Appendix F

Annual Treasury Outturn Report 2018/19

HAMPSHIRE FIRE AND RESCUE AUTHORITY

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.

2.2. The Fire and Rescue Authority's treasury management strategy for 2018/19 was approved at a meeting of Hampshire Fire and Rescue Authority in February 2018. 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. This annual report sets out the performance of the treasury management function during 2018/19, to include the effects of the decisions taken and the transactions executed in the past year.

2.5. 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.

2.6. All treasury activity has complied with the Fire and Rescue Authority's Treasury Management Strategy and Investment Strategy for 2018/19, 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. The Fire and Rescue Authority has also complied with all the prudential indicators set in its Treasury Management Strategy.

2.7. The 2017 Prudential Code includes the requirement to produce a Capital Strategy, a summary document approved 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 20 February 2019

3. External Context

3.1. The following sections outline the key economic themes currently in the UK against which investment and borrowing decisions were made in 2018/19.

Economic Commentary

3.2. UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year/year, just above the consensus forecast but broadly in line with the Bank of England's February Inflation Report. The most recent labour market data for the three months to January 2019 showed the unemployment rate fell to a new low 3.9% while the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%.

3.3. After rising to 0.6% in the third calendar quarter from 0.4% in the second, fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since.

3.4. While the domestic focus has been on Brexit's potential impact on the UK economy, which has weighed on sterling and UK markets, globally the first quarter of 2019 has been overshadowed by a gathering level of broader based economic uncertainty. The International Monetary Fund downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.

Financial markets

3.5. Markets for riskier asset classes fell in December 2018, most notably for equities. The FTSE 100 (a good indicator of global corporate sentiment) returned -8.8% assuming dividends were reinvested; in pure price terms it fell around 13%. However, since the beginning of 2019 markets have rallied, and the FTSE 100 and FTSE All share indices were both around 10% higher than at the end of 2018.

3.6. Gilt yields continued to display significant volatility over the period on the back of ongoing economic and political uncertainty in the UK and Europe. After rising in October, gilts regained their safe-haven status throughout December and into the new year - the 5-year benchmark gilt yield fell as low as 0.80% and there were similar falls in the 10-year and 20-year gilts over the same period dropping from 1.73% to 1.08% and from 1.90% to 1.55%. The increase in Bank Rate pushed up money markets rates over the year and 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.53%, 0.67% and 0.94% respectively over the period.

Credit Background

3.7. Credit Default Swap (CDS) spreads drifted up towards the end of 2018 on the back of Brexit uncertainty before declining again in 2019 and continuing to remain low in historical terms. After hitting around 129 basis points in December 2018, the spread on non-ringfenced bank NatWest Markets plc fell back to around 96bps at the end of March, while for the ringfenced entity, National Westminster Bank plc, the CDS spread held relatively steady around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 33 and 79bps at the end of the period.

3.8. The ringfencing of the big four UK banks (Barclays, Bank of Scotland/Lloyds, HSBC and RBS/NatWest Bank plc) transferred their business lines into retail (ringfenced) and investment banking (non-ringfenced) entities.

3.9. In February, Fitch put the UK AA sovereign long-term rating on Rating Watch Negative as a result of Brexit uncertainty, following this move with the same treatment for UK banks and a number of government-related entities.

3.10. There were minimal other credit rating changes during the period. Moody's revised the outlook on Santander UK to positive from stable to reflect the bank's expected issuance plans which will provide additional protection for the its senior unsecured debt and deposits.

4. Local Context

4.1. At 31 March 2019 the Fire and Rescue Authority's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £11.2m, while usable reserves and working capital are the underlying resources available for investment and amounted to £24.7m (principal invested plus gains on investments with a variable net asset value). These factors and the year-on-year change are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31/03/18 Balance £m	Movement £m	31/03/19 Balance £m
CFR	(11.7)	0.5	(11.2)
Less: Resources for investment	26.1	(1.4)	24.7
Net investments	14.4	(0.9)	13.5

4.2. CFR has reduced due to MRP as all 2018/19 capital expenditure was funded without new borrowing. The Fire and Rescue Authority's strategy was to maintain borrowing and investments below their underlying levels, referred to as internal borrowing, in order to reduce risk and keep interest costs low. Internal borrowing has caused a reduction in resources for investment, which has resulted in a small decrease in net investments reported at 31 March 2019.

