TREASURY MANAGEMENT STRATEGY UPDATE 2023/24

REPORT OF THE TREASURER

CLEVELAND FIRE AUTHORITY

For Recommendation

1. PURPOSE OF REPORT

1.1 The purpose of the report is to:

i) Provide a review of Treasury Management activity for 2022/23 including the 2022/23 outturn Prudential Indicators; and

ii) Provide a first quarter update of the 2023/24 Treasury Management activity.

2. RECOMMENDATION

2.1 It is recommended that Members note the report and approve the proposal to recommend to the Authority that the investment time limit is increased to 2 years, with a total investment limited for this period of £5m.

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 that 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 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 outturn position for 2022/23
- Treasury Management Strategy 2023/24 first quarter review

3.6 The current Treasury Management Strategy was approved by the Authority on 24th March 2023 and as detailed in the following sections there have been significant changes in the level of interest rates and the outlook for future years.

3.7 **Economic Background and Outlook for Interest Rates**

3.8 **UK –** As reported in March 2023 the Bank of England's Monetary Policy Committee (MPC) increased interest rates for the tenth time to 4% in February 2023. Seven members of the MPC voted for this increase and two voted to retain the rate at 3.5%. At that time most forecasters expected interest rates to peak at 4.5% in the early part of 2023 and to then begin falling from September 2023.

Since February 2023 the UK economy has faced an extended and on-going period of economic uncertainty with significant inflationary pressures. The Bank of England's Monetary Policy Committee (MPC) have implemented further increases, with the most recent 0.25% in August taking the rate to 5.25%.

The Bank issued a new warning in August that borrowing costs were likely to stay high for some time, as it pledged to ensure its base rate "is sufficiently restrictive for sufficiently long to return inflation to the 2 per cent target". Governor Andrew Bailey said: "We have to remain evidence-driven if we get more evidence of more persistent inflation, then we will have to react to that", adding "it was far too soon to speculate about the timing of any rate cuts".

To provide context to the recent increases:

- the interest rate in January 2022 was 0.25% - which highlights the scale of the increase to 5.25%; and

- the interest rate over the period March 2009 to December 2021 never exceeded 0.75% and for the majority of this period was 0.5%.

3.9 The latest CPI data for June shows that the UK CPI measure of inflation dropped back to 7.9% (from 8.7%) and was in line with expectations. The fall was accounted for by declines in energy and fuel prices, and to a lesser degree food and core goods price inflation. Services price inflation, however, is projected to remain elevated at close to its current rate in the near term.

3.10 The Office for Budget Responsibility's revised growth forecasts up to 2027 are set out in the following table:

Year	March 2022 Growth Forecast	March 2023 Growth Forecast
2023	1.8%	(0.2%)
2024	2.1%	1.8%
2025	1.8%	2.5%
2026	1.7%	2.1%
2027		1.9%

3.11 **European Union (EU) –** The economy is expected to expand 1% this year, the improved forecast for Europe (which narrowly dodged a recession this winter) still represents a marked slowdown on last year. It reflects lower energy prices, which are reducing costs for businesses and easing the strain on households. Worryingly Germany, the Eurozone's biggest economy, slipped into recession in the first quarter of 2023. The European Central Bank raised interest rates by a quarter of a percentage point this month, the smallest increase since it started hiking in July, but hinted at further rate hikes to come given stubbornly high inflation.

3.12 **Other Economies –** elsewhere economies are grappling with similar inflationary pressures and uncertainty caused by geopolitical events including the war in Ukraine and continued tension between China and Taiwan. In the US, the central bank have said that inflation remains well above target and that the Federal Reserve is committed to bringing it back to its 2% target, but that stress in the banking sector may mean that it is not necessary to raise rates again.

