Treasury Management Mid-Year Monitoring Report 2020/21

1. Purpose

1.1. Hampshire Fire and Rescue Authority has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code), last updated in 2017. The CIPFA Code requires the Fire and Rescue Authority to approve a treasury management strategy before the start of the year and a semi-annual and annual treasury outturn report.

2. Summary

2.1. This report fulfils the Fire and Rescue Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code and provides an update on the performance of the treasury management function during 2020/21.

2.2. The Fire and Rescue Authority's treasury management strategy was most recently updated and approved at a meeting of the Fire and Rescue Authority in February 2020. 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.

2.3. 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."

2.4. 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 integral to the Fire and Rescue Authority's treasury management objectives.

2.5. All treasury activity has complied with the Fire and Rescue Authority's Treasury Management Strategy and Investment Strategy for 2020/21, 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.

2.6. The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, which is a summary document approved by full council covering capital expenditure and financing, treasury management and non-treasury investments. Hampshire Fire and Rescue Authority's Capital and Investment Strategy, complying with CIPFA's requirement, was approved by the Fire and Rescue Authority on 19 February 2020.

3. Recommendation

3.1. That the mid-year review of treasury management activities be noted.

4. External Context

4.1. The following sections outline the key economic themes against which investment and borrowing decisions have been made so far in 2020/21.

Economic Commentary

4.2. Coronavirus dominated the news during the period as countries around the world tried to manage the delicate balancing act of containing transmission of the virus whilst also supporting their economies. A national lockdown in the UK was followed by the gradual easing of restrictions and the introduction of various support packages, including the job retention scheme and the Eat Out to Help Out (EOHO) offer.

4.3. The Bank of England's (BoE) Monetary Policy Committee maintained Bank Rate at 0.1% throughout the period and increased its Quantitative Easing programme to £745 billion. It has also not ruled out the use of negative interest rates in future, which has had an impact on interest rates available in the money markets.

4.4. Gross Domestic Product (GDP) contracted by 19.8% in Quarter 2 according to the Office for National Statistics (ONS), pushing the annual growth rate down to -21.5%. Recent monthly estimates of GDP have shown growth recovering although output is still significantly below pre-coronavirus levels. A potential second wave of the virus and the impending end of the transition period for the UK's exit from the EU may have a further impact on GDP and the economy over the remainder of the year.

4.5. The headline rate of UK Consumer Price Inflation (CPI) fell to 0.2% year on year in August, significantly below the BoE's 2% target. Inflation was slightly higher at 0.5% year on year using the CPIH measure, which is preferred by the ONS and includes owner-occupied housing.

4.6. In the three months to July, the unemployment rate increased from 3.9% to 4.1% while wages fell in both real and nominal terms. The unemployment rate may pick up sharply in the coming months as the furlough scheme ends and the BoE has forecast unemployment could hit a peak of between 8% and 9%.

Financial Markets

4.7. After selling off sharply in March 2020, world equity markets started recovering in April and have continued to regain value during Quarters 2 and 3. Not all sectors and geographies have rebounded to the same extent and the recovery has largely been driven by a small number of US technology stocks, while in the UK the FTSE 100 and 250 have only made up around half of their pre-crisis losses. Central bank and government stimulus packages continue to support asset prices, but volatility and uncertainty remain.

4.8. Ultra-low interest rates and the flight to quality continued during the period, with the yield on some shorted-dated UK government bonds turning negative and yields on longer-dated bonds remaining low.

Credit Review

4.9. After rising sharply in late March, credit default swap (CDS) spreads slowly eased over Quarters 2 and 3 to slightly above their pre-crisis levels suggesting a relatively high level of confidence in UK banks. That being said, Fitch downgraded the UK sovereign credit rating to AA- in March, which was followed by revising the outlook for all UK banks approved for use by the Fire and Rescue Authority by Arlingclose either to negative or rating watch negative, although the long term rating for HSBC was increased. Fitch and S&P also downgraded the long-term rating for Transport for London.

4.10. The extent of the losses that banks and building societies will suffer as a result of the coronavirus pandemic remains uncertain but is expected to be substantial. Arlingclose have therefore conducted a stress testing exercise and consequently a number of UK banks and building societies were suspended from the counterparty list for unsecured deposits in June 2020. Arlingclose also continue to recommend a maximum duration of 35 days for investments with the remaining counterparties. Although far better capitalised than during the Great Financial Crisis there remains significant uncertainty about the impact of the pandemic and with the added unknown of what the final Brexit trade deal may look like. Arlingclose are therefore recommending a prudent approach and the institutions on Arlingclose's counterparty list remain under constant review.

