Treasury Management Strategy and Investment Strategy 2024/25 to 2026/27

1. Summary

1.1. The Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) require authorities to determine the Treasury Management Strategy Statement (TMSS) before the start of each financial year.

1.2. As per the requirements of the Prudential Code, Hampshire and Isle of Wight Fire and Rescue Authority has adopted the CIPFA Treasury Management Code. This report fulfils the Fire & Rescue Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.3. **This Report recommends:**

1.4. **That the Treasury Management Strategy, including the Annual Investment Strategy for 2024/25, (and the remainder of 2023/24) is approved; and**

1.5. **That authority is delegated to the Chief Financial Officer, who in turn discharges this function to Hampshire County Council's Deputy Chief Executive and Director of Corporate Operations as agreed in the Service Level Agreement, to manage the Fire & Rescue Authority's investments and borrowing according to the Treasury Management Strategy Statement as appropriate.**

2. Introduction

2.1. Treasury management is the management of the Fire & Rescue Authority's cash flows, borrowing and investments, and the associated risks. The Fire & Rescue Authority has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Fire & Rescue Authority's prudent financial management.

2.2. Treasury risk management at the Fire & Rescue Authority is conducted within the framework of the CIPFA Code which requires the Fire & Rescue Authority to approve a Treasury Management Strategy Statement (TMSS) before the start of each financial year. This report fulfils the Fire & Rescue Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

2.3. Investments held for service purposes or for commercial profit are considered in a different report, the Capital and Investment Strategy.

3. External Context

3.1. The following paragraphs explain the economic and financial background against which the TMSS is being set.

Economic background

3.2. The impact on the UK from higher interest rates and inflation, a weakening economic outlook, an uncertain political climate due to an upcoming general election, together with war in Ukraine and the Middle East, will be major influences on the Fire & Rescue Authority's treasury management strategy for 2024/25.

3.3. The Bank of England (BoE) increased Bank Rate to 5.25% in August 2023, before maintaining this level for the rest of 2023. The November 2023 quarterly Monetary Policy Report (MPR) forecast a prolonged period of weak Gross Domestic Product (GDP) growth with the potential for a mild contraction due to ongoing weak economic activity. The outlook for CPI inflation was deemed to be highly uncertain, with upside risks to CPI falling to the 2% target coming from potential energy price increases, strong domestic wage growth and persistence in price-setting.

3.4. Office for National Statistics (ONS) figures showed CPI inflation was 3.9% in November 2023, down from 4.6% in the previous month, and in line with the recent trend, lower than expected. The core CPI inflation rate declined to 5.1% from the previous month's 5.7%, again lower than predictions. Looking ahead, using the interest rate path implied by financial markets the BoE expects CPI inflation to continue falling slowly, but taking until early 2025 to reach the 2% target before dropping below target during the second half of 2025 and into 2026.

Credit outlook

3.5. Credit default swap (CDS) prices are used as an indicator of credit risk, where higher premiums indicate higher perceived risks. CDS prices were volatile during 2023, spiking in March 2023 on the back of banking sector contagion concerns following the major events of Silicon Valley Bank becoming insolvent and the takeover of Credit Suisse by UBS. After then falling back in Quarter 2 of calendar 2023, in the second half of the year, higher interest rates and inflation, the ongoing war in Ukraine, and now the Middle East, have led to CDS prices increasing steadily.

3.6. On an annual basis, CDS price volatility was lower in 2023 compared to 2022, but 2023 saw more of a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

3.7. Moody's revised its outlook on the UK sovereign to stable from negative to reflect its view of restored political predictability following the volatility after the 2022 mini-budget. Moody's also affirmed the Aa3 rating in recognition of the UK's economic resilience and strong institutional framework.

3.8. Following its rating action on the UK sovereign, Moody's revised the outlook on five UK banks to stable from negative and then followed this by the same action on five rated local authorities. However, within the same update the long-term ratings of those five local authorities were downgraded.

3.9. There remain competing tensions in the banking sector, on one side from higher interest rates boosting net income and profitability against another of a weakening economic outlook and likely recessions that increase the possibility of a deterioration in the quality of banks' assets.

