Appendix C

Treasury Management Q1 Report 2022/23

Purpose of the Report

1. Hampshire and Isle of Wight Fire and Rescue Authority has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve, as a minimum, treasury management semi-annual and annual outturn reports.

2. This quarterly report provides an additional update and includes the new requirement in the 2021 Code, mandatory from 1st April 2023, of quarterly reporting of the treasury management prudential indicators. The non-treasury prudential indicators are incorporated in the Authority's normal quarterly monitoring report.

Summary

3. The Fire and Rescue Authority's treasury management strategy was most recently updated and approved at a meeting of Hampshire & Isle of Wight Fire & Rescue Authority in February 2023. The Fire and 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 risk are therefore central to the Fire and Rescue Authority's treasury management strategy.

4. 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."

5. Overall responsibility for treasury management remains with the Fire and Rescue Authority. No treasury management activity is without risk and the effective identification and management of risk are therefore integral to the Fire and Rescue Authority's treasury management objectives.

6. All treasury activity has complied with the Fire and Rescue Authority's Treasury Management Strategy and Investment Strategy for 2023/24, and all relevant statute, guidance and accounting standards. In addition, support in undertaking treasury management activities has been provided by the Fire and Rescue Authority's treasury advisers, Arlingclose.

7. The Prudential Code includes the requirement to produce a Capital Strategy, a summary document to be approved covering capital expenditure and

financing, investments and treasury management. Government statutory guidance on local government investments also requires the production of an Investment Strategy. The Authority produces a combined Capital and Investment Strategy to meet these requirements, the most recent of which was approved by the Authority in February 2023.

External Context

8. The following sections outline the key economic themes in the UK against which investment and borrowing decisions have been made so far in 2023/24.

Economic commentary

9. From the start of the quarter until May it looked like peak global monetary policy rates were in sight as inflation continued to ease and central banks turned more dovish in tone. Only a few weeks later, stronger and more persistent inflation data, particularly in the UK, changed the picture. Central Bank rhetoric and actions remained consistent with combatting inflation. The Bank of England, US Federal Reserve, and European Central Bank all increased interest rates over the period, even in the face of potential economic slowdowns in those regions.

10. Inflation fell from its peak of 11.1% reached in October 2022, but annual headline CPI in May 2023 was higher than the consensus forecast at 8.7% (8.4% expected), largely driven by services inflation, while the annual measure of underlying core inflation rose to 7.1% from 6.8%.

11. After a sharp rise in interest rate expectations, with clearly serious implications for mortgage markets due to higher inflation and wage data, the Bank of England's Monetary Policy Committee reaccelerated monetary policy tightening over the period with a 0.25% rise in May to a 0.5% rise in June, taking the Bank Rate to 5.0%. At both meetings the vote was 7-2 in favour of increasing rates, with the two dissenters preferring to keep rates on hold.

12. Interest rate expectations priced in further hikes in policy rates. Arlingclose, the authority's treasury adviser, revised its forecast to include a further 0.5% of monetary tightening to take Bank Rate to 5.5%. The risks, however, are that rates could be higher; financial markets are forecasting policy interest rates above 6%.

13. With many mortgages at low fixed rates now systematically being re-set over the next 12-24 months at higher rates there has been a lagged effect of the feed through of monetary policy on households' disposable income. The economic slowdown is expected to develop over time and therefore, despite the GfK measure of consumer confidence improving to -24 in June 2023, it is likely confidence will be negatively affected at some point. The manufacturing sector contracted during the quarter according to survey data, which will

eventually feed into services, whose expansion is slowing.

Financial markets

14. Financial market sentiment and bond yields remained volatile, the latter continuing their general upward trend as uncertainty and concern over higher inflation and higher interest rates continued to dominate.

15. Gilt yields rose over the period. The 5-year UK benchmark gilt yield rose from 3.30% to 4.67%, the 10-year gilt yield from 3.43% to 4.39%, and the 20-year yield from 3.75% to 4.51%.