4.3. The treasury management position as at 31 March 2019 and the year-on-year change is shown in Table 2 below.

Table 2: Treasury Management Summary

	31/03/18 Balance £m	Movement £m	31/03/19 Balance £m	31/03/19 Rate %
Long-term borrowing	(8.4)	0.1	(8.3)	4.70
Short-term borrowing	-	(0.1)	(0.1)	4.88
Total borrowing	(8.4)	0.0	(8.4)	4.71
Long-term investments	6.5	0.0	6.5	3.12
Short-term investments	15.5	(5.5)	10.0	1.05
Cash and cash equivalents	3.7	4.2	7.9	0.77
Total investments	25.7	(1.3)	24.4	1.51
Net investments	17.3	(1.3)	16.0	

Note: the figures in the table above 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.

4.4. There has been no change in total borrowing and the Fire & Rescue Authority's internal borrowing policy has therefore translated into a reduction in investment balances in Table 2.

5. Borrowing Activity

5.1. At 31 March 2019 the Fire and Rescue Authority held £8.4m of loans as part of its strategy for funding previous years' capital programmes. The year-end treasury management borrowing position and year-on-year change is shown in Table 3 below. £0.1m of PWLB borrowing has moved from long-term to short-term and will mature during 2019/20.

Table 3: Borrowing Position

	31/03/18 Balance £m	Movement £m	31/03/19 Balance £m	31/03/19 Rate %	31/03/19 WAM* years
Public Works Loan Board	8.4	0.0	8.4	4.71	10.8
Total borrowing	8.4	0.0	8.4	4.71	10.8

* Weighted average maturity

Note: the figures in the table above 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.

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

5.3. 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.

5.4. 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.

5.5. There was no change in the borrowing position during the year to 31 March 2019 as no new loans were taken out and no existing loans matured.

6. Investment Activity

6.1. 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 £20.8m and £34.9m due to timing differences between income and expenditure. The investment position is shown in Table 4 below.

Table 4: Investment Position (Treasury Investments)

Investments	31/03/18 Balance £m	Movement £m	31/03/19 Balance £m	31/03/19 Rate %	31/03/19 WAM* years
Short term investments					
- Banks and Building Societies					
- Unsecured	2.1	1.0	3.1	0.98	0.19
- Secured	7.0	(3.0)	4.0	1.23	0.30
- Money Market Funds	3.1	3.7	6.8	0.78	0.00
- Local Authorities	7.0	(3.0)	4.0	0.78	0.14
	19.2	(1.3)	17.9	0.91	0.13
Long term investments					
- Banks and Building Societies					
- Secured	3.0	(1.0)	2.0	1.16	2.67
- Local Authorities	0.0	1.0	1.0	1.30	2.24
	3.0	0.0	3.0	1.21	2.53
High yield investments					
- Pooled Property Funds**	2.0	0.0	2.0	4.40	n/a
- Pooled Equity Funds**	1.5	0.0	1.5	5.23	n/a

	3.5	0.0	3.5	4.76	n/a
TOTAL INVESTMENTS	25.7	(1.3)	24.4	1.50	0.47

* Weighted average maturity

** The rates provided for pooled fund investments are reflective of the average of the most recent dividend return as at 31 March 2019.

Note: the figures in the table above 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.

6.2. 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 investments before seeking the highest 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 against the risk of receiving unsuitably low investment income

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

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

6.5. The Fire and Rescue Authority also makes use of secured investments products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.

6.6. To reduce risk, approximately 57% of the Fire and Rescue Authority's surplus cash is invested so that it is not subject to bail-in risk, as it is invested in local authorities, secured bank bonds, and pooled property, equity and multi-asset funds. The remaining balance is largely held in overnight money market funds, which are subject to reduced bail in risk. By comparison, only 40% of the cash held by other Fire and Police Authorities covered by Arlingclose's benchmarking data is not subject to bail-in risk.