3.10. However, the institutions on the Fire & Rescue Authority's treasury adviser, Arlingclose's, counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast (December 2023)

3.11. Although UK inflation and wage growth remain elevated, Arlingclose forecasts that Bank Rate has peaked at 5.25%. The BoE's Monetary Policy Committee will start reducing rates in 2024 to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. Arlingclose sees rate cuts from Quarter 3 2024 to a low of around 3% by early-mid 2026.

3.12. Arlingclose expects long-term gilt yields to be broadly stable at current levels (amid continued volatility), following the decline in yields towards the end of 2023, which reflects the expected lower medium-term path for Bank Rate. Yields will remain relatively higher than in the past, due to quantitative tightening and significant bond supply. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

3.13. A more detailed economic and interest rate forecast provided by Arlingclose is in Annex A.

4. Balance Sheet Summary and Forecast

Table 1: Balance sheet summary and forecast

	31/03/23 Actual £m	31/03/24 Estimate £m	31/03/25 Forecast £m	31/03/26 Forecast £m	31/03/27 Forecast £m
Capital Financing Requirement	**15.0**	**29.3**	**37.3**	**41.8**	**44.0**
Less: Other debt liabilities*					
- Leases**	0.0	0.0	(0.4)	(0.4)	(0.4)
Loans CFR	**15.0**	**29.3**	**36.5**	**41.4**	**43.6**
Less: External borrowing***:					
- Public Works Loan Board	(5.9)	(5.6)	(5.2)	(5.2)	(5.1)
Total debt	**(5.9)**	**(5.6)**	**(5.2)**	**(5.2)**	**(5.1)**
Internal borrowing	**9.1**	**23.7**	**31.3**	**36.2**	**38.5**
Less: Balance sheet resources	(37.5)	(27.9)	(13.9)	(5.7)	(7.0)
New borrowing (or treasury investments)	**(28.4)**	**(4.2)**	**17.4**	**30.5**	**31.5**

* leases that form part of the Fire & Rescue Authority's debt

** IFRS 16 requires the Fire & Rescue Authority to change how it recognises its leases from 1 April 2024

*** shows only loans to which the Fire & Rescue Authority is committed and excludes optional refinancing.

4.1. On 31 December 2023, the Fire & Rescue Authority held £5.6m of borrowing and £17.8m of investments. This is set out in further detail at Annex B. Forecast changes in these sums are shown in the balance sheet analysis in Table 1.

4.2. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Fire & Rescue Authority's current strategy is to maintain its investments below their underlying levels, sometimes known as internal borrowing.

4.3. The Fire & Rescue Authority has an increasing CFR due to its planned capital programme expenditure. In previous years, expenditure has been funded from the Authority's own resources but this will not be the case in future and the Authority will therefore be required to externally borrow over the forecast period. The increase in the Loans CFR is due to the major building works associated with the estate. The total CFR also includes the impact of the introduction of the new accounting standard for leases (IFRS 16) which changes the way the Fire & Rescue Authority accounts for leases but does not affect the overall revenue budget. The overall Capital Programme is detailed in Appendix C and shows that capital expenditure will predominantly be funded through borrowing and the use of reserves.

4.4. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Fire & Rescue Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Fire & Rescue Authority expects to comply with this recommendation during 2024/25.

Liability benchmark

4.5. To compare the Fire & Rescue Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1, but that cash and investment balances are kept to a minimum level at each year-end to maintain sufficient liquidity but minimise credit risk.