Credit review

16. Having completed a review of its credit advice on unsecured deposits at UK and non-UK banks following concerns of a wider financial crisis after the collapse of Silicon Valley Bank purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues, in March 2023 Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days. On the back of this, Arlingclose reduced its recommended maximum duration limit for unsecured deposits for all UK and Non-UK banks/institutions on its counterparty list to 35 days as a precautionary measure. No changes were made to the names on the list.

17. Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress but made no changes to the counterparty list or recommended durations over the quarter. Nevertheless, heightened market volatility is expected to remain a feature, at least in the near term and, as ever, the institutions and durations on the Authority's counterparty list recommended by Arlingclose remains under constant review.

Local Context

18. On 31 March 2023, the Fire & Rescue Authority had net investments of £28.4m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance sheet summary	31/03/23 Balance £m	31/03/24 Forecast £m
CFR	15.0	32.1
Less: External borrowing		
- Public Works Loan Board	(5.9)	(5.6)
Internal Borrowing	**9.1**	**26.5**
Less: Balance sheet resources	(37.5)	(21.7)
Net (Investments)/Borrowing	**(28.4)**	**4.8**

19. The treasury management position at 31 March 2023 and the change over the quarter is shown in Table 2 below.

Table 2: Treasury management summary	31/03/23 Balance £m	Movement £m	30/06/23 Balance £m	30/06/23 Rate %
Long-term borrowing	(5.6)	0.0	(5.6)	4.59
Short-term borrowing	(0.4)	0.0	(0.4)	5.88
Total borrowing	**(5.9)**	**0.0**	**(5.9)**	**4.66**
Long-term investments	7	0.0	7.0	4.73
Short-term investments	5.0	(1.9)	3.1	4.72
Cash and cash equivalents	16.5	(4.1)	12.3	4.69
Total investments	**28.5**	**(6.0)**	**22.5**	**4.71**
Net investments	**22.6**	**(6.0)**	**16.6**	

Note: the figures in Table 2 are from the balance sheet in the Fire and Rescue Authority's accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

20. The decrease in net investments of £6.0m shown in Table 2 can be attributed to a decrease in investment balances of £6.0m which reflects the Fire & Rescue Authority's normal pattern of activity, along with capital expenditure incurred in the first quarter of the year. No repayment of borrowing has been made in the first three months of 2023/24.

Borrowing Update

21. The Fire and Rescue Authority has no plans to borrow to invest primarily for commercial return and so is unaffected by the changes to the Prudential Code.

22. The Fire and Rescue Authority is not planning to purchase any investment assets primarily for yield, so is able to retain full access to the PWLB.

23. It is expected that during 2023/24 the CFR will rise as the Authority delivers the estates elements of its capital programme. Balance sheet resources are anticipated to drop which is expected to result in a positive liability benchmark as at 31 March 2024, which generally means an authority is required to take external borrowing to fund the gap between its resources and the CFR. Although the Fire and Rescue Authority currently holds external borrowing from its historic capital programme, this is not predicted to be sufficient to meet the CFR and therefore as a result further borrowing will be considered by the Chief Financial Officer for the delivery of the approved capital programme, if required.

24. Borrowing Strategy

25. At 30 June 2023 the Fire and Rescue Authority held £5.9m of loans as part of its strategy for funding previous years' capital programmes, representing no change since 31 March 2023. Outstanding loans are summarised in Table 3 below.

Table 3: Borrowing position	**31/03/23 Balance £m**	**Net movement £m**	**30/06/23 Balance £m**	**31/03/23 Weighted average rate %**	**31/03/23 Weighted average maturity (years)**
Public Works Loan Board	(5.9)	0.0	(5.9)	4.66	9.7
Total borrowing	**(5.9)**	**0.0**	**(5.9)**	**4.66**	**9.7**

Note: the figures Table 3 are from the balance sheet in the Fire and Rescue Authority's accounts but adjusted to exclude accrued interest.

