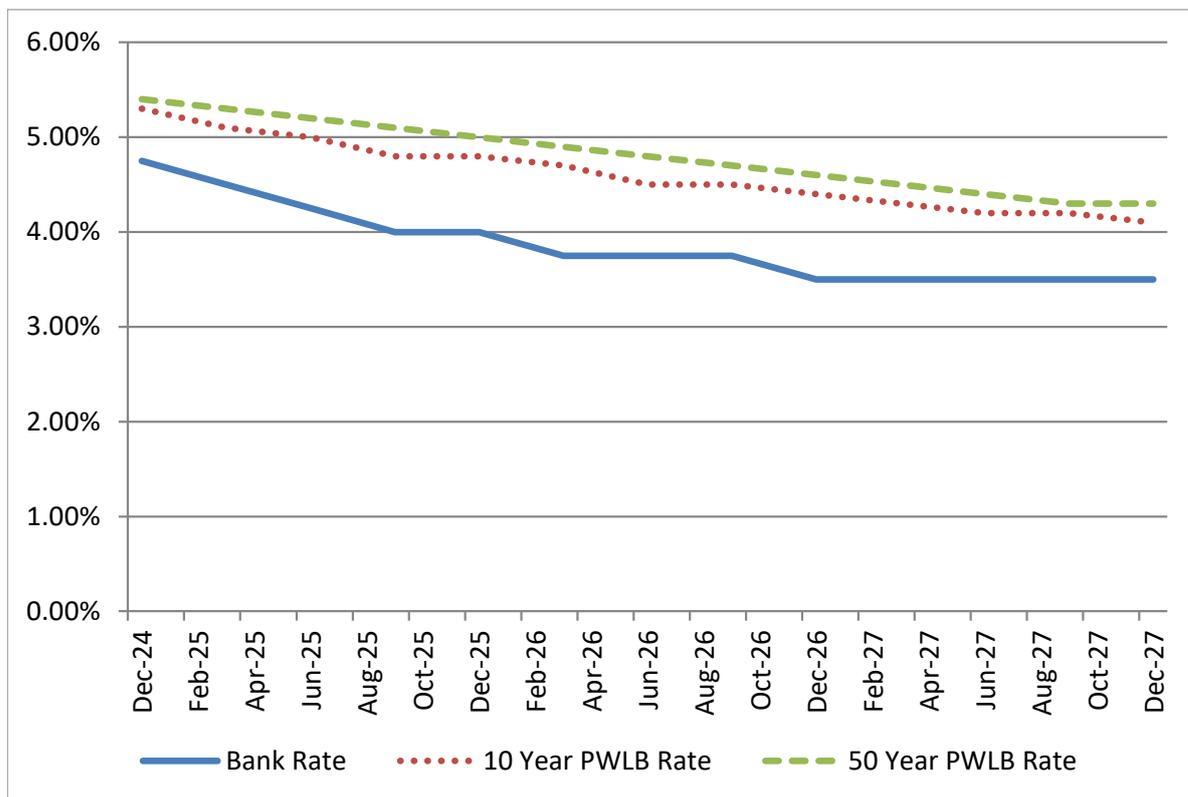
4. ECONOMIC BACKGROUND AND OUTLOOK FOR INTEREST RATES

4.1 The USA continues to have a major impact on the world economy and the outcome of the Presidential Election in November 2024 resulted in a period of uncertainty. This uncertainty, coupled with global factors, including market expectations of slower falls in inflation, resulted in interest rates for Government borrowing across the world increasing.