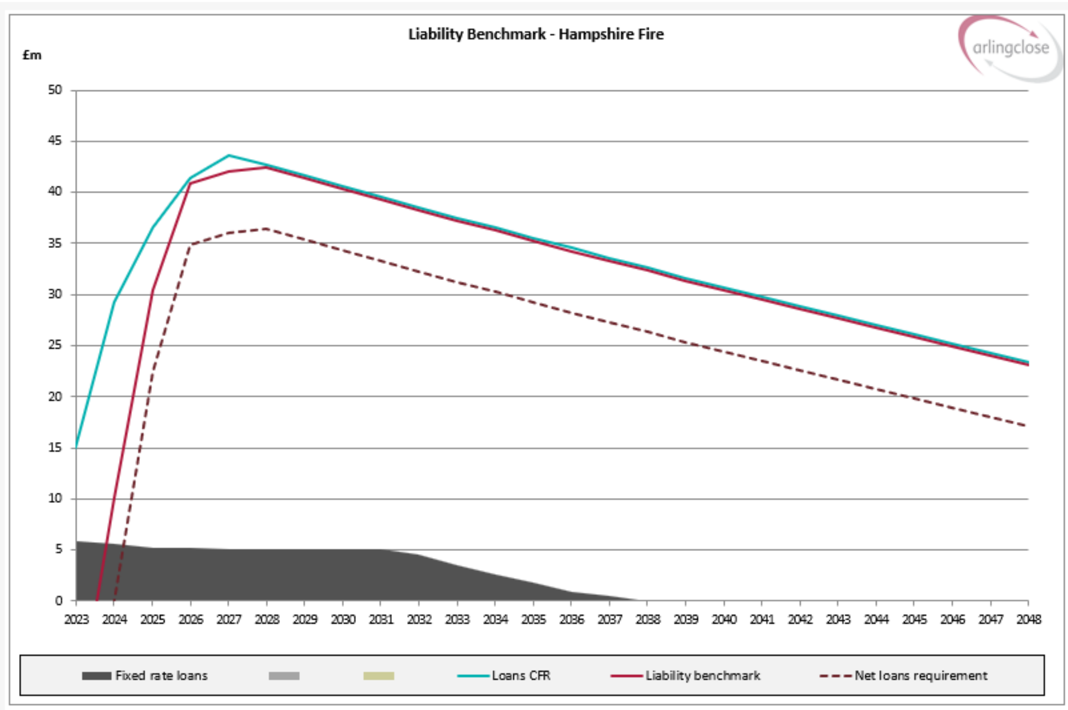
4.6. The liability benchmark is an important tool to help establish whether the Fire & Rescue Authority is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision-making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Fire and Rescue Authority must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

Table 2: Liability benchmark

	31/03/23 Actual £m	31/03/24 Estimate £m	31/03/25 Forecast £m	31/03/26 Forecast £m	31/03/27 Forecast £m
Loans CFR	15.0	29.3	36.5	41.4	43.6
Less: Balance sheet resources	(37.5)	(29.3)	(14.1)	(6.4)	(7.6)
Net loans requirement	**(22.5)**	**0.0**	**22.4**	**34.9**	**36.0**
Plus: Liquidity allowance	10.0	10.0	8.0	6.0	6.0
Liability benchmark	**(12.5)**	**10.0**	**30.4**	**40.9**	**42.0**

4.7. At the start of the period, 31 March 2023, the Fire & Rescue Authority had a Loans CFR of £15.0m, external borrowing of £5.9m and a liability benchmark of -£12.5m. The difference of £9.1m between the CFR and external borrowing is internal borrowing which is where the Fire & Rescue Authority has used its own resources to fund its borrowing requirement.

Graph 1: Liability Benchmark



4.8. The liability benchmark is the lowest level of debt the Fire & Rescue Authority could hold if it used all of its balances, reserves and cash flow surpluses to fund its CFR. The liability benchmark graph is created based on five years of data, which explains why the Loans CFR line reduces past the initial five-year period – the diagram assumes that no new capital projects will begin after 2026/27, which is a very unlikely scenario but a reflection of the current horizon for capital expenditure forecasts.

4.9. The Fire & Rescue authority expects a positive liability benchmark from 2024 onwards, reflecting the forecast balance sheet resources position mapped out in Tables 1 and 2. A positive liability benchmark that extends above the loans lines shows a need to take additional borrowing as the balance sheet resources and current external borrowing combined are not sufficient to meet the CFR. Therefore Table 2 and Graph 1 illustrate that the Fire & Rescue Authority's existing borrowing is forecast to no longer be sufficient to meet the liability benchmark and the Fire and Rescue Authority will need to source additional external borrowing if it is to meet the full delivery of its capital programme.

4.10. The Chief Financial Officer will continue to work closely with the Authority's treasury management advisor, Arlingclose, to borrow in the most effective way for the Authority.