26. The Fire and Rescue 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. The flexibility to renegotiate loans should the Fire and Rescue Authority's long-term plans change is a secondary objective.

27. The cost of carry (the difference between the interest paid on long-term borrowing versus short-term investments) continues to make taking out new long-term borrowing in advance of need not cost effective. The Authority has therefore considered it to be more advantageous in the near term to use internal resources than to use additional borrowing.

Treasury Investment Activity

28. CIPFA published a revised Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes on 20 December 2021. These define treasury management investments as investments that arise from the organisation's cash flows or treasury risk management activity that

ultimately represents balances that need to be invested until the cash is required for use in the course of business.

29. The Fire and Rescue Authority holds invested funds representing income received in advance of expenditure plus balances and reserves held. During the year, the Fire and Rescue Authority's investment balances have ranged between £18.6m and £30.8m due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Treasury investment position	**31/03/2022 balance £m**	**Net movement £m**	**31/03/2023 balance £m**	**31/03/23 Income return %**	**31/03/23 Weighted average maturity (years)**
Short term investments:					
Banks and Building Societies:					
- Unsecured	2.0	(0.3)	1.6	4.18	0.00
- Secured	1.0	0.1	1.1	5.13	0.54
Money Market Funds	15.1	(4.3)	10.7	4.77	0.00
Government:					
- Treasury Bill	3.5	(1.5)	2.0	4.51	0.23
Total	**21.5**	**-6.0**	**15.5**	**4.70**	**0.07**
Long term investments – higher yielding strategy:					
Pooled Funds					
- Pooled property*	3.3	0.0	3.3	3.50	N/A
- Pooled equity*	2.0	0.0	2.0	6.24	N/A
- Pooled multi-asset*	1.8	0.0	1.8	5.29	N/A
Total	**7.0**	**0.0**	**7.0**	**4.73**	N/A
Total investments	**28.5**	**(6.0)**	**22.5**	**4.71**	**0.05**

* The rates provided for pooled fund investments are reflective of annualised income returns over the year to 30 June 2023 based on the market value of investments at the start of the year.

Note: the figures in Table 4 are from the balance sheet in the Fire and Rescue Authority's accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

30. The CIPFA Code and government guidance both require the Fire and Rescue 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 Fire and Rescue Authority's objective when investing money is therefore to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults alongside managing the risk of

receiving unsuitably low investment income. The Fire and Rescue Authority's Treasury Management Strategy Statement (TMSS) sets out how it will manage and mitigate these risks.

31. As demonstrated by the liability benchmark in this report, the Fire & Rescue Authority expects to be a long-term borrower and new treasury investments are therefore primarily made to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds has been reviewed in Q2 of 2023/24 with advice from Arlingclose. £3.75m was disinvested from the funds to utilise more favourable rates of return on shorter dated investments and increase liquidity ahead of capital expenditure outflows in the near future.

32. The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment benchmarking (excluding pooled funds)	**Credit rating**	**Bail-in exposure**	**Weighted average maturity**	**Rate of return**
		%	**(days)**	**%**
31.03.2023	AA-	79%	15	4.04%
30.06.2023	AA-	80%	26	4.72%
Police & Fire Authorities	A+	84%	35	4.21%
All Las	A+	63%	11	4.44%

33. Table 5 shows the average credit rating of the portfolio has remained consistent at AA-. Bail-in exposure has risen in comparison to the end of March 2023, however this does not reflect that a significant proportion of liquid balances are invested in money market funds, which are technically exposed to bail-in risk however these are diversified products and are considered by Arlingclose to be 'bail-in risk light'. The Fire and Rescue Authority compared favourably with all other police and fire authorities included in the benchmarking exercise when looking at credit rating and rate of return.

Externally managed pooled funds

34. In order to minimise the risk of receiving unsuitably low investment income, the Fire and Rescue Authority has continued to invest a proportion of steady core balances in externally managed pooled funds as part of its higher yielding strategy.

