

## Appendix A

### Treasury Management Mid Year Monitoring Report 2018/19

#### 1. Executive Summary

- 1.1. The Hampshire Fire and Rescue Authority (HFRA) adopts the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the HFRA to approve treasury management semi-annual and annual reports.
- 1.2. This report fulfils the HFRA's legal obligation to have regard to the CIPFA Code.
- 1.3. The HFRA's Treasury Management Strategy (TMS) for 2018/19 was approved at an Authority meeting in February 2018. The HFRA 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 risk are therefore central to the HFRA's TMS.
- 1.4. Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter. In England the Ministry of Housing, Communities & Local Government (MHCLG) published its revised Investment Guidance which came into effect from April 2018.
- 1.5. The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by the Authority covering capital expenditure and financing, treasury management and non-treasury investments. The Capital Strategy will be produced later 2018/19 for approval by the Authority.
- 1.6. Treasury management in the context of this report is defined as:

"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."
- 1.7. Overall responsibility for treasury management remains with the Authority. No treasury management activity is without risk; the effective identification and management of risk are integral to the Authority's treasury management objectives.
- 1.8. All treasury activity has complied with the HFRA's TMS and Investment Strategy for 2018/19, and all relevant statute, guidance and accounting standards. In addition, Authority's treasury advisers, Arlingclose, provide support in undertaking treasury management activities. The HFRA has also complied with all of the prudential indicators set in its TMS.

## **2. Recommendation**

- 2.1. That the mid-year review of treasury management activities be noted by the Hampshire Fire and Rescue Authority.

## **3. External Context**

- 3.1. The following sections outline the key economic themes currently in the UK against which investment and borrowing decisions have been made to date in 2018/19.

### **Economic Commentary**

- 3.2. UK Consumer Price Inflation (CPI) index fell to 2.4% in June, a 12-month low, as the effects of sterling's large depreciation in 2016 began to fade. However CPI ticked back up marginally to 2.5% in July, mostly due to higher energy prices, and up again to 2.7% in August from cultural services, where theatre admission prices rose by more than a year ago, and games, toys and hobbies, where prices for computer games rose this year but fell a year ago. The most recent labour market data for July 2018 showed the unemployment rate at 4%; the lowest since 1975. The three month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9%. However, real wages (i.e. adjusted for inflation) grew only by 0.4%, a marginal increase unlikely to have had much effect for households.
- 3.3. The rebound in Gross Domestic Product (GDP) growth in Quarter 2 of 2018 to 0.4% confirmed that the weakness in economic growth in Quarter 1 was temporary and largely due to weather-related factors. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking the Bank Rate to 0.75%. No further change was made to monetary policy at the Bank of England's meeting in September.

### **Credit Background**

- 3.4. The big four UK banks are progressing well with ringfencing. Barclays Bank PLC and HSBC Bank PLC have created new banks (Barclays Bank UK and HSBC UK Bank) and transferred ringfenced (retail) business lines into the new companies. Lloyds Bank PLC has created Lloyds Bank Corporate Markets as a new non-ringfenced (investment) bank. RBS has renamed existing group entities and transferred accounts to leave NatWest Markets as the non-ringfenced bank and NatWest Bank, Royal Bank of Scotland and Ulster Bank as the ring-fenced banks. The Fire and Rescue Authority's day-to-day banking contract remains with NatWest Bank.

## **4. Local Context**

- 4.1. On 31 March 2018, the HFRA had net investments of £14.4m, a greater cash balance in comparison to the financing of its historical capital programme. 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. These factors are summarised in Table 1:

Table 1: Balance Sheet Summary

	31/03/2018 Balance £m
CFR	(11.7)
Less: Resources for investment	26.1
Net investments	14.4

- 4.2. The HFRA's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 30 September 2018, and the movement since 31 March 2018 is shown in Table 2:

Table 2: Treasury Management Summary

	31/03/2018 Balance £m	Movement £m	30/09/2018 Balance £m	30/09/2018 Rate %
Long-term borrowing	(8.4)	-	(8.4)	(4.71)
Short-term borrowing	-	-	-	-
Total borrowing	(8.4)	-	(8.4)	(4.71)
Long-term investments	6.5	1.0	7.5	3.04
Short-term investments	15.5	4.0	19.5	0.84
Cash and cash equivalents	3.7	0.4	4.1	0.70
Total investments	25.7	5.4	31.1	1.35
Net external investments	17.3	5.4	22.7	

Note: the figures as at 31 March 2018 in the table above are from the balance sheet in the HFRA's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

- 4.3. The increase in net investments of £5.4m shown in Table 2 above reflects the combination of repayment of no increase in borrowing, and an increase in investment balances of £5.4m. The increase in total investments since 31 March 2018 reflects the annual position of 31 March being a lower point for investment balances, due to many government grants being front-loaded; the largest of which is the annual pensions grant, which is received every July and paid out to pay pensions throughout the year.