5. Local Context

5.1. On 31 March 2020, the Fire and Rescue Authority had net investments of £14.4m. 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

	31/03/2020 Balance £m
CFR	10.8
Less: External borrowing	
- Public Works Loan Board	(8.3)
Internal borrowing	**2.5**
Less: Working capital liability	4.4
Less: Usable reserves	(31.3)
Net investments	**(24.4)**

5.2. The Fire and Rescue Authority's current strategy is to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, to reduce risk and keep interest costs low. The treasury management position as at 30 September 2020 and the movement since 31 March 2020 are shown in Table 2.

Table 2: Treasury Management Summary

	31/03/2020 Balance £m	Movement £m	30/09/2020 Balance £m	30/09/2020 Rate %
Long-term borrowing	(7.1)	-	(7.1)	4.7
Short-term borrowing	(1.2)	-	(1.2)	4.9
Total borrowing	(8.3)	-	(8.3)	4.7
Long-term investments	9.0	(1.0)	8.0	3.8
Short-term investments	4.0	8.0	12.0	0.3
Cash and cash equivalents	12.5	3.0	15.5	0.1
Total investments	25.5	10.0	35.5	1.0
Net investments	17.2	10.0	27.2	

Note: the figures in Table 2 at 31 March 2020 are from the balance sheet in the Fire and Rescue Authority's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments such as fair value gains/losses on pooled funds.

5.3. The increase in net investments of £10.0m shown in Table 2 reflects the combination of no change in borrowing, as well as an increase in investment balances of £10.0m. The increase in total investments since 31 March 2020 reflects the fact that the balance at 31 March is typically the lowest of the year, due to many government grants being front-loaded. The largest grant is the annual pensions grant, which is received every July and is used to pay pensions throughout the year.

5.4. Reference is made above to the fact that the financial markets are seeing negative interest rates on short dated UK government bonds. Whilst our investment strategy has been adjusted to ensure that we invest in longer term products in order to secure a positive return, the security of capital remains the number one priority.

5.5. In certain circumstances therefore it may be necessary to invest surplus cash in a negative interest rate produce if the risk to capital is considered to be of greater concern within what is available in the market. Given the short term nature of the investments and the very small negative return this is not expected to impact on overall investment returns for the year.

6. Borrowing Activity

6.1. As shown in Table 2, at 30 September 2020 the Fire and Rescue Authority held £8.3m of loans, as part of its strategy for funding previous years' capital programmes. The mid-year treasury management borrowing position and movement since 31 March 2020 are shown in Table 3.

Table 3: Borrowing Position

	31/03/2020 Balance £m	Movement £m	30/09/2020 Balance £m	30/09/2020 Rate %	30/09/2020 WAM* years
Public Works Loan Board	(8.3)	-	(8.3)	4.7	9.3
Total borrowing	(8.3)	-	(8.3)	4.7	9.3

* Weighted average maturity

Note: the figures in the Table 3 at 31 March 2020 are from the balance sheet in the Fire and Rescue Authority's statement of accounts but adjusted to exclude borrowing taken out on behalf of others and accrued interest.

6.2. 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, with flexibility to renegotiate loans should the Fire and Rescue Authority's long-term plans change being a secondary objective.

6.3. Short-term interest rates have remained much lower than long-term rates and the Fire and Rescue Authority has therefore considered it to be more cost effective in the near term to use internal resources than to use additional borrowing.

6.4. With the assistance of Arlingclose, the benefits of this internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing costs may be higher.

6.5. In keeping with these objectives, no new borrowing was undertaken in the period. This strategy enabled the Fire and Rescue Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

7. Investment Activity

7.1. The Fire and Rescue Authority holds invested funds representing income received in advance of expenditure plus balances and reserves. The Fire and Rescue Authority's investment holding was £35.5m at 30 September 2020, which was £1.5m (4%) higher than the same time last year.

7.2. During the six month period from 1 April to 30 September 2020, the Fire and Rescue Authority's investment balance ranged between £19.5m and £38.5m due to timing differences between income and expenditure.

7.3. Table 4 shows investment activity for the Fire and Rescue Authority as at 30 September 2020 in comparison to the reported activity as at 31 March 2020.

7.4. The increase in total investments since 31 March 2020 reflects the fact that the balance at 31 March is typically the lowest of the year, due to many government grants being front-loaded. The largest grant is the annual pensions grant, which is received every July and used to pay pensions throughout the year.

