Appendix B

Treasury Management Mid-Year Report 2023/24

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, four treasury management reports a year, including an annual strategy and outturn report.

2. This report provides an update on treasury management activity in the first half of 2023/24 and meets the requirement in the 2021 Code, mandatory from 1 April 2023, of quarterly reporting of the treasury management prudential indicators.

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. UK inflation has remained high over the period, keeping market expectations elevated of how much further the Bank of England (BoE) would hike rates. The Bank of England's (BoE) Monetary Policy Committee (MPC) continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August 2023, however, inflation data published in the latter part of the period undershot expectations, causing financial markets to reassess the peak in BoE Bank Rate. This was followed by the BoE deciding to keep Bank Rate on hold at 5.25% in both September and November 2023.

10. Economic growth in the UK remained relatively weak over the period. In calendar Quarter 2 2023, the economy expanded by 0.4%, beating market expectations of a 0.2% increase. However, monthly Gross Domestic Product (GDP) data showed a 0.5% contraction in July 2023, which was the largest fall to date this calendar year and worse than the 0.2% decline predicted.

11. Although still high, inflation has fallen from its peak as annual headline CPI (Consumer Prices Index) declined to 6.7% in July 2023 from 6.8% in the previous month against market expectations for a rise. The largest downward contribution came from food prices.

12. Following the September MPC meeting, Arlingclose modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate.

Financial markets

13. Financial market sentiment and bond yields remained volatile, with the latter generally trending downwards as there were signs inflation, while still high, was moderating and interest rates were at a peak. Gilt yields fell towards the end of the period.

Credit review

14. In March 2023 Arlingclose 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, and the purchase of Credit Suisse by UBS, as well as other well-publicised banking sector issues. As a result, Arlingclose reduced the advised maximum duration limit for all banks on its recommended counterparty list to 35 days for unsecured investments. This stance continued to be maintained during Quarter 2 of the financial year.

15. Arlingclose continued to monitor and assess credit default swap levels for signs of ongoing credit stress and no changes were made to recommended bank durations over Quarter 2 of the financial year. Credit default swaps are used as an indicator of credit risk, where higher premiums indicate higher perceived risks. Northern Trust Corporation was added to the counterparty list.

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

Local Context

17. 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.

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**

18. The treasury management position at 30 September 2023 and the change over the first half of the year is shown in Table 2.

Table 2: Treasury management summary	31/03/23 Balance £m	Movement £m	30/09/23 Balance £m	30/09/23 Rate %
Long-term borrowing	(5.6)	0.0	(5.6)	4.59
Short-term borrowing	(0.3)	0.3	0.0	0.00
Total borrowing	**(5.9)**	**0.3**	**(5.6)**	**4.59**
Long-term investments	7.0	(3.7)	3.3	3.87
Short-term investments	5.0	(1.9)	3.1	5.29
Cash and cash equivalents	16.5	5.1	21.6	5.20
Total investments	**28.5**	**(0.5)**	**28.0**	**5.06**
Net investments	**22.6**	**(0.2)**	**22.4**	

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.

19. The decrease in net investments of £0.2m shown in Table 2 can be attributed to a decrease in investment balances of £0.5m, which reflects the Fire & Rescue Authority's normal pattern of activity as well as capital expenditure incurred in the first quarter of the year. In addition, £0.3m of borrowing from the Public Works Loan Board (PWLB) was repaid at maturity in the period.

Borrowing Update

20. 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.

21. 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.

22. 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. The Chief Financial Officer will work closely with Arlingclose to determine the optimal borrowing approach.

Borrowing Strategy

23. At 30 September 2023 the Fire and Rescue Authority held £5.6m of loans as part of its strategy for funding previous years' capital programmes. Outstanding loans are summarised in Table 3.

Table 3: Borrowing position	**31/03/23 Balance £m**	**Net movement £m**	**30/09/23 Balance £m**	**30/09/23 Weighted average rate %**	**30/09/23 Weighted average maturity (years)**
Public Works Loan Board	(5.9)	0.3	(5.6)	4.59	10.3
Total borrowing	**(5.9)**	**0.3**	**(5.6)**	**4.59**	**10.3**

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

24. 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.

25. £0.3m of PWLB borrowing was repaid at maturity during the period and no new borrowing was taken out.

26. 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

27. The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Authority'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.

28. 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 £37.0m due to timing differences between income and expenditure. The investment position is shown in Table 4.