- 4.2 The new USA President took office on 20th January and whilst he has made significant policy announcements there remains uncertainty regarding his actual decisions in relation to trade tariffs. Until this position becomes clear there will continue to be uncertainty around global economic growth, inflation and interest rates.
- 4.3 The UK economy is not immune to international events and gilt yields (the interest rate for UK Government borrowing) increased significantly in December 2024, when the 30 year rate gilt yield increased to 5.4% - the highest rate since 1998. Most financial commentators have recognised that the majority of this increase appears to a response to global factors. However, some of the impact reflects the Chancellor's budget statement on 30 October 2024. The financial markets have reacted in a calmer manner to the global increase in interest rates and have not reacted in the same way as they did as a result of the mini-budget in September 2022.
- 4.4 Whilst, the financial markets have been calmer and are largely being driven by global factors the current increase in gilt yields has a number of significant impacts:
- If these rates are sustained they will increase the cost of Government borrowing and potentially require the Chancellor to announce lower government spending and/or higher taxes. The Chancellor will have to address this issue as part of the fiscal update scheduled for 26th March 2025.
 - Impact on the timing and scope of reductions in the Base Rate by the Bank of England.
 - Increase the interest rates set by the Public Works Loans Board (PWLB). As Members are aware the PWLB provides loans for capital expenditure to councils and Fire and Rescue Authority's. The interest rates set by the PWLB are driven by the Government gilt yields. As detailed later in the report the current gilt and PWLB rates are higher than forecast in the previous Treasury Management Strategy and this report sets out the proposal for managing the position.
- 4.5 **Interest Rate Forecasts**
- 4.6 Link Group (the Authority's Treasury Management advisors) were acquired by Mitsubishi UFJ Financial Group Pension and Market Services (MUFG) on 16th May 2024. The relationship with the Treasury Advisors and the service the Authority receives has not changed. MUFG continue to update their interest rate forecasts to reflect statements made by the Governor of the Bank of England and changes in the economy.
- 4.7 The Bank of England reduced the Bank Rate by 0.25% on 7th November 2024. A further 0.25% cut was made on 6th February 2025 and the Bank of England Rate is now 4.5%.
- 4.8 MUFG's view is that monetary policy (interest rates) is sufficiently tight at present to cater for some further reductions loosening, the extent of which will continue to be data dependent. MUFG forecast a pattern to evolve whereby rate cuts are made quarterly- and in keeping with the release of the Bank's Quarterly Monetary Reports (May, August and November).

4.9 Economic and interest rate forecasting remains difficult with so many influences impacting on the economy. UK gilt yields (i.e. Government borrowing) and Public Works Loan Board (PWLB) interest forecasts made by MUFG may be liable to further amendment depending on how the political, economic and international developments transpire over the next year.

4.10 Interest Rate Forecast up to December 2027



5. TREASURY MANAGEMENT STRATEGY 2024/25 3RD QUARTER REVIEW

5.1 The Treasury Management Strategy for 2024/25 was approved by the Full Fire Authority on 22nd March 2024. The Authority’s borrowing and investment position as at 31st December 2024 is summarised as follows:

| | £m | Average Rate |
|-----------------------|-------------|--------------|
| LOBO Loan # | 2.0 | 3.95% |
| PWLB Loans | 6.7 | 2.92% |
| Gross Debt | 8.7 | 3.15% |
| Investments | 19.0 | 4.92% |
| Net Investment | 10.3 | |

A LOBO (Lender Option, Borrower Option) loan was taken out in March 2007 at which time interest rates for comparative PWLB loans were 4.3%. The LOBO has call date of 29 March 2025 at which point the lender can potentially increase the interest rate and the Authority can either accept the new rate, or repay the loan and refinance with another lender.

- 5.2 As part of the Treasury Strategy for 2024/25 the Authority set a number of prudential indicators. Compliance against these indicators is monitored on a regular basis and there are no breaches to report.
- 5.3 The CFR and capital expenditure financed by borrowing will vary from the original estimate approved by the Full Fire Authority in March 2024 owing to planned capital expenditure being re-phased between financial years.
- 5.4 As at 31st December, the temporary investment funds amounted to £19.0m, which reflected strategic investments, the positive cashflow impact of when capital expenditure is incurred and the receipt of the Pension Grant. All investments complied with the Annual Investment Strategy and are shown below.

| Borrower | Duration | Value of Loan (£m) | Rate (%) | Start Date | Maturity Date |
|-------------------------------|----------|--------------------|--------------|------------|---------------|
| Money Market Funds | | | | | |
| Blackrock | On Call | 1.500 | 4.730 | | Call |
| | | 1.500 | 4.730 | | |
| Fixed term Deposits | | | | | |
| Standard Chartered Bank | 1 year | 2.000 | 5.170 | 26/02/24 | 25/02/25 |
| Lloyds Bank Corporate Markets | 1 year | 5.000 | 4.550 | 04/10/24 | 03/10/25 |
| Goldman Sachs | 1 year | 3.000 | 5.140 | 05/07/24 | 04/07/25 |
| Goldman Sachs | 1 year | 2.000 | 5.230 | 15/04/24 | 15/04/25 |
| NatWest Markets Plc | 1 year | 5.000 | 5.000 | 26/07/24 | 25/07/25 |
| Debt Management Office | <1 month | 0.511 | 4.710 | 23/12/24 | 15/01/25 |
| | | 17.511 | 4.933 | | |
| Total Deposits | | 19.011 | 4.917 | | |

- 5.5 The investment strategy has secured investment income to support the Medium Term Financial Strategy to 2027/28. As interest rates on investments are continuing at a higher level than previously forecast, following slower reductions in the Bank of England base rate than anticipated, the investment strategy may provide additional one off income in 2025/26. A strategy for using this income will be developed as part of the 2026/27 budget process as it may be possible to extend support for the revenue budget at the rate of £0.250m for a further year – i.e. 2028/29, to protect front line services.

