Appendix D - Annual Treasury Outturn Report 2022/23

Purpose of the Report

1. Hampshire and Isle of Wight 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 2021. 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. The purpose of this report is therefore to meet this obligation by providing an update on the performance of the treasury management function during 2022/23.

Summary

2. 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 2022/23.

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. This annual report sets out the performance of the treasury management function during 2022/23, to include the effects of the decisions taken and the transactions executed in the past year.

6. 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.

7. All treasury activity has complied with the Fire and Rescue Authority's Treasury Management Strategy and Investment Strategy for 2022/23, 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.

8. The Prudential Code includes the requirement to produce a Capital and Investment Strategy, a summary document to be approved covering capital expenditure and financing, treasury management and non-treasury investments. The most recent Capital and Investment Strategy, complying with CIPFA's requirement, was approved by the Fire and Rescue Authority in February 2023.

External Context

9. The following sections outline the key economic themes in the UK against which investment and borrowing decisions were made in 2022/23.

Economic commentary

10. The war in Ukraine continued to keep global inflation above central bank targets and the UK economic outlook remained relatively weak with the chance of a mild recession. The economic backdrop during the January to March 2023 period continued to be characterised by high energy and commodity prices, high inflation, and the associated impact on household budgets and spending.

11. 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.

12. Starting the financial year at 5.5%, the annual CPI measure of UK inflation rose strongly to hit 10.1% in July and then 11.1% in October 2022. Inflation remained high in subsequent months but appeared to be past the peak, before unexpectedly rising again in February 2023. Annual headline CPI registered 10.4% in February, up from 10.1% in January 2023, with the largest upward contributions coming from food and housing. RPI followed a similar pattern during the year, hitting 14.2% in October 2022. In February 2023 RPI measured 13.8%, up from 13.4% in the previous month.

13. Following the decision by the UK government under Rishi Sunak and Jeremy Hunt to reverse some of the support to household energy bills announced under Liz Truss, further support in the form of a cap on what energy suppliers could charge household was announced in the March Budget to run from April

until end June 2023. Before the announcement, typical household bills had been due to rise to £3,000 a year from April 2023.

14. The labour market remained tight albeit with some ongoing evidence of potential loosening at the end of the period. The unemployment rate 3mth/year eased from 3.8% April-June to 3.6% in the following quarter, before picking up again to 3.7% between October-December 2022. The most recent information for the period December-February 2023 showed an unemployment rate of 3.7%.

15. The Bank of England increased the official Bank Rate to 4.25% during the financial year. From 0.75% in March 2022, the Monetary Policy Committee (MPC) pushed through rises at every subsequent meeting over the period, with recent hikes of 50bps in December 2022 and February 2023 and then 25bps in March 2023, taking Bank Rate to 4.25%. March's rise was voted by a majority of 7-2, with two MPC members preferring to maintain Bank Rate at 4.0%. The Committee noted that inflationary pressures remain elevated with growth stronger than was expected in the February Monetary Policy Report. The February vote was also 7-2 in favour of a hike, and again with two members preferring to keep Bank Rate on hold.

Financial markets

16. Uncertainty continued to be a key driver of financial market sentiment and bond yields remained relatively volatile due to concerns over elevated inflation and higher interest rates, as well as the likelihood of the UK entering a recession and for how long the Bank of England would continue to tighten monetary policy. Towards the end of the period, fears around the health of the banking system following the collapse of Silicon Valley Bank in the US and purchase of Credit Suisse by UBS caused further volatility.

Credit review

17. Credit Default Prices had been rising since the start of the period on the back of the invasion of Ukraine, and in the UK rose further in September/October 2022 at the time of the then-government's mini budget. After this, CDS prices had been falling, but the fallout from SVB caused a spike on the back of the heightened uncertainty. However, they had moderated somewhat by the end of the period as fears of contagion subsided, but many are still above their pre-March levels reflecting that some uncertainty remains.

18. 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.

19. As market volatility is expected to remain a feature, at least in the near term, as ever, the institutions and durations on the Fire and Rescue Authority's counterparty list recommended by Arlingclose remains under constant review.

Local Context

20. At 31 March 2023 the Fire and Rescue Authority's underlying need to borrow for capital purposes was £15m as measured by the Capital Financing Requirement (CFR). Usable reserves and working capital are the underlying resources available for investment and amounted to £37.5m. These factors are summarised in Table 1.