6.7. To ensure sufficient liquidity, the Fire and Rescue Authority has made use of call accounts and money market funds. With the uncertainty around Brexit, the Fire and Rescue Authority also ensured there were enough accounts open at UK domiciled banks and Money Market Funds to hold sufficient liquidity over the year end and that its account with the Debt Management Account Deposit Facility (DMADF) remained available for use in an emergency

6.8. The UK Bank Rate increased marginally by 0.25% in August 2018 to 0.75% and with short-term money market rates also remaining relatively low, there has been an ongoing impact on the Fire and Rescue Authority's ability to generate income on cash investments. The rate of return achieved on the Fire and Rescue Authority's internally managed funds was 0.87% in the year to 31 March 2019.

6.9. 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 below.

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

	Credit Rating	Bail-in Exposure	WAM* (days)	Rate of Return**
31.03.2018	AA	23%	187	0.63%
31.03.2019	AA	43%	178	0.93%
Police & Fire Authorities	AA-	60%	63	0.74%
All LAs	AA-	55%	29	0.85%

* Weighted average maturity
** based on investments held at end of quarter

6.10. In order to minimise the risk of receiving unsuitably low investment income, the Fire and Rescue Authority has continued to invest in externally managed pooled funds as part of its high yielding strategy, as shown in Table 4.

6.11. These investments in pooled property and equity funds allow the Fire and Rescue Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments, with £3.5m currently invested

6.12. These funds 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.

6.13. The £3.5m portfolio of externally managed pooled equity and property funds generated an average total return of 7.11%, comprising 4.82% income return used to support services in year, and 2.29% of capital growth. By comparison, the average rate of return for internal investments was 0.87%, giving an average rate of return across the whole investment portfolio of 1.37%.

6.14. The high yielding strategy comprised approximately 14% of the invested balance at the end of March 2019 but accounted for over 47% of the income generated by the portfolio during the year.

6.15. Although money can usually be redeemed from the pooled funds at short notice, the Fire and Rescue Authority's intention is to hold them for at least the medium-term. Investments are made in the knowledge that capital values will move both up and down in the short term, but with the confidence that over a three- to five- year period total returns should exceed cash interest rates.

6.16. The performance and ongoing suitability of these pooled funds in meeting the Council’s investment objectives is monitored regularly and discussed with Arlingclose.

7. Financial Implications

7.1. The outturn for debt interest paid in 2018/19 was £393,000 on an average debt portfolio of £8.35m, against a budgeted £393,000 on an average debt portfolio of £8.35m.

7.2. The outturn for investment income received in 2018/19 was £379,000 on an average investment portfolio of £27.5m, therefore giving a yield of 1.37%, against a budgeted £210,000. By comparison investment income received in 2017/18 was £316,000 on an average investment portfolio of £29.1m with a yield of 1.09%.

8. Other Non-Treasury Holdings and Activity

8.1. 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. This is replicated in MHCLG’s Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

8.2. This could include the direct purchase of land or property and any such loans and investments will be subject to the Fire & Rescue Authority’s normal approval processes for revenue and capital expenditure and need not comply with the treasury management strategy. The Fire & 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 2018/19 with the CIPFA Code of Practice and the Fire and Rescue Authority’s approved Treasury Management Strategy.

9.2. Compliance with the authorised limit and operational boundary for external debt, is demonstrated in Table 6 below.

Table 6: Debt Limits

	2018/19 Maximum £m	31/03/19 Actual £m	2018/19 Operational Boundary £m	2018/19 Authorised Limit £m	Complied
Borrowing	8.4	8.4	15.0	18.7	✓
Total debt	8.4	8.4	15.0	18.7	✓

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 7 – Interest Rate Exposures

	31/03/19 Actual	Impact of +/- 1% interest rate change
Variable interest rate investment exposure	£19.9m	£0.2m
Variable interest rate borrowing exposure	£0m	£0.0m

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

Table 8 – Maturity Structure of Borrowing

	31/03/19 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	1%	50%	0%	✓
12 months and within 24 months	14%	50%	0%	✓
24 months and within 5 years	19%	50%	0%	✓
5 years and within 10 years	5%	75%	0%	✓
10 years and within 20 years	61%	75%	0%	✓
20 years and above	0%	100%	0%	✓

Principal Sums Invested for Periods Longer than 364 days

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.

Table 9 – Principal Sums Invested for Periods Longer than 364 days

	2018/19	2019/20	2020/21
Actual principal invested beyond year end	£6.5m	£5.5m	£4.5m
Limit on principal invested beyond year end	£10m	£10m	£10m
Complied	✓	✓	✓