Table 4: Treasury investment position	31/03/2023 balance £m	Net movement £m	30/09/2023 balance £m	30/09/23 Income return %	30/09/23 Weighted average maturity (years)
Short term investments:					
Banks and Building Societies:					
- Unsecured	1.9	0.4	2.3	4.44	0.00
- Secured	1.0	0.1	1.1	5.44	0.29
Money Market Funds	15.1	4.2	19.3	5.29	0.00
High quality bonds	0.0	1.0	1.0	5.44	0.25
Government:					
- Treasury Bill	3.5	(2.5)	1.0	5.01	0.18
Total	**21.5**	**3.2**	**24.7**	**5.21**	**0.03**
Long term investments – higher yielding strategy:					
Pooled Funds					
- Pooled property*	3.3	0.0	3.3	3.87	N/A
- Pooled equity*	2.0	(2.0)	0.0	N/A	N/A
- Pooled multi-asset*	1.7	(1.7)	0.0	N/A	N/A
Total	**7.0**	**(3.7)**	**3.3**	**3.87**	N/A
Total investments	**28.5**	**(0.5)**	**28.0**	**5.06**	**0.03**

* The rate provided for the pooled property fund investment is reflective of annualised income returns over the 12 months to 30 September 2023.

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.

29. 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 Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

30. The security of investments has been maintained by following the counterparty policy and investment limits within the Treasury Management Strategy Statement (TMSS), taking advice from Arlingclose on changes in

counterparty credit worthiness, and making use of secured investment products that provide collateral. The Authority should invest in liquid investments to ensure money is available when required to meet its financial obligations, spreading these investments across a number of counterparties to mitigate operational risk.

31. As demonstrated by the liability benchmark shown later 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. As previously detailed in the Quarter 1 Treasury Management Report, the existing portfolio of strategic pooled funds has been reviewed in Quarter 2 with advice from Arlingclose. £3.75m was disinvested from the funds to take advantage of more favourable rates of return on shorter dated investments and increase liquidity ahead of capital expenditure outflows in the near future.

32. Over this financial year to date Bank Rate has increased by 1%, from 4.25% to 5.25% as at 30 September 2023. Short term investment interest rates have risen commensurately, with 3-month rates rising to around 5.25%, and 12 month rates to nearly 6%. The interest rates on Debt Management Account Deposit Facility (DMADF) deposits also rose, ranging between 4.8% and 5.4% and Money Market Rates between 5.0% and 5.3%.

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

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	4.12%
30.09.2023	AA-	87%	12	5.14%
Police & Fire Authorities	AA-	59%	41	4.87%
All LAs	AA-	59%	13	4.79%

34. Table 5 shows the average credit rating of the portfolio has remained consistent at AA- since March 2023, whilst bail-in exposure has increased marginally. The Authority's bail-in exposure is higher than that of comparative authorities, but it should be noted that a significant proportion of liquid balances are invested in money market funds, which are technically exposed to bail-in risk but as diversified products are considered by Arlingclose to be 'bail-in risk light'. The Authority continues to utilise money market funds for the high levels of liquidity they offer whilst simultaneously providing better levels of security than unsecured bank deposits. This is in conjunction with the comparatively higher rates of return they offer to other short-dated

instruments. Rates of return across the portfolio as a whole have improved since March 2023 and compare favourably to other Arlingclose clients.

Externally managed pooled funds

35. £3.3m of the Authority's investments are invested in an externally managed strategic pooled property fund where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. As set out in the TMS, the Authority only considers it appropriate to hold pooled fund investments where the intention is to hold them for at least the medium term to help ensure compliance with the requirements of the TM Code (i.e. to prioritise security and liquidity over yield).This fund and the other pooled funds that the Authority held until this quarter, have generated an average total return of 27.3% since purchase.

36. During the period investor sentiment for UK commercial property was more settled than in Quarter 3 and Quarter 4 of 2022 when the sharp rise in bond yields resulted in a big fall in property valuations. There were signs of returning investor interest, occupier resilience and a perception that the downturn in commercial real estate may be at an end. It helped rental income and led to some stabilisation in capital values. However, the combination of high interest rates and bond yield, higher funding costs and the prospect of sluggish economic growth constrain the outlook for commercial property.

37. The combination of the above had a marginal negative effect on the value of the Fire & Rescue Authority's pooled fund investment since March 2023. Based on market values at 30 September 2023, the Authority currently has a £0.2m unrealised loss on the £3.3m book value of its pooled fund holdings, summarised in Table 6.

Table 6: Higher yielding investments – market value performance	**Amount invested**	**Market value at 30/09/23**	**Gain / (fall) in capital value**	
			Since purchase	**2023/24**
	£m	**£m**	**£m**	**£m**
Pooled property funds	3.3	3.1	(0.2)	(0.1)
Total	3.3	3.1	(0.2)	(0.1)

38. The Authority's investments in pooled funds target long-term price stability and regular revenue income. As shown in Table 7, the annualised income returns have averaged 4.29% pa (per annum) since purchase, contributing to a total return of 27.3%.

Table 7: Higher yielding investments – income and total returns since purchase	Annualised income return	Total return
	%	%
Pooled property funds	3.96	27.33
Pooled equity funds*	4.78	45.03
Pooled multi-asset funds*	4.52	6.97
Total	**4.29**	**27.30**

* fully divested August 2023

39. 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. Following the latest review, and as outlined in the Quarter 1 report, in August 2023 the Authority divested £3.75m it had in pooled equity and multi-asset 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. The pooled multi-asset and equity funds are therefore included in Table 7 for indicative purposes, but these funds are no longer held.