Table 1: Balance sheet summary	**31/03/22 Balance £m**	**Movement £m**	**31/03/23 Balance £m**
CFR	11.0	4.0	15.0
Less: External borrowing			
- Public Works Loan Board	(6.7)	0.8	(5.9)
Internal Borrowing	**4.4**	**4.7**	**9.1**
Less: Usable Reserves	(41.4)	3.1	(38.3)
Less: Working Capital liability	4.9	(4.1)	0.8
Net Investments	**(32.1)**	**3.7**	**(28.4)**

21. The CFR has increased by £4m during 2022/23 as a result of expenditure incurred in delivering the Station Investment Programme, offset partly by Minimum Revenue Provision (MRP) charges relating to capital expenditure from previous years. External borrowing reduced by £0.8m as a result of the scheduled repayment of Public Works Loan Board (PWLB) borrowing. Usable reserves rose as contributions were made to the Capital Payments Reserve (CPR), Transformation Reserve, IT Reserve and Equipment Reserve in line with the Medium Term Financial Plan (MTFP), net of the planned use of reserves.

22. In addition, the outturn report recommends that the Authority approves the transfer of the 2022/23 underspend of £0.165m to the CPR. This modest contribution will help manage future demands on the capital programme.

23. It is likely that new external borrowing will be required in future years to fund capital expenditure commitments, and the Chief Financial Officer is actively working with Hampshire County Council's Investments and Borrowing team and treasury advisors Arlingclose to ascertain at what point it would be prudent to take out additional borrowing.

24. The Fire and Rescue Authority's strategy was to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, to

reduce risk and keep interest costs low. This has meant that internal funds have been utilised in lieu of taking on external borrowing debt. The treasury management position at 31 March 2023 and the change during the year are shown in Table 2.

Table 2: Treasury management summary	31/03/22 Balance £m	Movement £m	31/03/23 Balance £m	31/03/23 Rate %
Long-term borrowing	(5.90)	0.35	(5.55)	4.58
Short-term borrowing	(0.75)	0.40	(0.35)	5.88
Total borrowing	**(6.65)**	**0.75**	**(5.90)**	**4.66**
Long-term investments	8.00	(1.00)	7.00	4.52
Short-term investments	13.01	(7.00)	5.02	3.95
Cash and cash equivalents	11.08	4.40	16.47	4.07
Total investments	**32.09**	**(3.60)**	**28.49**	**4.16**
Net investments	**25.44**	**(2.85)**	**22.59**	

Note: the figures in Table 2 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.

25. The decrease in net investments of £2.85m shown in Table 2 reflects an decrease in investment balances of £3.60m in combination with the repayment at maturity of borrowing of £0.75m, in line with the Fire and Rescue Authority's policy on internal borrowing. Further details are provided in the Borrowing Strategy and Treasury Investments Activity sections of this report.

Borrowing Update

26. 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.

27. 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.

28. Further, the Fire and Rescue Authority has invested in pooled funds as part of its Treasury Management strategy. This is not a policy to primarily generate yield but a part of the implementation of the wider Treasury Management strategy to invest the Fire and Rescue Authority's surplus cash and reserves ensuring it is investing its funds prudently, having regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. By investing a diversified portfolio in respect of yield this meets the Fire and Rescue Authority's aim of protecting reserves from high inflation.

29. It is expected that during 2023/24 the CFR will rise as the Authority delivers the Station Investment 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 in the delivery of the Station Investment Programme, if required.

30. The Chief Financial Officer will review the current pooled fund investments prior to making any external borrowing decisions.

31. Borrowing Strategy

32. At 31 March 2023 the Fire and Rescue Authority held £5.9m of loans (a decrease of £0.75m from 31 March 2022) as part of its strategy for funding previous years' capital programmes. The year-end treasury management borrowing position and year-on-year change are summarised in Table 3.

Table 3: Borrowing position	**31/03/22 Balance £m**	**Net movement £m**	**31/03/23 Balance £m**	**31/03/23 Weighted average rate %**	**31/03/23 Weighted average maturity (years)**
Public Works Loan Board	(6.65)	0.75	(5.90)	4.66	9.96
Total borrowing	**(6.65)**	**0.75**	**(5.90)**	**4.66**	**9.96**

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

33. 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.

34. 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. In line with this strategy, £0.75m of PWLB loans were allowed to mature without refinancing.

35. This borrowing strategy has been monitored with the assistance of Arlingclose and has enabled the Fire and Rescue Authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

Treasury Investment Activity

36. 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.

37. 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 £25.7m and £45m due to timing differences between income and expenditure. The year-end investment position and the year-on-year change are shown in Table 4.