5. Borrowing Strategy

5.1. The Fire & Rescue Authority held £5.6m of loans as at 31 December 2023, which is £1.1m lower than the previous year, as part of its strategy for funding previous years' capital programmes. The reduction in borrowing balances of £1.1m reflects the repayment of maturing Public Works Loan Board (PWLB) debt, which has not been replaced. The balance sheet forecast in Table 1 shows that the Fire & Rescue Authority may need to borrow in 2024/25 to fund capital programme requirements. The Fire & Rescue Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £43.3m (2024/25).

Objectives

5.2. The Fire & Rescue Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Fire & Rescue Authority's long-term plans change is a secondary objective.

Strategy

5.3. Given the significant cuts to public expenditure, the Fire & Rescue Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. Short-term interest rates are currently at a 15-year high but are expected to fall in the coming years and it is therefore likely to be more cost effective over the medium term to either use internal resources or to borrow short term loans instead.

5.4. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Fire & Rescue Authority with this 'cost of carry' and breakeven analysis and this will be used to help determine whether the Fire & Rescue Authority borrows additional sums at long-term fixed rates in 2024/25 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

5.5. The Fire & Rescue Authority has previously raised all of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pension funds and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. New PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Fire & Rescue Authority intends to avoid this activity, and so will retain its access to PWLB loans.

5.6. The Fire & Rescue Authority may also arrange forward starting loans during 2024/25, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

5.7. In addition, the Fire & Rescue Authority may borrow short-term loans (normally for up to one month) to cover unplanned cash flow shortages.

Sources of borrowing

5.8. The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- UK Infrastructure Bank Ltd
- any institution approved for investments
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Hampshire Pension Fund)
- capital market bond investors
- retail investors via a regulated peer-to-peer platform
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other sources of debt finance

5.9. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback
- similar asset based finance

Short-term and variable rate loans

5.10. These loans leave the Fire & Rescue Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators at Section 7 of this appendix.

Debt rescheduling

5.11. The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Fire & Rescue Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

6. Treasury Investment Strategy

6.1. The Fire & Rescue Authority holds invested funds representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Fire & Rescue Authority's treasury investment balance has ranged between £18.6m and £37.0m, however it is expected that balances will fall between now and 31 March 2024 as shown in Table 1.

6.2. The reduction in investment balances predicted are as a result of the planned funding of the capital programme, as well as due to the normal pattern of expected income and expenditure whereby the largest balances are expected in August following the receipt of the annual pension grant in July.

Objectives

6.3. The CIPFA Code requires the Fire & Rescue Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Fire & Rescue Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Fire & Rescue Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Fire & Rescue Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

Strategy

6.4. As demonstrated by the liability benchmark above, the Fire & Rescue Authority expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments.

6.5. Approximately 47% of the Fire & Rescue Authority's investment balances as at 31 December 2023 was invested so that it was not subject to bail-in risk, as it was invested in Government investments, pooled property funds, and secured bank bonds. Of the 53% of investment balances subject to bail-in risk, 77% was held in overnight money market funds which are subject to a reduced risk of bail-in due to the high level of diversification within these investments, with the remainder being held in overnight bank call accounts for liquidity purposes and short term bank notice accounts.

6.6. Further detail is provided at Annex B. This diversification represents a continuation of the strategy adopted in 2015/16.

Environmental, social and governance factors

6.7. Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Fire & Rescue Authority does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Fire & Rescue Authority will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

Business models

6.8. Under the IFRS 9 standard, the accounting for certain investments depends on the 'business model' for managing them. The Fire & Rescue Authority aims to achieve value from its internally managed treasury investments through a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Investments targeting higher returns

6.9. In previous years the Fire & Rescue Authority earmarked an amount of its cash balances for investments targeting higher yields; these were made from its most stable core balances with the intention that they would be held for at least the medium term, and it was targeted that these investments would achieve a return of at least 4%. This was a successful approach through the period of very low interest rates, as this portfolio achieved higher interest rates than what was being achieved by cash investments and significantly increased the annualised average income return for the total investment portfolio.

6.10. Following the increases in UK Bank Rate the decision was made to subsume the investments targeting higher returns within the long-term investment portfolio as there was no longer a significant difference between the interest rates being achieved by those investments and cash, as short-term interest rates are now comparable with longer term interest rates.