6. TREASURY MANAGEMENT STRATEGY 2025/26

- 6.1 Prudential Indicators and other regulatory information in relation to the 2025/26 Treasury Management Strategy is set out in Appendix A.
- 6.2 The key elements of the Treasury Management Strategy which Members need to consider are the Borrowing and Investment Strategies, detailed in section 7 and 8.

7. **BORROWING STRATEGY 2025/26**

- 7.1 Following the development and implementation of the Asset Management Plan (AMP) the Authority's CFR has risen and is forecast to continue to rise. Therefore, it was recognised that a proactive borrowing strategy would need to be adopted to finance the borrowing element of the AMP and to secure historically low interest rates.
- 7.2 As indicated in Appendix A (indicator 5.1) the Authority has a net borrowing requirement for the AMP up to 2027/28 of £13.856m. The interest cost of this requirement can be funded from a combination of the recurring revenue budget and the one-off reserves earmarked to manage the phasing of these costs. This position is based on borrowing at a lower level than current PWLB interest rates. In the short-term this is a low risk as short-term interest rates are below current longer term interest rates.
- 7.3 Until long term interest rates reduce from their current level it would not be prudent to lock into interest rates for the borrowing requirements. Therefore, in the short-term (i.e. through to the end of 2025/26) the borrowing requirement will be funded from a combination of temporary borrowing and/or netting down investments. These borrowing decisions will also reflect the timing of actual capital expenditure as this tends to be towards the end of the financial year owing to the lead in time for capital schemes. This position may continue into 2026/27 and potentially 2027/28 as current interest forecasts indicate short-term interest rates being lower than longer term interest rates.
- 7.4 This position may result in short-term interest savings against the revenue budget and it is recommended these amounts are earmarked to make Voluntary Revenue Payments to reduce the level of borrowing required. This strategy will protect against higher long term interest rates by reducing the amount that needs to be borrowed.
- 7.5 It is recognised that the Authority is managing a significant increase in the net borrowing requirement over the next few years, at a time when there is uncertainty over the timing of reduction in the Bank of England Base Rate, the scale of these reductions and the ongoing level of gilt yields. As referred to earlier in this report gilt and PWLB yields will continue to be driven by global factors. This risk is addressed in the following paragraphs.
- 7.6 **Impact of Capital Programme on the Revenue Budget**
- 7.7 In relation to the Authority's Borrowing Strategy the financial risk to the revenue budget arising from increased interest rates is significantly mitigated owing to the level of existing borrowing with low fixed interest rates (£6.7m of PWLB at an average interest rate of 2.92% and £2m LOBO loans at a rate of 3.95%). As highlighted in the following tables these loans cover 70% of the amount the Authority needs to borrow for the Asset Management Plan (technically referred to as the Capital Financing Requirement) forecast as at 31 March 2025 and 52% at 31 March 2030.

- 7.8 The table also shows the low potential revenue budget pressure at 31 March 2030 if interest rates are 1% higher than forecast and built into the MTFs. If the Authority had not adopted the existing borrowing strategy and secured fixed interest for 52% of the forecast borrowing requirement for the AMP as at 31 March 2030 this financial risk would be significantly higher.

| | 31.03.25 Forecast | 31.3.28 Forecast | 31.03.30 Forecast |
|---|----------------------|---------------------|----------------------|
| Amount Authority needs to borrow for Asset Management Plan (AMP) | £12.392m | £13.856m | £15.614m |
| Amount Authority needs to borrow for AMP covered by existing fixed rate loans | £8.694m (70%) | £8.370m (60%) | £8.137m (52%) |
| Amount Authority needs to borrow for AMP not covered by existing fixed rate loans | £3.699m (30%) | £5.487m (40%) | £7.477m (48%) |
| Potential Revenue budget pressures of actual borrowing costs exceeding forecast by 1% for new AMP borrowing not covered by existing fixed rate borrowing | £0.037m | £0.055m | £0.075m |

- 7.9 The annual borrowing costs (i.e. interest and provision for repayment of the amount borrowed) will be 3.11% of the Authorities forecast 2027/28 budget and this percentage will not increase significantly over the period up to 31 March 2030. To provide context, figures from the Office for Budget Responsibility show that Government interest costs for 2024/25 will be 7.3% of Government Spending (which includes Pensions and Welfare spending).