3.13 **Interest Rate Forecasts**

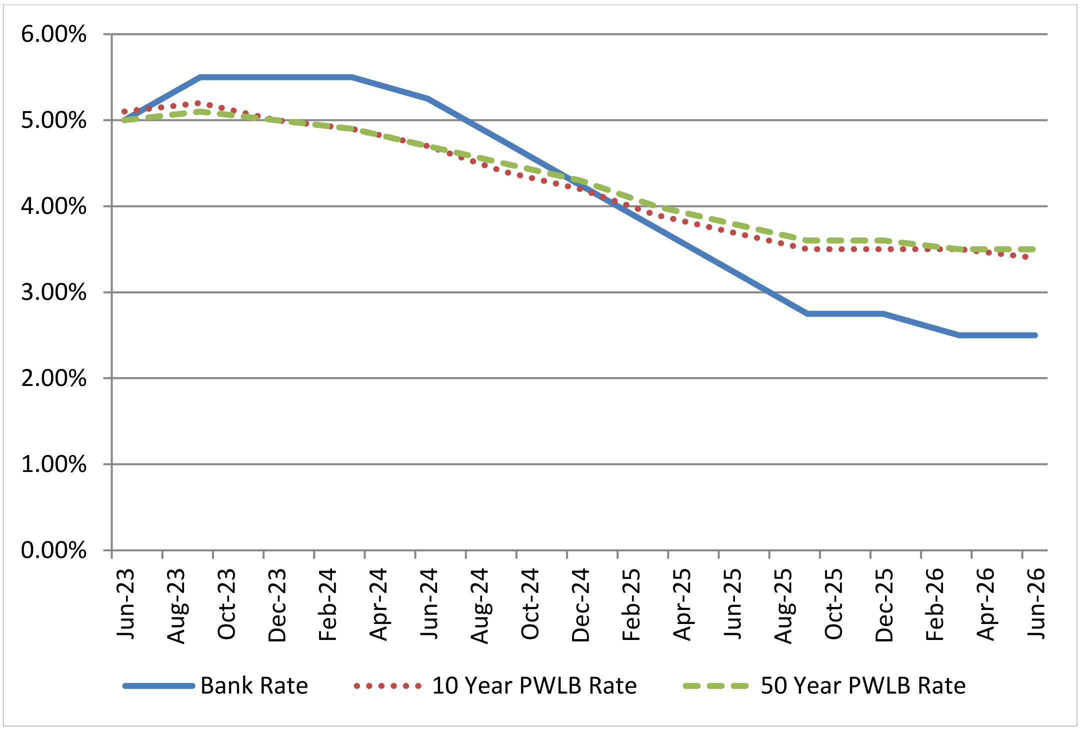
3.14 Link Asset Services (the Authority's Treasury Management advisors) continue to update their interest rate forecasts to reflect statements made by the Governor of the Bank of England and changes in the economy.

3.15 In August the MPC increased the Base Rate to 5.25% pushing borrowing costs to the highest level since 2009. Forecasts reflect a view that the MPC will be keen to further demonstrate its anti-inflation credentials by delivering additional increases in Bank Rate at future meetings. This has happened to a degree but with inflation remaining elevated Link Asset Services anticipate that the Bank Rate will need to increase to at least 5.5%, if not higher, to sufficiently slow the UK economy and loosen the labour market.

3.16 The CPI measure of inflation announcement on the 24th May 2023 reported it dropped back to 7.9% (from 8.7%). Link Asset Services anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind – but that timing will remain one of fine judgement. Current judgement is that rates will have to increase and stay at their peak until the second quarter of 2024 as a minimum.

3.17 Markets reaction to higher than expected inflation pushed gilt yields higher across the curve (i.e. interest rates increased for all periods of borrowing). In addition, the market is pricing in a base rate peak of somewhere between 5.25% and 5.5%, with little prospect of rates coming down from that peak before the second quarter of 2024.

3.18 Interest Rate Forecast up to June 2026



4. TREASURY MANAGEMENT OUTTURN POSITION 2022/23

4.1 **Capital Expenditure and Financing 2022/23**

4.2 The Authority's approved capital programme was funded from a combination of borrowing, the Capital Investment Programme Reserve, Revenue Contributions and Capital Receipts.

4.3 Actual capital expenditure forms one of the required prudential indicators. As shown at Appendix A, the total amount of capital expenditure for the year was £1.108m, funded by a mix of the Capital Investment Programme Reserve, Revenue Contributions, Capital Receipts and Borrowing.

4.4 The Authority's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is the accumulated value of capital expenditure which is not funded from revenue or capital resources. Each year the Authority is required to apply revenue resources to reduce this outstanding balance (termed the Minimum Revenue Provision).