35. Financial market conditions were volatile during the quarter, but favourable in some areas. Resilient economic data, which led to diminishing talk of recessions at a time when interest rate peaks are thought to be near, initially

helped UK, euro-area and US equity markets. However, UK equities fell in May (sterling's strength weighed on some sectors) and ended the quarter marginally lower. Eurozone equities were slightly higher but did not match the larger global rally in US equities (helped by a soft-landing scenario for the economy and enthusiasm over AI) and Japanese equities.

36. UK property markets continued to struggle as higher interest rates and bond yields and higher funding costs weighed on the sector. There was some improvement in May, building on signs of returning investor interest and transactional activity in calendar Q1 and a perception that the downturn in commercial real estate may be bottoming out. This has helped support capital values and rental income. The additional move upwards in yields in late May/June and the prospect of sluggish economic growth however constrained the outlook.

37. The combination of the above had a marginal negative effect on the combined value of the Fire & Rescue Authority's pooled funds since March 2023. Income returns remained broadly consistent, but capital values have decreased particularly in the pooled property and multi-asset funds held by the Fire & Rescue Authority.

38. Because these 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 medium-to long-term investment objectives are regularly reviewed.

39. This report covers the period to the end of June 2023, however given the timescales for reporting to the Authority, it is worth noting that in August 2023 the Authority divested £3.75m of the £7m invested in pooled fund investments. After taking advice from Arlingclose, the Chief Financial Officer determined it to be prudent to reduce exposure to pooled fund investments, taking the decision in accordance with the delegated authority granted by the Authority as part of the Treasury Management Strategy.

40. The decision to sell the investments was linked to the anticipated ongoing reduction in balances over time as a result of the approved capital programme and other planned expenditure from reserves. The redemptions resulted in a small loss on the principal sum invested of £18,532 (or less than 0.5% of the £3.75m invested) however the Authority has received approximately £1m in dividends from these pooled funds since purchase, giving a total return of c.25% over an average holding period of between 5 and 6 years.

41. The Chief Financial Officer will continue to seek the advice of Arlingclose on the ongoing suitability of the remaining pooled fund investment balance of £3.25m.

42. In April 2023 the Department for Levelling Up, Housing and Communities published the full outcome of the consultation on the extension of the statutory override on accounting for gains and losses on pooled investment funds through the in-year revenue account. The override has been extended for 2 years until 31 March 2025 but no other changes have been made; whether the override will be extended beyond the new date is unknown but commentary to the consultation outcome suggests not. The Fire & Rescue Authority will discuss with Arlingclose the implications for the investment strategy and what action may need to be taken.

43. The Authority's Capital and Investment Risk Reserve, created during 2022/23, is in place to mitigate inflationary and interest rate risks to the capital programme and risks related to investments held by the Authority, including those related to pooled funds and the IFRS 9 statutory override.

Non-Treasury Investments

44. The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Fire and Rescue Authority as well as other non-financial assets which the Fire and Rescue Authority holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) and or for commercial purposes (made primarily for financial return).

45. Investment Guidance issued by the Department for Levelling Up Housing and Communities (DLUHC) and Welsh Government also broadens the definition of investments to include all such assets held partially or wholly for financial return.

46. This could include the direct purchase of land or property and any such loans and investments will be subject to the Fire and Rescue Authority's normal approval processes for revenue and capital expenditure and need not comply with the treasury management strategy. The Fire and Rescue Authority has two properties classified as investment properties on its Balance Sheet, relating to the use of parts of existing sites that were deemed surplus to requirements to provide accommodation to partner organisations and bringing in rental income to the Authority.

Compliance Report

47. The Fire and Rescue Authority confirms compliance of all treasury management activities undertaken during the quarter with the CIPFA Code of Practice and the County Council's approved Treasury Management Strategy.