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 £3.7m 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 £3.3m.

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) 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 8.

Table 8 – Investment limits	30/09/23 Actual £m	2023/24 Authorised Limit	Complied
The UK Government	1.0	n/a	✓
Local authorities & other government entities	0.0	Unlimited	✓
Secured investments	1.1	Unlimited	✓
Banks (unsecured)	3.3	Unlimited	✓
Building societies (unsecured)	0.0	£6m	✓
Registered providers	0.0	£6m	✓
Money market funds	19.3	Unlimited	✓
Strategic pooled funds	3.3	£24m	✓
Real estate investment trusts	0.0	£6m	✓
Other investments	0.0	£6m	✓

49. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 9.

Table 9 – Debt limits	H1 2023/24 Maximum £m	30/09/23 Actual £m	2023/24 Operational Boundary £m £m	2023/24 Authorised Limit £m	Complied
Total debt	6.3	5.6	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 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 10: 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 £37.5m of new prudential borrowing to support the approved 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

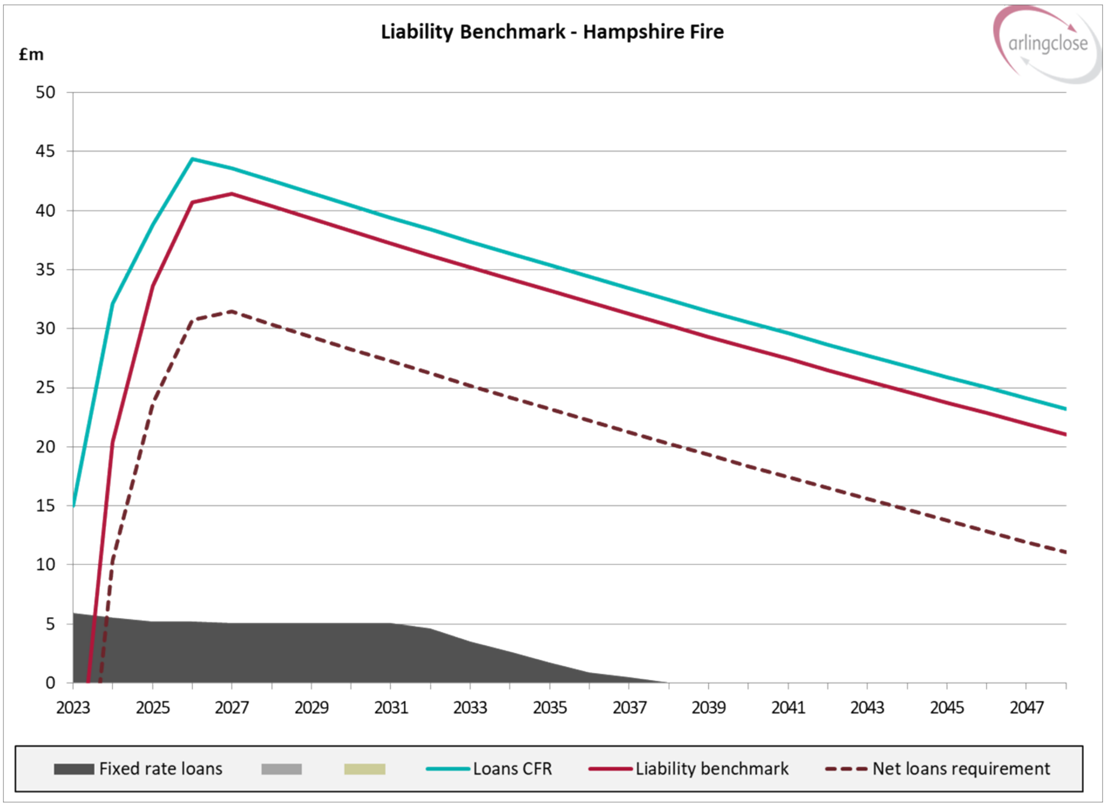
the Authority can meet its net loans requirement plus hold an appropriate amount of liquidity.

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. The Liability Benchmark is shown in Graph 1 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).

Graph 1: Liability Benchmark – Hampshire & IOW Fire Authority



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 11 – Refinancing rate risk indicator	30/06/23 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	0%	50%	0%	✓
12 months and within 24 months	6%	5%	0%	✓
24 months and within 5 years	2%	50%	0%	✓
5 years and within 10 years	29%	75%	0%	✓
10 years and within 20 years	63%	75%	0%	✓
20 years and above	0%	100%	0%	✓

Long term Treasury Management investments

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

62. The table includes investments in strategic pooled funds of £3.3m 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.

Interest rate exposures

63. The following indicator shows the sensitivity of the council's current investments and borrowing to a change in interest rates:

Table 13: Interest rate risk indicator	**30/09/23 Actual**	**Impact of +/-1% interest rate change**
Sums subject to variable interest rates:		
Investments	£24.8m	+/- £0.2m
Borrowing	£0.0m	+/- £0.0m