## 5. Borrowing Activity

5.1. As shown in Table 2, at 30 September 2018 the HFRA held £8.4m of loans, as part of its strategy for funding previous years' capital programmes. Further details are shown in Table 3:

Table 3: Borrowing Position

	31/03/2018 Balance £m	Movement £m	30/09/2018 Balance £m	30/09/2018 Rate %	30/09/2018 WAM* years
Public Works Loan Board	(8.4)	-	(8.4)	(4.71)	11.15
Total borrowing	(8.4)	-	(8.4)	(4.71)	11.15

\* Weighted average maturity

- 5.2. The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.
- 5.3. In keeping with these objectives, no new borrowing was undertaken in the period. This strategy enabled the Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.
- 5.4. The benefits of internal borrowing are monitored regularly against the potential for incurring additional costs by deferring borrowing into future years, when long-term borrowing rates are forecast to rise. Arlingclose assists the Authority with the monitoring of internal and external borrowing.

## 6. Investment Activity

6.1. The HFRA holds invested funds representing income received in advance of expenditure plus balances and reserves. The HFRA's investment holding was £31m at 30 September 2018, which was £2m (6%) lower than the same time last year. During the six month period from 1 April to 30 September 2018, the Authority's investment balance ranged between £21m and £35m due to timing differences between income and expenditure. Table 4 shows investment activity for the HFRA as at 30 September 2018 in comparison to the reported activity as at 31 March 2018:

Table 4: Investment Position (Treasury Investments)

Investments	31/03/2018 Balance £m	Movement £m	30/09/2018 Balance £m	30/09/2018 Rate %	30/09/2018 WAM* years
Short term investments					
- Banks and Building Societies					
- Unsecured	2.11	2.61	4.72	0.77	0.18
- Secured	7.00	-	7.00	1.02	0.45
- UK Treasury Bills	-	1.00	1.00	0.61	0.08
- Money Market Funds	3.06	(0.14)	2.92	0.69	0.00
- Local Authorities	7.00	(1.00)	6.00	0.71	0.44
- Corporate Bonds	-	2.00	2.00	0.80	0.48
	19.17	4.47	23.64	0.81	0.33
Long term investments					
- Banks and Building Societies					
- Secured	3.00	-	3.00	0.97	2.55
- Local Authorities	-	1.00	1.00	1.30	2.74
	3.00	1.00	4.00	1.05	2.59
High yield investments					
- Pooled Property Funds**	2.00	-	2.00	4.27	n/a
- Pooled Equity Funds**	1.50	-	1.50	6.73	n/a
	3.50	-	3.50	5.32	n/a
<b>TOTAL INVESTMENTS</b>	<b>25.67</b>	<b>5.47</b>	<b>31.14</b>	<b>1.35</b>	<b>0.58</b>

\* Weighted average maturity

\*\* The rates provided for pooled fund investments are reflective of the average of the most recent dividend return as at 30 September 2018.

Note: the figures in the table above are from the balance sheet in the HFRA's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

- 6.2. Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The HFRA'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.
- 6.3. During the first half of 2018/19, investment balances increased by £5m, which is in line with what is expected at this point in the year; this is due to the receipt of front-loaded grant, the largest of which is the annual pensions grant, which is received every July and paid out to pay pensions throughout the year. The majority of this has been invested in short-term investment instruments as these funds will be required within the year, whilst £1m has been invested for longer term with local authorities.
- 6.4. Security of capital has remained the Authority's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy Statement for 2018/19.

- 6.5. Counterparty credit quality was assessed and monitored with reference to credit ratings, for financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.
- 6.6. The HFRA will also consider the use of secured investments products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.
- 6.7. The Authority maintained a sufficient level of liquidity through the use of call accounts and money market funds. The HFRA sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate increased by 0.25% to 0.75% in August 2018 and short-term money market rates have remained at relatively low levels which has continued to have a significant impact on cash investment income.
- 6.8. The progression of credit risk and return metrics for the Authority's investments managed in-house (excluding external pooled funds) are shown in the extracts from Arlingclose's investment benchmarking in Table 5:

Table 5: Investment Benchmarking (investments managed in-house)