48. Compliance with specific investment limits is demonstrated in Table 6 below.

Table 6 – Investment limits	**2023/24 Maximum £m**	**30/06/23 Actual £m**	**2023/24 Authorised Limit**	**Complied**
The UK Government	3.5	2.0	n/a	✓
Local authorities & other government entities	0.0	0.0	Unlimited	✓
Secured investments	2.1	1.1	Unlimited	✓
Banks (unsecured)	3.1	1.6	Unlimited	✓
Building societies (unsecured)	0.0	0.0	£6m	✓
Registered providers	0.0	0.0	£6m	✓
Money market funds	19.3	10.7	Unlimited	✓
Strategic pooled funds	7.0	7.0	£24m	✓
Real estate investment trusts	0.0	0.0	£6m	✓
Other investments	0.0	0.0	£6m	✓

49. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 7.

Table 7 – Debt limits	**Q1 2023/24 Maximum £m**	**30/06/23 Actual £m**	**2023/24 Operational Boundary £m £m**	**2023/24 Authorised Limit £m**	**Complied**
Total debt	6.3	6.3	45.8	51.0	✓

50. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure. However this limit was not breached during the financial year to date.

Treasury Management Indicators

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

Liability benchmark

52. This new indicator compares the Authority's actual existing borrowing against a liability benchmark that has been calculated to show the lowest risk level of borrowing. The liability benchmark is an important tool to help establish whether the 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. It represents an estimate of the cumulative amount of external borrowing the Council 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 8: Liability benchmark	**31/03/2023 Actual £m**	**31/03/2024 Forecast £m**	**31/03/2025 Forecast £m**	**31/03/2026 Forecast £m**
Loans CFR	15.0	32.1	38.8	44.4
Less: Balance sheet resources	(37.5)	(21.7)	(15.2)	(13.7)
Net loans requirement	**(22.5)**	**10.4**	**23.6**	**30.7**
Plus: Liquidity allowance	10.0	10.0	10.0	10.0
Liability benchmark	**(12.5)**	**20.4**	**33.6**	**40.7**
Existing borrowing	**5.9**	**5.6**	**5.2**	**5.2**
New borrowing given liability benchmark	**0.0**	**14.8**	**28.4**	**35.5**

53. The **Loans CFR** (Capital Financing Requirement) is the cumulative outstanding amount of debt financed from borrowing (it excludes leases). The Authority has approved up to £37.45m of prudential borrowing to support the existing capital programme and the CFR therefore increases over the forecast period in line with the capital programme plans.

54. The amount of external borrowing required can be lower than the CFR as the Authority has resources on its Balance Sheet (usable reserves and working capital). The **Net Loans Requirement** represents the level of external borrowing required if the Authority first uses all its Balance Sheet resources to cover the CFR.