4.5 Whilst the Authority's CFR sets a limit on the level of borrowing, the Authority can manage the actual borrowing position by either:

- borrowing externally to the level of the CFR; or
- choosing to use temporary internal cash flow funds instead of borrowing; or
- a combination of the two.

4.6 The Authority's CFR for the year was £8.881m as shown at Appendix A.

4.7 The Authority can also borrow for future planned increases in the CFR up to 3 years in advance, when this is deemed to be appropriate. As previously reported, in line with the approved Treasury Management Strategy, long term borrowing secured low interest rates to fund the business case for the Asset Management Plan.

4.8 The Authority's total long term external borrowing as at 31st March, 2023 was £9.896m, which funds the CFR up to 2023/24.

4.9 **Prudential Indicators and Compliance Issues 2022/2023**

4.10 Details of each Prudential Indicator are shown at Appendix A. Some of the prudential indicators provide either an overview or specific limits on treasury activity. The key Prudential Indicators to report at outturn are described below.

4.11 The **Authorised Limit** is the "Affordable Borrowing Limit" required by Section 3 of the Local Government Act 2003. The Authority does not have the power to borrow above this level. Appendix A demonstrates that during 2022/2023 the Authority has maintained gross borrowing within the Authorised Limit.

4.12 **Gross Borrowing and the CFR** – In order to ensure that borrowing levels are prudent, over the medium term the Authority's external borrowing, must only be for a capital purpose. Gross borrowing should not exceed the CFR for 2022/23 plus the expected changes to the CFR over 2023/24 and 2024/25. The Authority has complied with this Prudential Indicator.

4.13 **The Treasury position at 31st March 2023**

4.14 The table below shows the treasury position for the Authority as at the 31st March, 2023 compared with the previous year:

Treasury position	31st March 2022		31st March 2023	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt				
- PWLB	£7.0m	2.92%	£6.9m	2.92%
- Market Loans (LOBOs)	£2.0m	3.95%	£2.0m	3.95%
Total Long Term Debt	**£9.0m**	**3.15%**	**£8.9m**	**3.15%**
Temporary Borrowing	-	-	£3.0m	4.20%
Total Investments	**(£8.2m)**	**0.17%**	**(£13.2m)**	**4.60%**
Net Debt / (Investment) Position	**£0.8m**		**(£1.3m)**	

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%.

4.15 A key performance indicator shown in the above table is the low average interest rate for external long term debt of 3.15% for debt held as at 31st March, 2023.

4.16 The Authority's investment policy is governed by Department for Levelling Up, Communities and Housing (DLUCH) guidance, which has been implemented in the annual investment strategy approved by Authority.

4.17 The Authority continues to keep under review the most opportune approach to borrowing. Given the increase in interest rates experienced during 2022, no long term borrowing has been entered into. However, during the financial year end a short term loan was taken out for 1 month at a rate of 4.2% to manage the cash balances being used to manage the capital programme in the short -term.

4.18 In late summer 2022 there was a short period of interest rate volatility and the Authority secured a 12 month investment at an interest rates of 5.3%. This secured investment income of £0.5m and £0.425m was earmarked to support the 2023/24 budget.

4.19 The principals and hierarchy of security / liquidity / rate of return continue to be closely adhered to.

4.20 **Regulatory Framework, Risk and Performance 2022/23**

4.21 The Authority's Treasury Management activities are regulated by a variety of professional codes, statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Authority or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made since this power was introduced);

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act, and requires the Authority to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Authority to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the DLUCH has issued Investment Guidance to structure and regulate the Authority's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November, 2007.

4.22 The Authority has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with Treasury Management activities.

5. TREASURY MANAGEMENT STRATEGY 2023/24 1st QUARTER REVIEW

5.1 The 2023/24 Treasury Management Strategy was approved on the 24th, March, 2023. The Authority's borrowing and investment position as at 30th June 2023 is summarised as follows:

	£m	Average Rate
LOBO Loan #	2.0	3.95%
PWLB Loans	6.9	2.92%
Gross Long Term Debt	**12.9**	**3.15%**
Temporary Borrowing	4.0	4.36%
Investments	14.1	4.57%
Net Investment	**1.2**	

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%.