	Credit Rating	Bail-in Exposure	WAM* (days)	Rate of Return
HFRA performance:				
- 31/03/2018	AA	23%	187	0.63%
- 30/09/2018	AA+	24%	241	0.85%
Police & Fire Authorities	AA-	66%	69	0.65%
All LAs	AA-	60%	61	0.76%

\* Weighted average maturity

- 6.9. The Authority has targeted a proportion of funds towards high yielding investments as shown in Table 4. Investments yielding higher returns will contribute additional income to the HFRA, although some come with the risk that they may suffer falls in the value of the principal invested.
- 6.10. The Authority's £3.5m portfolio of externally managed pooled equity and property funds generated an average annual total return of 9.41%, comprising a 4.83% income return which is used to support services in year, and 4.58% of capital growth. As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives are regularly reviewed.
- 6.11. The investments in pooled funds allow the HFRA to diversify into asset classes other than cash without the need to own and manage the underlying investments. The funds, which are operated on a variable net asset value

(NAV) basis, offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short term. All of the Fire and Rescue Authority's pooled fund investments are in the respective fund's distributing share class which pay out the income generated. The Authority's intention is to hold them for at least the medium term.

- 6.12. MHCLG released a consultation on statutory overrides relating to the introduction of IFRS 9 Financial Instruments accounting standard from 2018/19. The consultation recognises that the requirement in IFRS 9 for certain investments to be accounted for a fair value through profit and loss may introduce "more income statement volatility" which may impact on budget calculations. The consultation proposes a time-limited statutory override and has sought views whether it should be applied only to pooled property funds. The HFRA has responded to the consultation which closed on 30 September. The Authority's response stated that the HFRA agrees that there should be a statutory override, but that it should not be time limited, as the circumstances meaning an override is appropriate now will still apply in April 2021 and beyond. The statutory override should apply to all pooled investment funds, as the Authority sees no reason for the Government to incentivise property funds over other pooled funds. Good treasury risk management requires long-term investments to be diversified over a range of asset classes, and the government should support this by extending the proposed override to all types of collective investment scheme.

## **7. Non Treasury Investments**

- 7.1. Although not classed as treasury management activities the HFRA may also make loans and investments for Service purposes, for example the direct purchase of land or property. Such loans and investments will be subject to the Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy. The HFRA does not have any existing non-treasury investments.

## **8. Compliance Report**

- 8.1. The Authority confirms compliance of all treasury management activities undertaken during the period with the CIPFA Code of Practice and the Authority's approved TMS. Compliance with specific investment limits, as well as the authorised limit and operational boundary for external debt, is demonstrated in Tables 6 and 7 overleaf.

Table 6: Debt Limits

	2018/19 Maximum £m	30/09/2018 Actual £m	2018/19 Operational Boundary £m	2018/19 Authorised Limit £m	Complied
Borrowing	8.4	8.4	13.9	16.5	✓
Total debt	8.4	8.4	13.9	16.5	✓

Table 7: Investment Limits

	2018/19 Maximum	30/09/2018 Actual	2018/19 Limit	Complied
Any single organisation, except the UK Central Government	£2m	£2m	£4m	✓
Any group of organisations under the same ownership	£2m	£2m	£4m	✓
Any group of pooled funds under the same management	£2m	£2m	£4m	✓
Registered providers	£0m	£0m	£6m	✓
Money market funds	24%	9%	50%	✓

## 9. Treasury Management Indicators

9.1. The HFRA measures and manages its exposures to treasury management risks using the following indicators.

### Interest Rate Exposures

9.2. This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed will be:



Table 8 – Interest Rate Exposures

	30/09/2018 Actual	2018/19 Limit	Complied
Upper limit on fixed interest rate investment exposure	£1.0m	£10m	✓
Upper limit on variable interest rate investment exposure	£30.1m	£45m	✓
Upper limit on fixed interest rate borrowing exposure	£8.4m	£16m	✓
Upper limit on variable interest rate borrowing exposure	£0.0m	£16m	✓

- 9.3. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

#### **Maturity Structure of Borrowing**

- 9.4. This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 9 – Maturity Structure of Borrowing

	30/09/2018 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	0%	50%	0%	✓
12 months and within 24 months	1%	50%	0%	✓
24 months and within 5 years	32%	50%	0%	✓
5 years and within 10 years	5%	75%	0%	✓
10 years and within 20 years	61%	75%	0%	✓
20 years and above	0%	100%	0%	✓

#### **Principal Sums Invested for Periods Longer than 365 days**

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

Table 10 – Principal Sums Invested for Periods Longer than 365 days

	2018/19	2019/20	2020/21
Actual principal invested beyond year end	£7.5m	£5.5m	£4.5m
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied	✓	✓	✓