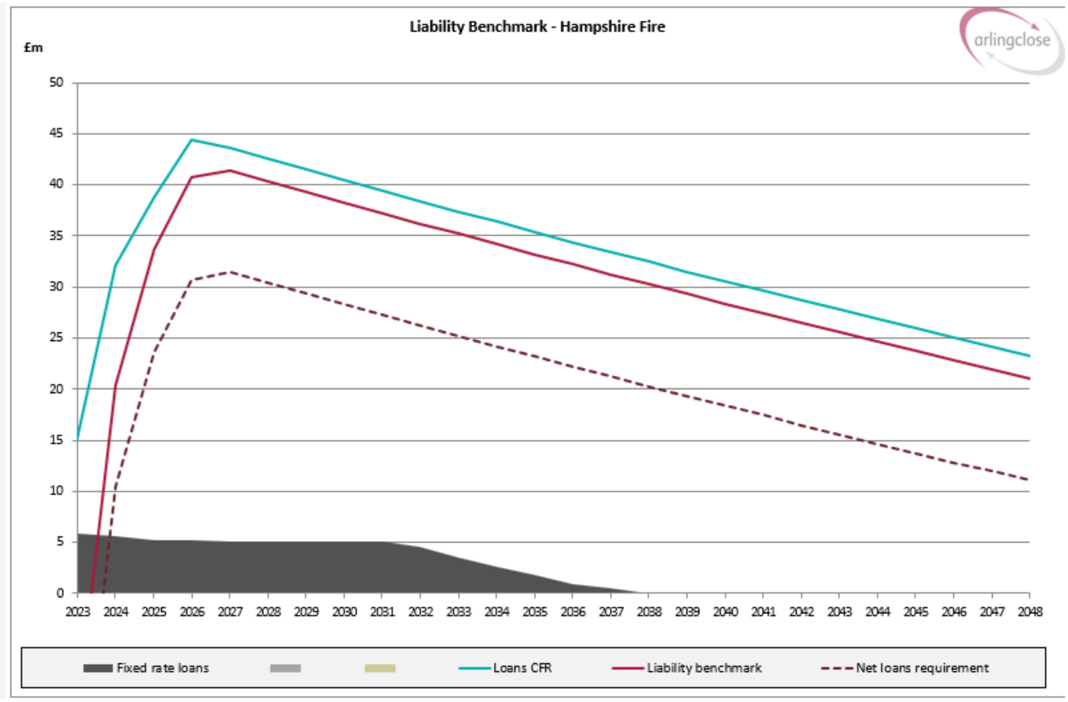
55. Differences in timing between income and expenditure mean the Authority cannot use up all of its Balance Sheet resources as it needs to keep a balance for day to day liquidity to ensure it can meet its financial obligations. The **Liability Benchmark** is therefore the amount of borrowing that means the Authority can meet its net loans requirement plus hold an appropriate amount of liquidity.

56. As set out in the Reserves Strategy and the February 2023 revenue budget and capital programme, the Authority expects to reduce its reserves balance

over the coming years. Reserves held to smooth the expenditure on IT and equipment (which involves large but infrequent spend) and the Capital Payments Reserve (supporting expenditure on the estate and vehicle purchases) are all expected to reduce over time.

57. As would be expected, reducing reserves balances plus planned expenditure funded from prudential borrowing means the Authority will not have the Balance Sheet resources to internally borrow (as has been the strategy in recent years) and instead will need to commit to new external borrowing.

58. This is shown in the Liability Benchmark chart below, which shows a sharp increase in the CFR as expenditure funded from borrowing occurs, with the Liability Benchmark increasing similarly based on expected reductions in Balance Sheet resources. Minimum Revenue Provision (MRP) payments mean the CFR reduces over time and the liability benchmark also falls as borrowing is assumed to be repaid (the liability benchmark should never be above the CFR if the Authority is to meet the requirements of the Prudential Code only to borrow for capital purposes except in the short term).



59. The need to take out new external borrowing will be considered by the Chief Financial Officer to ensure borrowing is undertaken at the most appropriate time.

Maturity structure of borrowing

60. This indicator is set to control the Fire and Rescue Authority's exposure to refinancing risk. The upper and lower limits show the maximum and minimum

maturity exposure to fixed rate borrowing as agreed in the Treasury Management Strategy Statement:

Table 9 – Refinancing rate risk indicator	**30/06/23 Actual**	**Upper Limit**	**Lower Limit**	**Complied**
Under 12 months	6%	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	27%	75%	0%	✓
10 years and within 20 years	59%	75%	0%	✓
20 years and above	0%	100%	0%	✓

Principal sums invested for periods longer than a year

61. The purpose of this indicator is to control the Fire and 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 were:

Table 10 – Price risk indicator	**2022/23**	**2023/24**	**2024/25**
Principal invested beyond year end	£7m	£3m	£3m
Limit on principal invested beyond year end	£12m	£12m	£12m
Complied?	✓	✓	✓

62. The table includes investments in strategic pooled funds of £7m at 30 June 2023 as although these can usually be redeemed at short notice, the Fire and Rescue Authority intends to hold these investments for at least the medium-term.