6.11. The Fire & Rescue Authority will however continue to make use of long-term balances where appropriate, with the option of making investments in longer term investments including local authorities, other asset classes and regions, fixed capital value and pooled funds to mitigate the risk of low interest rates which will affect cash investments when UK Bank Rate is reduced. This diversification also helps to mitigate the risk of overexposure to a single event affecting a specific asset class, although given the reductions in investment balances resulting from the Authority's planned expenditure on the capital programme it is likely that the Authority will not hold significant amounts in longer term investments.

6.12. The Fire & Rescue Authority continues to hold investments in pooled funds (although this allocation has reduced over the last 12 months) which enables the Fire & Rescue Authority to achieve a greater degree of diversification than could effectively be achieved by directly owning individual assets. Pooled funds are managed by specialist external fund managers who are best placed to select and manage investments, for example with property investments in selecting appropriate buildings and then managing the relationship with tenants and the maintenance of those buildings.

6.13. Diversification in itself does not guarantee positive outcomes. The selection of pooled funds is carefully managed to target funds with a strong performance track record and objectives that are well aligned to the Fire & Rescue Authority's income returns aims without putting its initial investment at undue risk over the longer term. The Fire & Rescue Authority is therefore currently invested in pooled funds that specialise in providing income returns to support the revenue budget. As a result of their income focus these funds may not achieve the same capital growth and therefore total return, as other more general investment funds, however they are likely to deliver good income returns for the longer term.

6.14. The investible universe for pooled funds is vast and part of the service provided by Arlingclose as treasury advisers is to conduct research and suitable due diligence on pooled funds prior to making recommendations to their clients.

6.15. Past performance does not guarantee that funds can replicate successful outcomes in future and knowing which funds will perform well is not an exact science. The Fire & Rescue Authority will therefore continue to conduct its own ongoing review and scrutiny of the performance of its pooled fund investments. The Fire & Rescue Authority will also discuss these investments regularly with Arlingclose, who provide advice based on regular meetings with representatives from the pooled funds and their own ongoing due diligence on areas such as performance and investment style, strategy and process.

6.16. Previously, given the medium to long term nature of the investments, it was unlikely that a capital loss would have been realised since the Fire & Rescue Authority would have avoided selling investments wherever possible that crystallised a capital loss. As the Authority has an identified need to borrow in future, the Chief Financial Officer will continue to review the appropriateness of holding pooled fund investments and the associated risks and benefits taking advice from Arlingclose. In addition to the risk of realising a capital loss, changes to IFRS 9 mean that capital gains and losses on investments need to be reflected in the revenue account on an annual basis, although there is currently a statutory override in place for local authorities (including fire and rescue authorities) that exempts them from complying with this requirement.

6.17. The Fire & Rescue Authority is aware of the risks involved with investing in pooled funds and approved the creation of a Capital and Investment Risk Reserve in February 2023 to mitigate inflationary and interest rate risks to the capital programme and risks associated with the Authority's investments. Further details are provided in the Reserves Strategy.

Investment limit

6.18. The maximum that will be lent to any one organisation (other than the UK Government) will be £4m, which represents a reduction in comparison to the previous TMSS.

6.19. Table 1 indicates that treasury balances are forecast to reduce over all periods and therefore new external borrowing will need to be secured to deliver the anticipated capital programme. However, this investment strategy needs to contain investment limits that allow flexibility to manage higher investment balances to ensure that all of the Fire & Rescue Authority's cash can be invested in accordance with this TMSS in the eventuality that the capital programme doesn't proceed as planned, and increased investment balances become available as well as to manage timing differences between income and expenditure.

6.20. A group of entities under the same ownership will be treated as a single organisation for limit purposes. Limits are also placed on fund managers as shown in Table 3.

Table 3: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£4m each
UK Central Government	Unlimited
Any group of pooled funds under the same management	£10m per manager

Approved counterparties

6.21. The Fire & Rescue Authority may invest its surplus funds with any of the counterparty types in Table 4, subject to the limits shown.