5.2 As part of the Treasury Management Strategy for 2023/24 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 Fire Authority in March 2023 owing to planned capital expenditure being re-phased between financial years.

5.4 **Investment Strategy** - The Authority has previously limited investments to 1 year or less. However, in view of the current and forecast level of interest rates it is recommended that the time limit for investment be extended to up to 2 years. This limit would be applied using the existing counterparty criteria with a total limit for investments of up to 2 years of £5m. This approach will enable the Authority to secure investment income to support the budget in 2024/25 and 2025/26. If Members approve this proposals details of the investment income secured will be reported as part of the Medium Term Financial Strategy to enable the Authority to approve the strategy for using these one off resources. Other than this proposed change there are no changes to the counterparty investment limits as agreed as part of the Investment strategy and set out in the table below.

Category	Fitch	Moody's	Standard & Poor's	Proposed Counterparty Limit	Proposed Time Limit
A	F1+/AA-	P-1/Aa3	A-1+/AA-	£7m	2 years
B	F1/A-	P-1/A3	A-1/A-	£5m	2 years
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)

5.5 **Borrowing Strategy** - In relation to the Authority's borrowing requirement for approved capital expenditure in 2023/24 it is not recommended that any new borrowing is undertaken during the current year as interest rates are expected to fall in future years. Therefore, by deferring borrowing decisions the Authority will not lock into these high interest rates.

5.6 It is recognised that there is a potential risk that current interest rates may prevail longer than currently anticipated. However, it is expected these rates will fall once the MPC is satisfied inflation is under control, although interest rates are unlikely to fall to the previously historical low level of recent years.

5.7 In the short-term any borrowing requirement for the approved 2023/24 capital programme will be funded from a combination of netting down investments and borrowing (in a similar way to an individual having an offset mortgage), or temporary borrowing for a short period if this is necessary. This approach will minimise the net overall costs of the Authority's investments and borrowing requirement.

6. CIPFA TREASURY MANAGEMENT CODE OF PRACTICE

6.1 The Authority has adopted the updated CIPFA Treasury Management Code of Practice published 20th December 2021.

6.2 **Treasury Management Advisors**

6.3 The Authority uses Link Asset Services – Treasury Solutions as its external treasury management advisors.

6.4 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.

6.5 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.

7. CONCLUSIONS

7.1 For over a decade UK and international interest rates were at a historically and unprecedented low level and this included the Bank of England base rating being 0.5% for a sustained period. It was always anticipated that this position would not be sustained, although the change to slightly higher rates was expected to be gradual and the new ‘normal’ interest rates would still remain low by historic standards.

7.2 During this period the Authority’s treasury management strategy secured long-term borrowing at low interest rates. This has secured the financing of a significant element of the Asset Management Plan and has protects the authority against increases in longer term interest rates.

7.3 The significant economic turmoil of the last year, which is driven by the invasion of Ukraine by Russia, has resulted in an unprecedented spike in inflation. This has resulted in central banks across the world increasing interest rates. Within the UK the MPC has had to increases interest rates by more than they had indicated earlier in the year in response to inflation remaining high. With interest rates increasing from 0.25% in January 2022 to 5.25% in August 2023 it is anticipated that interest rates are near to their peak level. It is still uncertain what the peak level of interest rates will be and when they will begin to fall.

7.4 The current economic environment makes Treasury Management significantly more challenging that it has been for over a decade. Against this background the recommended strategy is designed to manage these risks and minimise costs to the Authority.

7.5 The report sets out how the Authority will comply with the regulatory framework to ensure the Council achieves the lowest borrowing costs and security for any temporary cash investments. Within this framework and the more uncertain / volatile financial environment officers will continue to actively manage borrowing and investments to support the overall financial position of the Authority.

CHRIS LITTLE
TREASURER

APPENDIX A

Prudential Indicators 2022/23 Outturn

1. Ratio of Financing Costs to Net Revenue Stream

This indicator shows the proportion of the total annual revenue budget that is funded by the local tax payer and Central Government, which is spent on servicing debt. This is slightly lower than the estimate owing to a change in the profile of funding sources compared to what was originally forecast.