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	5.83	(3.88)	1.95	3.91	0.10
- Secured	4.00	(3.00)	1.00	4.14	0.03
Money Market Funds	9.76	5.29	15.05	4.10	0.00
Government:					
- Local Authorities	1.00	(1.00)	-	-	-
- Debt Management Office	1.50	(1.50)	-	-	-
- UK Gilt	1.00	(1.00)	-	-	-
- Treasury Bill	1.00	2.49	3.49	3.84	0.18
Total	**24.09**	**(2.60)**	**21.49**	**4.04**	**0.04**
Long term investments:					
Banks and Building Societies:					
- Secured	1.00	(1.00)	-	-	-
Total	**1.00**	**(1.00)**	**-**	**-**	**-**

Long term investments – higher yielding strategy:					
Pooled Funds					
- Pooled property*	3.25	-	3.25	3.62	N/A
- Pooled equity*	2.00	-	2.00	5.55	N/A
- Pooled multi-asset*	1.75	-	1.75	5.02	N/A
Total	**7.00**	**-**	**7.00**	**4.52**	**N/A**
Total investments	**32.09**	**(3.60)**	**28.49**	**4.16**	**0.04**

* The rates provided for pooled fund investments are reflective of annualised income returns over the year to 31 March 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 statement of accounts, but adjusted to exclude operational cash, accrued interest and other accounting adjustments.

38. 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.

39. The Fire and Rescue Authority benchmarks the performance of its internally managed investments against that of other Arlingclose clients. Internally managed investments include all investments except externally managed pooled funds but do include MMFs. The performance of these investments against relevant measures of security, liquidity and yield are shown in Table 5, providing data for the quarter ended 31 March 2023 and at the same date in 2022 for comparison.

Table 5: Investment benchmarking (excluding pooled funds)	Credit rating	Bail-in exposure	Weighted average maturity	Rate of return
		%	(days)	%
31.03.2022	AA-	62%	52	0.43%
31.03.2023	AA-	79%	15	4.04%
Police & Fire Authorities	AA-	84%	17	3.70%
All LAs	A+	59%	12	3.67%

40. Table 5 shows the average credit rating of the portfolio has remained consistent at AA-. Bail-in exposure has risen in comparison to the same time

in 2022, 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 across all metrics.

Externally managed pooled funds

41. 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.

42. The CIPFA Code requires the Fire and Rescue Authority to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest yield. As a result, the Fire and Rescue Authority’s investments targeting higher yields have been made from its most stable balances and with the intention that they will be held for at least the medium term. This means that the initial costs of any investment and any periods of falling capital values can be overcome and mitigates the risk of having to sell an asset for liquidity purposes, helping to ensure the long-term security of the Fire and Rescue Authority’s investments.

43. The negative correlation between bonds and equities, which had featured for some years, turned positive in 2022 as both bonds and equities sold off concurrently against an outlook of sticky inflation and high interest rates. Simultaneously, tighter financial conditions, higher bond yields and challenges in some segments of commercial real estate (e.g. offices post-COVID, high street shops and shopping centres) saw commercial property values fall during 2022, with a large fall in the final calendar quarter.

Table 6 – Higher yielding investments – market value performance	**Amount invested***	**Market value at 31/03/23**	**Gain/(fall) in capital value**	
			Since purchase	**2022/23**
	£m	**£m**	**£m**	**£m**
Pooled property funds	3.25	3.13	(0.12)	(0.62)
Pooled equity funds	2.00	2.24	0.24	0.01
Pooled multi-asset funds	1.75	1.51	(0.24)	(0.21)
Total pooled funds	**7.00**	**6.87**	**(0.13)**	**(0.82)**

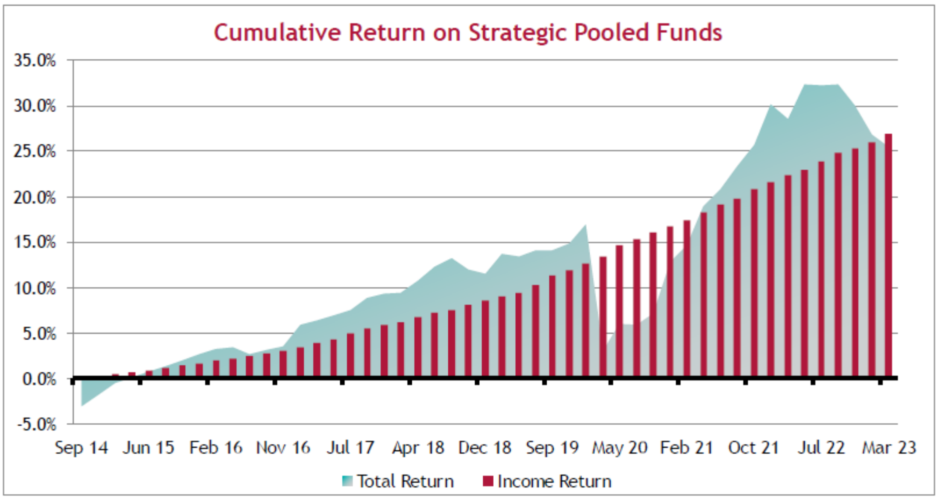
44. The Fire and Rescue Authority’s investments in pooled funds target long-term price stability and regular revenue income and bring significant benefits to the