8. **INVESTMENT STRATEGY 2025/26**

- 8.1 The Department of Levelling Up, Housing and Communities (DLUHC) issued investment guidance in 2010, updated in 2017, and this forms the structure of the Authority's policy. The key intention of the Guidance is to maintain the current requirement for authorities to invest prudently and that priority is given to security and liquidity before interest return. The Authority has adopted the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes and applies its principles to all investment activity. In accordance with the Code, the Treasurer has produced Treasury Management practices covering investment counterparty policy which requires approval each year.
- 8.2 The primary objectives of the Authority's investment strategy in order of importance are:
- safeguarding the re-payment of the principal and interest of its investments on time;
 - ensuring adequate liquidity;
 - investment return.

8.3 Counterparty Selection Criteria

- 8.4 The Authority's criteria for providing a pool of high quality investment counterparties uses the credit rating information produced by the three major ratings agencies (Fitch, Moody's and Standard & Poor's) and is supplied by our treasury consultants. All active counterparties are checked against criteria outlined below to ensure that they comply with the criteria. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered on a daily basis before investments are made. For instance a negative rating watch applying to a counterparty at the minimum criteria will be suspended from use, with all others being reviewed in light of market conditions.
- 8.5 The **lowest common denominator** method of selecting counterparties and applying limits is used. This means that the application of the Authority's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Authority's criteria, the other does not, the institution will fall outside the lending criteria.
- 8.6 The Treasurer will continue to adopt a vigilant approach resulting in what is effectively a 'named' list. This consists of a select number of counterparties that are considered to be the lowest risk.
- 8.7 The use of Local Authority counterparties will be considered and due diligence carried out on an individual basis. The media often describes issuing a section 114 notice as 'bankruptcy', but in fact, a section 114 notice means the Authority cannot make new spending commitments. Local authorities are regarded as very low credit risk investment counterparties and as such are included on our counter party list.

| Category | Fitch | Moody's | Standard & Poor's | Proposed Counterparty Limit | Proposed Time Limit |
|----------|--|---------|-------------------|-----------------------------|-------------------------|
| A | F1+/AA- | P-1/Aa3 | A-1+/AA- | £7m | 1 year |
| B | F1/A- | P-1/A3 | A-1/A- | £5m | 1 year |
| C | Debt Management Office/Treasury Bills/Gilts | | | £14m | 1 year |
| D | Nationalised Banks | | | £5m | 2 years |
| E | Other Local Authorities Individual Limits per Authority: - £3m County, Metropolitan or Unitary Councils - £1.5 District Councils, Police or Fire Authorities | | | £15m | 2 years |
| F | Three Money Market Funds (AAA) with maximum investment of £1.5m per fund | | | £4.5m | Liquid (instant access) |

8.8 Specified and Non-Specified Investments

- 8.9 MHCLG regulations classify investments as either Specified or Non-Specified. Non-Specified Investment is any investment not meeting the Specified definition.

- 8.10 The investment criteria outlined above is different to that used to define Specified and Non-Specified investments. This is because it is intended to create a pool of high quality counterparties for the Authority to use rather than defining what its investments are.
- 8.11 Specified Investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Authority has the right to be repaid within twelve months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is small. These would include investments with:
- The UK Government (such as the Debt Management Office, UK Treasury Bills or a Gilt with less than one year to maturity).
 - Other Local Authorities.
 - Pooled investment vehicles (such as Money Market Funds) that have been awarded a high credit rating (AAA) by a credit rating agency.
 - A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society). This covers bodies with a minimum rating of A- (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies. Within these bodies, and in accordance with the Code, the Authority has set additional criteria to set the time and amount of monies which will be invested in these bodies.
- 8.12 Non-specified Investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non-specified investments would include any investments with:
- Building societies not meeting the basic security requirements under the specified investments. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings.
 - Any bank or building society that has a minimum long term credit rating of A- for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).
- 8.13 It is recommended that maturing investments are re-invested with phased maturity dates. This approach will enable the Authority to benefit from existing interest rates and ensure that future investments do not all mature at a time when interest rates are expected to have reduced significantly.