2022/23 Estimate £'000		2022/23 Outturn £'000
2.97%	Ratio of Financing costs to net revenue stream	2.16%

2. Capital Expenditure

This indicator shows the total capital expenditure for the year and the outturn reflects the actual phasing of capital expenditure.

2022/23 Estimate £'000		2022/23 Outturn £'000
2,162	Capital Expenditure	1,108

3. Capital Expenditure Financed from Borrowing

This shows the borrowing required to finance the capital expenditure programme.

2022/23 Estimate £'000		2022/23 Outturn £'000
943	Capital Expenditure Financed by Borrowing	283

The actual is lower than estimated owing to the phasing of capital expenditure between years.

4. Capital Financing Requirement (CFR)

CFR is used to determine the minimum annual revenue charge for capital expenditure repayments (net of interest). It is calculated from the Authority's Balance Sheet and is shown below. Forecasts for future years are directly influenced by the capital expenditure decisions taken and the actual amount of revenue that is set aside to repay debt.

2022/23 Estimate £'000		2022/23 Outturn £'000
9,562	Capital Financing Requirement	8,881

The capital financing requirement is lower than estimated owing to the phasing of capital expenditure.

5. Authorised Limit for External Debt

The authorised limit determines the maximum amount the Authority may borrow at any one time. The authorised limit covers both long term borrowing for capital purposes and borrowing for short term cash flow requirements. The authorised limit is set above the operational boundary to provide sufficient headroom for operational management and unusual cash movements. In line with the Prudential Code, the level has been set to give the authority flexibility to borrow up to three years in advance of need if more favourable interest rates can be obtained.

2022/23 Limit £'000		2022/23 Peak £'000
14,000	Authorised limit for external debt	11,896

6. Operational Boundary for External Debt

The operational boundary is the most likely prudent, but not worst case scenario, level of borrowing without the additional headroom included within the authorised limit. The level is set so that any sustained breaches serve as an early warning that the Authority is in danger of overspending or failing to achieve income targets and gives sufficient time to take appropriate corrective action.

2022/23 Limit £'000		2022/23 Peak £'000
12,000	Operational boundary for external debt	11,896

7. Interest Rate Exposures

This indicator is designed to reflect the risk associated with both fixed and variable rates of interest, but must be flexible enough to allow the Authority to make best use of any borrowing opportunities.

2022/23 Limit £'000	Upper limits on fixed and variable interest rate exposure	2022/23 Peak £'000
100% 75%	Fixed Rates Variable Rates	78% 22%

8. Maturity Structure of Borrowing

This indicator is designed to reflect and minimise the situation whereby the Authority has a large repayment of debt needing to be replaced at a time of uncertainty over interest rates, but as with the indicator above, it must also be flexible enough to allow the Authority to take advantage of any borrowing opportunities.

	Upper Limit £'000	Lower Limit £'000	Actual by Maturity Date £'000	Actual by soonest call date £'000
Under 12 months	8,000	0	99	99
12 month to 2 years	10,000	0	102	2,102
2 years to 5 years	10,000	0	325	325
5 years to 10 years	10,000	0	608	608
10 years to 20 years	10,000	0	1,514	1,514
20 years to 30 years	10,000	0	2,025	2,025
30 years to 40 years	10,000	0	2,223	2,223
40 years to 50 years	10,000	0	0	0
50 years to 60 years	10,000	0	0	0
60 years to 70 years	10,000	0	2,000	0

The Authority's current outstanding borrowing includes a LOBO (Lender Option Buyer Option) loan which provide fixed interest rates for defined periods and also defined dates for reviewing interest rates, known as 'call dates'. A change to the Prudential Code requires that the call date is reflected in the Maturity Structure indicator above rather than maturity date. However the likelihood of a LOBO being 'called' at present is very low and both methods are presented above for completeness.

9. Investments over Maturing over One Year

This sets an upper limit for amounts invested for periods longer than 364 days. The limit was not exceeded as a prudent approach to investment has been taken owing to uncertainties in the economy. This is in line with the Treasury Management Strategy. Consequently all investments made during the year were limited to a maximum of one year.

	1 year £000	2 year £000	3 year £000
Maximum Limit	5,000	0	0
Actual	0	0	0