Table 4: Sector and counterparty limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	30 years	Unlimited	n/a
Local authorities & other government entities	25 years	£4m	Unlimited
Secured investments *	25 years	£4m	Unlimited
Banks (unsecured) *	13 months	£2m	Unlimited
Building societies (unsecured) *	13 months	£2m	£4m
Registered providers (unsecured) *	5 years	£2m	£10m
Money market funds *	n/a	£4m	Unlimited
Strategic pooled funds	n/a	£4m	£20m
Real estate investment trusts	n/a	£4m	£10m
Other investments *	5 years	£2m	£4m

This table must be read in conjunction with the notes below

*** Minimum credit rating**

6.22. Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-/A3. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant known factors including external advice will be taken into account.

6.23. For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

Government

6.24. Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 30 years.

Secured investments

6.25. Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Banks and building societies (unsecured)

6.26. Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Registered providers (unsecured)

6.27. Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money market funds

6.28. Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Fire & Rescue Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds

6.29. Shares or units in diversified investment vehicles consisting of bond, equity and property investments. These funds offer enhanced returns over the longer term but are more volatile in the short term and allow the Fire & Rescue Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. This sector also includes cash plus funds which are also a type of pooled fund, but are used for short-term funds, with a lower risk appetite. Because strategic pooled funds have no defined maturity date, but are available for withdrawal after a notice period; their performance and continued suitability in meeting the Fire & Rescue Authority's investment objectives will be monitored regularly.

Real estate investment trusts (REITs)

6.30. Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Other investments

6.31. This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Fire & Rescue Authority's investment at risk.

Operational bank accounts

6.32. The Fire & Rescue Authority may incur operational exposures, for example though current accounts, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept low. The Fire & Rescue Authority's operational bank account is with National Westminster and aims to keep the overnight balances held in current accounts as positive, and as close to £0 as possible. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Fire & Rescue Authority maintaining operational continuity.

Risk assessment and credit ratings

6.33. Short and long-term credit ratings from the three main providers (Fitch Ratings, Moody's and Standard and Poor's) are obtained and monitored by the Fire & Rescue Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

6.34. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments

6.35. The Fire & Rescue Authority understands that credit ratings are good but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press and analysis and advice from the Fire & Rescue Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

6.36. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2020 and 2022, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Fire & Rescue Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Fire & Rescue Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office, or invested in government treasury bills for example, or with other local authorities. This will likely lead to investment returns falling but will protect the principal sum invested.

Reputational aspects

6.37. The Fire & Rescue Authority is aware that investment with certain counterparties, while considered secure from a purely financial perspective, may leave it open to criticism, valid or otherwise, that may affect its public reputation, and this risk will therefore be taken into account when making investment decisions.

Liquidity management

6.38. The Fire & Rescue Authority has due regard for its future cash flows when determining the maximum period for which funds may prudently be committed. Historic cash flows are analysed in addition to significant future cash movements, such as payroll, capital payments, grant income and council tax precept. Limits on long-term investments are set by reference to the Fire & Rescue Authority's medium term financial position (summarised in Table 1) and forecast short-term balances.

6.39. The Fire & Rescue Authority will spread its liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider, except in cases of extreme market stress whereby the Fire & Rescue Authority will be able to invest all of its liquid cash in one provider only, being the Debt Management Office.

7. Treasury Management Indicators

7.1. The Fire & Rescue Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest rate exposures

7.2. The following indicator shows the sensitivity of the Fire & Rescue Authority's current investments and borrowing to a change in interest rates. Fixed rate investments maturing during the year are assumed to be variable for the remainder of the year.

Table 5: Interest rate risk indicator

	31 December 2023	Impact of +/-1% interest rate change
	£m	£m
Sums subject to variable interest rates		
Investment	17.8	+/- 0.2
Borrowing	0.0	+/- 0.0

Maturity structure of borrowing

7.3. This indicator is set to control the Fire & Rescue Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Table 6: Refinancing rate risk indicator

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	75%	0%
20 years and above	100%	0%

7.4. Time periods start of the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than a year

7.5. The purpose of this indicator is to control the Fire & Rescue Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Table 7: Price risk indicator

	2024/25	2025/26	2026/27	No fixed date
Limit on principal invested beyond a year	£12m	£10m	£8m	£4m

8. Related Matters

8.1. The CIPFA Code require the Fire & Rescue Authority to include the following in its treasury management strategy.

Financial derivatives

In the absence of any explicit legal power to do so, the Fire & Rescue Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

Investment Advisers

8.2. Arlingclose Limited is appointed as treasury management advisers and provides specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings with Hampshire County Council's Director of Corporate Operations' staff and Arlingclose.