Table 4: Investment Position (Treasury Investments)

Investments	31/03/2020 Balance £m	Movement £m	30/09/2020 Balance £m	30/09/2020 Rate %	30/09/2020 WAM* years
Short term investments					
- Banks and Building Societies					
- Unsecured	3.0	0.2	3.2	0.1	0.0
- Secured	1.0	(1.0)	-	N/A	N/A
- Money Market Funds	9.5	5.3	14.8	0.1	0.0
- Local Authorities	3.0	6.5	9.5	0.4	0.6
	16.5	11.0	27.5	0.2	0.2
Long term investments					
- Banks and Building Societies					
- Secured	1.0	-	1.0	0.7	2.5
- Local Authorities	1.0	(1.0)	-	N/A	N/A
	2.0	(1.0)	1.0	0.7	2.5
Long term investments – higher yielding strategy					
- Pooled Property Funds**	3.3	-	3.3	4.0	N/A
- Pooled Equity Funds**	2.0	-	2.0	4.6	N/A
- Pooled Multi-Asset Funds**	1.7	-	1.7	4.1	N/A
	7.0	-	7.0	4.2	N/A
TOTAL INVESTMENTS	25.5	10.0	35.5	1.00	0.3

*The weighted average maturity (WAM) figures exclude pooled funds which have no fixed end date.

** The rates provided for pooled fund investments are reflective of annualised income returns over the year to 30 September 2020.

Note: the figures in Table 4 at 31 March 2020 are from the balance sheet in the Fire and Rescue Authority's statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments such as fair value gains/losses for pooled funds.

7.5. 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 and the risk of receiving unsuitably low investment income.

7.6. Security of capital has remained the Fire and Rescue Authority's main investment objective and has been maintained by following the Fire and Rescue's counterparty policy as set out in its Treasury Management Strategy Statement.

7.7. Counterparty credit quality has been assessed and monitored with reference to credit ratings, the analysis of funding structures and susceptibility to bail-in of financial institutions, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

7.8. The Fire and Rescue Authority also makes use of secured investment products that provide collateral in the event that the counterparty cannot meet its obligations for repayment, and invests in secured bank bonds and with other local authorities and the UK government to minimise bail-in risk.

7.9. Over the six month period, the Fire and Rescue Authorities investments have continued to feel the effects of the Coronavirus pandemic. This has resulted in falling money market rates, fewer suitable counterparties, and a reduction in advised investment durations.

7.10. To reduce credit and liquidity risk, liquid cash has been invested across multiple counterparties, including bank call accounts, Money Market Funds (MMFs) and the UK government's Debt Management Office Deposit Facility (DMADF).

7.11. The DMADF provides a high degree of security as the Fire and Rescue Authority is lending to the UK government. However, on 25 September the overnight, 1- and 2-week deposit rates on DMADF deposits dropped below zero percent to -0.03%. The Fire and Rescue Authority has not to date used the DMADF at negative rates and has therefore maintained a positive net return.

7.12. The return on MMFs net of fees also fell over the six month period and for many funds net returns now range between 0% and 0.1%, with fund management companies in several instances temporarily lowering or waiving fees to maintain a positive net return.

7.13. Against this backdrop, the Fire and Rescue Authority has sought to optimise returns commensurate with the objectives of security and liquidity, achieving an average rate of return of 0.18% on internally managed funds as at 30 September 2020 whilst also maintaining sufficient liquidity through the use of call accounts, the DMADF and money market funds.

7.14. The progression of credit risk and return metrics for the Fire and Rescue Authority's investments managed in-house (excluding external pooled funds) are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5. This compares the data for the quarter ended 30 September 2020 with data for the quarter ended 31 March 2020.

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

	Credit Rating	Bail-in Exposure	WAM* (days)	Rate of Return**
31/03/2020	AA-	68%	99	0.61%
30/09/2020	AA-	63%	102	0.18%
Police & Fire Authorities	AA-	57%	44	0.11%
All LAs	AA-	64%	18	0.27%

* Weighted average maturity

** based on investments held at end of quarter

7.15. During the six-month period from 31 March to 30 September 2020, the impact of the two Bank Rate cuts in March was felt across the money markets. This resulted in the investment return on internally managed investments in the portfolio reducing, although these returns were greater than the average of Arlingclose's other Police and Fire Authority clients.

7.16. The proportion of investments subject to bail-in risk was lower at 30 September than at the end of the last financial year, which was largely due to investing part of the annual pension grant that was received in July in a number of short term investments with local authorities. Where the Fire and Rescue Authority is exposed to bail-in risk, it is largely through investments in MMFs, which invest in instruments that are highly diversified therefore reducing bail-in risk.