9. MINIMUM REVENUE PROVISION AND INTEREST COSTS AND OTHER REGULATORY INFORMATION 2025/26

- 9.1 There are two elements to the Authority's annual loan repayment costs – the statutory Minimum Revenue Provision (MRP) and interest costs. The Authority is required to pay off an element of the Capital Financing Requirement (CFR) each year through a revenue charge called the Minimum Revenue Provision (MRP).

- 9.2 DLUHC Regulations require the Authority to approve **an MRP Statement** in advance of each year. This will determine the annual loan repayment charge to the revenue budget.
- 9.3 The budget strategy is based on the following MRP statement and the Authority is recommended to formally approve the existing statement:
- For capital expenditure incurred before 1st April, 2008 the Authority's MRP policy is to calculate MRP in accordance with former CLG Regulations. This is 4% of the Capital Financing Requirement except where the Authority makes Voluntary Revenue Payments which is in excess of the amount required by these regulations, based on asset life;
 - From 1st April, 2008 the Authority calculates MRP based on asset life for all assets or where prudential borrowing is financed by a specific annuity loan, MRP will be calculated according to the actual annuity loan repayments.
 - Continue to authorise the Treasurer to make VRP payments to reduce the Authority's overall CFR if it is in the best interests of the Authority to do so. Such VRP payments can then be potentially offset against future MRP charges if this is in the Authority's interests.
- 9.4 The flexible use of VRP will ensure the CFR is repaid within the original timescale, whilst providing the potential opportunity to either effectively take a MRP holiday - whilst repaying the CFR within the approved timeframe, or repay the CFR early to achieve a permanent saving. This flexibility will support managing the budget and services over a period of financial uncertainty.
- 9.5 Any future VRP payments will be reported as part of future Treasury Management reports.
- 9.6 **CIPFA Treasury Management Code of Practice**
- 9.7 The Authority is adopting the updated CIPFA Treasury Management Code of Practice published 20th December 2021.
- 9.8 The revised Treasury Management Code requires the implementation of the following:
- 1. Adopt a new liability benchmark treasury indicator** to support the financing risk management of the capital financing requirement, with material differences between the liability benchmark and actual loans explained, this is detailed in Appendix A.
 - 2. A knowledge and skills register** for officers and members involved in the treasury function;
 - 3. Reporting to members on a quarterly basis;**
 - 4. Have consideration for Environmental, Social and Governance (ESG) issues.**

9.9 Treasury Management Advisors

- 9.10 The Authority uses MUFG as its external treasury management advisors.
- 9.11 The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.
- 9.12 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

9.13 Markets in Financial Instruments Directive (MIFID II)

- 9.14 On 3rd January 2018 an updated version of the European Union's Markets in Financial Instruments Directive (known as MIFID II) came into effect. It is designed to offer greater protection for investors and inject more transparency into financial markets. Under MIFID II all local authorities are classified as "retail" counterparties and had to consider whether to opt up to "professional" status and for which type of investments. The Fire Authority opted up to professional status in order to maintain the Authority's ability to operate effectively under the new regime.

10. CONCLUSION

- 10.1 The MTFs has previously benefitted from careful management of investments and this is providing annual support for the revenue budget of £0.250m up to and including 2027/28. As a result of interest rate reductions occurring later than anticipated it should be possible to achieved additional investment income during 2025/26 which will enable this strategy to continue into 2028/29, which will protect front line services.
- 10.2 The MTFs also benefits from previous decisions to lock into low interest rates for capital borrowing.
- 10.3 The approved Asset Management Plan requires significant additional borrowing over the period up to March 2030. The phasing of this borrowing will depend on when actual capital expenditure is incurred. Locking into current long term interest rates is not appropriate as these are currently anticipated to exceed the Bank of England Base Rate until at least December 2027.
- 10.4 It is therefore recommended that the borrowing requirement is funded from a combination of netting down investments / borrowings and then funding the net borrowing requirement using short-term loans. This approach will provide the lowest cost in the short-term (i.e. 2025/26) and also enable the Authority to minimise the long term cost (i.e. from 2026/27 onwards) of financing the approved Asset Management Plan by either;

- continuing this strategy if current interest rate structures continue for longer than forecast (i.e. short-term interest rates remain below long-term interest rates); or
- lock into long-term interest rates if these are more favourable and there is a risk of short-term interest rates increasing.

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