Markets in Financial Instruments Directive

8.3. The Fire & Rescue Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Fire & Rescue Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status at this current time.

8.4. As shown in Table 1, it is expected that over the forecast period investment balances will reduce and further external borrowing will need to be secured. As a result, in future the investment balances may reduce to below the £10m minimum threshold expected of professional clients by the Directive, which means that some financial institutions (including the Fire & Rescue Authority's treasury advisers, Arlingclose) may no longer accept the Fire & Rescue Authority as a professional client.

8.5. However in the event that this does happen, the Chief Financial Officer does not expect a retail client status to negatively affect the Fire & Rescue Authority's treasury management activities due to Arlingclose being able to accept it as a retail client, as well as the service provided by Hampshire County Council. Through the treasury management service supplied by Hampshire County Council, the Fire & Rescue Authority will have access to information on appropriate options for investment, which are shared amongst all partners. The Chief Financial Officer will agree suitable investment counterparties, based on this information for the sectors described in paragraphs 6.23-6.32.

8.6. The Chief Financial Officer will provide an update on the professional client status of the Fire & Rescue Authority in the Treasury Management Strategy Statement that will be produced for the 2025/26 financial year.

9. Financial Implications

9.1. The budget for investment income in 2024/25 is £0.210m, whilst the budget for debt interest paid in 2024/25 is £2.252m, although the actual borrowing costs are likely to vary from this amount as they are dependent on the timing of capital expenditure and the associated timing, source and interest rates secured on any new external borrowing.

10. Other Options Considered

10.1. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed in Table 8.

Table 8: Alternative strategies and their implications

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term

Table 8: Alternative strategies and their implications

Alternative	Impact on income and expenditure	Impact on risk management
		interest costs may be less certain.

Annex A – Arlingclose Economic & Interest Rate Forecast - December 2023

Underlying assumptions:

- UK inflation and wage growth remain elevated but have eased over the past two months fuelling rate cuts expectations. Near-term rate cuts remain unlikely, although downside risks will increase as the UK economy likely slides into recession.
- The MPC's message remains unchanged as the Committee seeks to maintain tighter financial conditions. Monetary policy will remain tight as inflation is expected to moderate to target slowly, although some wage and inflation measures are below the Bank's last forecasts.
- Despite some deterioration in activity data, the UK economy remains resilient in the face of tighter monetary policy. Recent data has been soft but mixed; the more timely PMI figures suggest that the services sector is recovering from a weak Q3. Tighter policy will however bear down on domestic and external activity as interest rates bite.
- Employment demand is easing. Anecdotal evidence suggests slowing recruitment and pay growth, and we expect unemployment to rise further. As unemployment rises and interest rates remain high, consumer sentiment will deteriorate. Household and business spending will therefore be weak.
- Inflation will fall over the next 12 months. The path to the target will not be smooth, with higher energy prices and base effects interrupting the downtrend at times. The MPC's attention will remain on underlying inflation measures and wage data. We believe policy rates will remain at the peak for another 10 months, or until the MPC is comfortable the risk of further 'second-round' effects has diminished.
- Maintaining monetary policy in restrictive territory for so long, when the economy is already struggling, will require significant loosening in the future to boost activity.
- Global bond yields will remain volatile. Markets are currently running with expectations of near-term US rate cuts, fuelled somewhat unexpectedly by US policymakers themselves. Term premia and bond yields have experienced a marked decline. It would not be a surprise to see a reversal if data points do not support the narrative, but the current 10-year yield appears broadly reflective of a lower medium- term level for Bank Rate.
- There is a heightened risk of fiscal policy and/or geo-political events causing substantial volatility in yields.

Forecast:

- The MPC held Bank Rate at 5.25% in December. We believe this is the peak for Bank Rate.
- The MPC will cut rates in the medium term to stimulate the UK economy but will be reluctant to do so until it is sure there will be no lingering second-round effects. We see rate cuts from Q3 2024 to a low of around 3% by early mid 2026.