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

7.18. Pooled fund investments are likely to be more volatile than cash in the short-term but generate regular revenue income whilst also providing diversification and the potential for enhanced returns over the longer term. By holding these investments for the longer term, the Fire and Rescue Authority is able to ride out periods of volatility that result in falls in value and manage the security of its original investment. Investing only steady core balances also means the Fire and Rescue Authority should not ever need to be a forced seller for liquidity reasons.

7.19. The Fire and Rescue Authority's investments in pooled property, equity and multi-asset funds allow diversification into asset classes other than cash without the need to own and manage the underlying investments, with £7m now invested.

7.20. These investments have no defined maturity date but are available for withdrawal after a notice period and their performance and continued suitability in meeting the Fire and Rescue Authority's investment objectives is monitored regularly and discussed with Arlingclose.

7.21. The impact of the COVID-19 pandemic on financial markets at the end of the financial year meant that the Fire and Rescue Authority's investments in these pooled funds suffered a £1.1m fall in capital value (15.2%) over the year to 31 March 2020, however such losses are only realised if the assets are sold before they have the chance to regain value, which the Fire and Rescue Authority does not plan to do.

7.22. Since March there has been improvement in market sentiment in equity and bond markets, which is reflected in increases in capital values of the multi-asset income fund and one (of two) equity income funds in the Fire and Rescue Authority's portfolio. Property prices have continued to fall, which has cancelled out the increase in the value of the other pooled funds, which is summarised in Table 6.

Table 6: Pooled Fund Capital Values

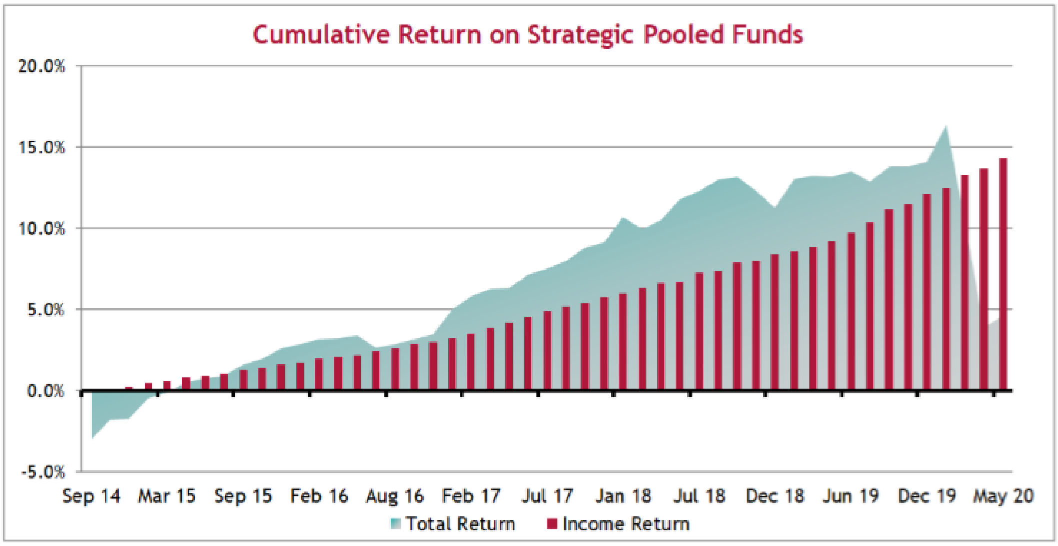
	Principal Invested £m	31/03/2020 Capital Value £m	Movement £m	30/09/2020 Capital Value £m
Pooled Property	3.3	3.21	(0.13)	3.08
Pooled Equity	2.0	1.67	0.00	1.67
Pooled Multi-Asset	1.7	1.45	0.13	1.58
Total	7.0	6.33	0.00	6.33

7.23. Dealing in the CCLA Local Authorities Property Fund was suspended by the fund in March 2020. The relative infrequency of property transactions as the pandemic intensified meant that it was not possible for valuers to be confident that their valuations correctly reflected prevailing conditions. To avoid material risk of disadvantage to buyers, sellers, and holders of units in the property fund, the management company was obliged to suspend transactions until the required level of certainty was re-established. The dealing suspension was lifted in September 2020. There has also been a change to redemption terms for this property fund; from September 2020 investors are now required to give at least 90 calendar days' notice for redemptions.