revenue budget. As shown in Table 7 the annualised income returns have averaged 4.31% pa (per annum) since purchase, contributing to a total return of 25.98%.

Table 7 – Higher yielding investments – income and total returns since purchase	**Annualised income return**	**Total return**
	%	**%**
Pooled property funds	3.98	26.19
Pooled equity funds	4.86	44.38
Pooled multi-asset funds	4.41	4.58
Total pooled funds	**4.31**	**25.98**

45. The margin between cash and non-cash (pooled fund) investments was negligible by the end of March 2023. In these conditions it is unlikely any new pooled fund investments will be made. The existing allocation of £7m to pooled funds has provided good income returns for the Fire and Rescue Authority (as shown in the return figures above), mostly in contrast to very low interest rates prior to 2022. This allocation will continue to provide protection against a return to lower interest rates but the position remains under review with the assistance of Arlingclose. The Chief Financial Officer will also review the current pooled fund investments prior to making any external borrowing decisions.

46. The cumulative total return from the Fire and Rescue Authority's investments in pooled equity, property and multi-asset funds since purchase is shown in the following graph.



47. The Department for Levelling Up Homes and Communities (DLUHC) published a consultation on the IFRS 9 pooled investment fund statutory

override for English authorities for fair value gains and losses on pooled investment funds which was due to expire with effect from 2023/24. The options under evaluation were to allow the override to lapse, to extend it, or to make it permanent. The override will be extended for two years and therefore remain in place for the 2023/24 and 2024/25 financial years. Under the Regulations, gains and losses resulting from unrealised fair value movements relating to treasury pooled investment funds, that otherwise must be recognised in profit or loss under IFRS 9, are not charges to the revenue account, and must be taken into an unusable reserve account.

48. 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.

Financial Implications

49. The outturn for debt interest paid in 2022/23 was £311,750 on an average debt portfolio of £6.6m, against a budgeted £818,00. The difference is due to the slower than originally planned timing of capital programme expenditure and the continued use of internal borrowing, which has reduced the need for external borrowing to date.

50. The outturn for investment income received in 2022/23 was £878,000 on an average investment portfolio of £34.5m, therefore giving a yield of 2.54%, against a budgeted £250,000. By comparison investment income received in 2021/22 was £350,000 on an average investment portfolio of £34.2m with a yield of 1.02%. The Authority has benefited from the higher interest rate environment.

Non-Treasury Investments

51. 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).

52. 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.

53. 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

54. The Fire and Rescue Authority confirms compliance of all treasury management activities undertaken during 2022/23 with the CIPFA Code of Practice and the Fire and Rescue Authority's approved Treasury Management Strategy.

55. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 8.

Table 8 – Debt limits	**2022/23 Maximum £m**	**31/03/23 Actual £m**	**2022/23 Operational Boundary £m**	**2022/23 Authorised Limit £m**	**Complied?**
Borrowing	7.40	6.7	22.1	27.3	✓
Other long-term liabilities	-	-	5.0	5.0	✓
Total debt	**7.40**	**6.7**	**27.1**	**32.3**	✓

56. 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.

Treasury Management Indicators

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

Interest rate exposures

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

Table 9 – Interest rate risk indicator	31/03/23 Actual	Impact of +/-1% interest rate change
Sums subject to variable interest rates		
Investment	£17.9m	+/- £0.18m
Borrowing	£0.19m	+/-£0.002m

59. 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

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 10 – Refinancing rate risk indicator	31/03/23 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	6%	50%	0%	✓
12 months and within 24 months	6%	50%	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 11 – Price risk indicator	2022/23	2023/24	2024/25
Actual principal invested beyond year end	£7m	£7m	£7m
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied?	✓	✓	✓

62. 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.