- The immediate risks around Bank Rate have become more balanced, due to the weakening UK economy and dampening effects on inflation. This shifts to the downside in the short term as the economy weakens.
- Long-term gilt yields are now substantially lower. Arlingclose expects yields to be flat from here over the short-term reflecting medium term Bank Rate forecasts. Periodic volatility is likely.

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	Current	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.25	5.25	5.25	5.25	5.00	4.75	4.25	4.00	3.75	3.50	3.25	3.00	3.00
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
3-month money market rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00
Central Case	5.40	5.40	5.40	5.30	5.15	4.80	4.30	4.10	3.80	3.50	3.25	3.05	3.05
Downside risk	0.00	0.00	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
5yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.77	3.75	3.75	3.75	3.70	3.60	3.50	3.50	3.40	3.30	3.30	3.30	3.35
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
10yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.72	3.75	3.80	3.80	3.80	3.80	3.80	3.80	3.75	3.65	3.60	3.65	3.70
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
20yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	4.16	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.20	4.25
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
50yr gilt yield													
Upside risk	0.00	0.25	0.75	0.85	0.85	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.76	3.80	3.85	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.95	3.95	3.95
Downside risk	0.00	-0.25	-0.75	-0.85	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%; PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB HRA Rate (Maturity Loans) = Gilt yield + 0.40%; UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

Annex B - Existing Investment & Debt Portfolio Position at 31 December 2023

Treasury investment position

Investments	30/09/23 Balance £m	Net movement £m	31/12/23 Balance £m	31/12/23 Income return %	31/12/23 Weighted average maturity (years)
Short term investments					
Banks and building societies:					
- Unsecured	2.3	(0.1)	2.2	4.45	0.01
- Secured	1.1	0.0	1.1	5.44	0.04
- High quality	1.0	(1.0)	0.0	N/A	N/A
Money Market Funds	19.3	(12.2)	7.2	5.32	0.01
Government:					
- Local Authority	0.0	1.0	1.0	5.45	0.26
- Treasury Bills	1.0	2.0	3.0	5.32	0.18
	24.7	**(10.2)**	**14.5**	**5.21**	**0.05**
Long term investments					
Pooled funds:					
- Pooled property*	3.3	0.0	3.3	4.76	N/A
	3.3	**0.0**	**3.3**	**4.76**	**N/A**
TOTAL INVESTMENTS	**28.0**	**(10.2)**	**17.8**	**5.13**	**0.05**

* The rates provided for pooled fund investments are reflective of annualised income returns over the year to 31 December 2023 based on the market value of investments 12 months earlier.

Treasury management position

	31/12/23 Balance £m	31/12/23 Rate %
External Borrowing - PWLB	(5.6)	(4.59)
Investments - Total Investments	17.8	5.13
NET INVESTMENTS	**12.2**	

Annex C – Treasury management indicators at 31 December 2023

Investment limits	31/12/23 Actual £m	2023/24 Authorised Limit	Complied
The UK Government	3.0	Unlimited	✓
Local authorities & other government entities	1.0	Unlimited	✓
Secured investments	1.1	Unlimited	✓
Banks (unsecured)	2.2	Unlimited	✓
Building societies (unsecured)	0	£6m	✓
Registered providers	0	£6m	✓
Money market funds	7.2	Unlimited	✓
Strategic pooled funds	3.3	£24m	✓
Real estate investment trusts	0	£6m	✓
Other investments	0	£6m	✓

Debt limits	2023/24 YTD Maximum £m	31/12/23 Actual £m	2023/24 Operational Boundary £m	2023/24 Authorised Limit £m	Complied
Total debt	6.3	5.6	45.8	51.0	✓

Refinancing rate risk indicator	31/12/23 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	0%	50%	0%	✓
12 months and within 24 months	6%	5%	0%	✓
24 months and within 5 years	2%	50%	0%	✓
5 years and within 10 years	35%	75%	0%	✓
10 years and within 20 years	57%	75%	0%	✓
20 years and above	0%	100%	0%	✓

Long term investments	**2023/24**	**2024/25**	**2025/26**
Principal invested beyond year end	£3.3m	£3.3m	£3.3m
Limit on principal invested beyond year end	£12m	£12m	£12m
Complied?	✓	✓	✓