7.24. In 2020/21, the Fire and Rescue Authority expects to receive significantly lower income from both its internally managed cash and its higher yielding portfolio than it did in previous years and it should be noted that the average return in Table 4 is likely to fall further over the course of the financial year. Dividends and income paid will depend on many factors including the ongoing impact of the pandemic and the individual strategies of each pooled fund, such as their sectoral allocations and investment decisions. Equity income funds will also be affected by enforced or voluntary dividend cuts and deferrals.

7.25. Given the impact on capital values and income described above the investments in pooled funds have been reviewed with Arlingclose, whose advice remains that these investments continue to be appropriate for the Fire and Rescue Authority. Capital values should recover over time and in the meantime these investments will continue to generate income returns significantly in excess of what could be achieved on traditional cash investments, to benefit the revenue budget

7.26. The chart below shows the positive impact of regular income returns from these pooled funds over time and the ongoing suitability of the Fire and Rescue Authority's approach to pooled fund investments will continue to be reviewed regularly with Arlingclose.



8. Non-Treasury Investments

8.1. Although not classed as treasury management activities the Fire and Rescue Authority 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 Fire and Rescue Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy. The Fire and Rescue Authority does not have any existing non-treasury investments.

9. Compliance Report

9.1. The Fire and Rescue Authority confirms compliance of all treasury management activities undertaken during the period with the CIPFA Code of Practice and the Fire and Rescue Authority's approved Treasury Management Strategy. Compliance with the authorised limit and operational boundary for external debt is demonstrated in Tables 7.

Table 7: Debt Limits

	2020/21 Maximum £m	30/09/20 Actual £m	2020/21 Operational Boundary £m	2020/21 Authorised Limit £m	Complied
Borrowing	(8.3)	(8.3)	(13.2)	(15.9)	✓
Other long term liabilities	-	-	(5.0)	(5.0)	✓
Total debt	(8.3)	(8.3)	(18.2)	(20.9)	✓

10. Treasury Management Indicators

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

Interest Rate Exposures

10.2. The following indicator shows the sensitivity of the Fire and Rescue Authority’s current investments and borrowing to a change in interest rates:

Table 8: Interest Rate Exposures

	30/09/20 Actual	Impact of +/-1% interest rate change
Sums subject to variable interest rates:		
Investment	£26.8m	+/- £0.3m
Borrowing	£0.0m	n/a

10.3. 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

10.4. 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 structure of fixed rate borrowing as agreed in the Treasury Management Strategy Statement.

Table 9 – Refinancing Rate Risk Indicator

	30/09/20 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	14%	50%	0%	✓
12 months and within 24 months	5%	50%	0%	✓
24 months and within 5 years	18%	50%	0%	✓
5 years and within 10 years	1%	75%	0%	✓
10 years and within 20 years	62%	75%	0%	✓
20 years and above	0%	100%	0%	✓

Principal Sums Invested for Periods Longer than a year

10.5. 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 total principal sum invested to final maturities beyond the period end will be:

Table 10 – Price Risk Indicator

	2020/21	2021/22	2022/23
Actual principal invested beyond year end	£8m	£8m	£7m
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied	✓	✓	✓

10.6. The table includes investments in strategic pooled funds of £7m 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.

11. Other

11.1. IFRS 16: The implementation of the new IFRS 16 Leases accounting standard has been delayed until 2021/22.

12. Arlingclose's outlook for the remainder of 2020/21

12.1. The medium-term global economic outlook is weak. While the strict initial lockdown restrictions have eased, the coronavirus has not been supressed and second waves have prompted more restrictive measures on a regional and national basis. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

12.2. The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise. This has supported a sizeable economic recovery in Quarter 3.

12.3. However, the scale of the economic shock to demand, on-going social distancing measures, regional lock downs and reduced fiscal support will mean that the subsequent pace of recovery is limited. Early signs of this are already evident in UK monthly GDP and PMI data, even before the latest restrictions.

12.4. This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets have already priced in a chance of a negative Bank Rate.

12.5. Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or if the UK leaves the EU without a deal.

12.6. Arlingclose expects Bank Rate to remain at the current 0.10% level and additional monetary loosening in the future most likely through further financial asset purchases (QE). While Arlingclose's central case for Bank Rate is no change from the current level of 0.1%, further cuts to Bank Rate to zero or even into negative territory cannot be completely ruled out.

12.7. Gilt yields are expected to remain very low in the medium term. Shorter-term gilt yields are currently negative and will remain around zero or below until either the Bank of England expressly rules out negative Bank Rate or growth/inflation prospects improve.

12.8. Downside risks remain in the near term, as the government dials down its fiscal support measures, reacts to the risk of a further escalation in infection rates and the Brexit transition period comes to an end.

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50