Essex County Fire and Rescue Service Treasury Management Strategy

2022/23

Last updated on 11 February 2022

Contents

1. Background

Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial 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 financial risk are therefore central to the Authority's prudent financial management.

The Authority has engaged with Arlingclose, treasury management advisors, to provide support in producing this strategy. All decisions relating to treasury management are the responsibility of the Authority. Looking forward, the Authority is seeking a joint procurement with Essex Police to tender for collaborative treasury management advice.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

2. Highlights

a. The Authority may need to borrow in 2024/25 to deliver the capital programme.

b. The Authority is compliant with the recommendations of the CIPFA's Prudential Code for Capital Finance.

c. Loans of £24.5m are held against an approved limit of £40m of debt.

d. The Authority is unable to repay loans early without significant penalties.

e. The Authority aims to maintain an investment portfolio of high credit quality investments with a liquid maturity profile.

3. Changes Since 2021/22 Treasury Management Strategy

a. The Capital Financing Requirement (CFR) is forecast to increase to £35.4m by 2024/25, which is £3m higher than under the previous strategy (£32.4m). This is due to changes reflected in the capital programme (see Capital Strategy).

b. As a result, the Authority may need to borrow £1.6m in 2024/25. Under the previous strategy, the Authority was forecast to have cash available to invest of £0.8m in 2024/25.

c. The Liability Benchmark is forecast to increase to £34.1m. Under the previous strategy, this was forecast as £31.7m. The increase is a result of a higher CFR.

d. The Approved Counterparty Limits (table 4) has been updated to reflect the latest risk profile of the Authority.

4. Local Context

On 31st March 2021, the Authority held £24.5m of borrowing and £12.0m of investments. This is set out in further detail at ***Appendix C***. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

[Note - 31.3.21 figures are taken from the audited 2021 accounts]

Table 1: Balance sheet summary and forecast (further detail 31.3.21 at appendix D)

	Audited 2020-21 £Million	Forecast 2021-22 £Million	Forecast 2022/23 £Million	Forecast 2023/24 £Million	Forecast 2024/25 £Million
General Fund CFR	32.7	32.1	32.7	34.5	35.4
Less: External borrowing [1]	(24.5)	(24.5)	(23.5)	(23.5)	(22.5)
Internal financing [2]	**8.2**	**7.6**	**9.2**	**11.0**	**12.9**
Earmarked and General Reserves [3]	(17.8)	(12.7)	(10.8)	(10.3)	(10.3)
Capital Receipts Reserve	(9.7)	(13.4)	(11.5)	(8.5)	(3.5)
Plus: Working capital [4]	9.3	2.5	2.5	2.5	2.5
Investments/ (external financing) [5]	**10.0**	**16.1**	**10.6**	**5.4**	**(1.6)**

[1] Shows only loans to which the Authority is committed and excludes optional refinancing.

[2] Refers to capital expenditure funded through internal resources such as reserves and working capital.

[3] Earmarked and General Reserves is unusually high in 2020-21 due to a £3m National Non-Domestic Rates (NNDR) earmarked reserve, which was created to reflect the recognition of a one-off grant to compensate for a fall in NNDR collections due to the pandemic.

[4] Working capital is high in 20/21 as this includes specific year end accounting adjustments.

[5] Cash available to invest could reduce, as reserves are utilized for projects. A negative investment balance indicates the Authority may need additional borrowing.

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. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority's capital expenditure plans may require additional external borrowing in 2024/25 based on current internal funding. The liability benchmark and borrowing strategy is set out later in this report. Funds available for investment are forecast to fall due to higher budgeted capital expenditure in later years, which cannot be fully funded by capital receipts.

Investments fall from 21/22 due to the planned use of Earmarked and Capital Receipts Reserves to fund projects.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2022/23.

Liability benchmark: To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

Liability Benchmark	Audited 2020-21 £Million	Forecast 2021-22 £Million	Forecast 2022/23 £Million	Forecast 2023/24 £Million	Forecast 2024/25 £Million
Loans CFR	32.7	32.1	32.7	34.5	35.4
Less: Usable reserves	(27.5)	(26.2)	(22.3)	(18.8)	(13.8)
Plus: Working capital	9.3	2.5	2.5	2.5	2.5
Plus: Minimum investments	10.0	10.0	10.0	10.0	10.0
Liability Benchmark	**24.5**	**18.4**	**22.9**	**28.1**	**34.1**

The table above shows that the liability benchmark of the Authority could increase to £34.1m by 24/25. This indicates an underlying need to borrow due to a reduction in usable reserves and a stable, but increasing, capital finance requirement.

Table 3: Debt profile

Total capital repayable	£Million
Repayable within 1 year	1.0
Repayable within 2-5 years	2.0
Repayable within 5-10 years	15.0
Repayable within 10-15 years	6.5
Total	**24.5**

The table above shows high debt expiry in 5-10 years of £15m. The Authority will need to refinance to meet these repayments. The borrowing strategy is considered in the next section.

<u>Related Strategies</u>

The Treasury Management Strategy has been produced alongside several other key strategies of the Authority. These Strategies were prepared based on the same underlying forecasts and assumptions. These Strategies are:

- Reserves Strategy
- Medium Term Financial Strategy
- Capital Strategy and MRP Policy

5. Borrowing Strategy

The Authority currently holds £24.5 million of loans as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority does not expect to need to borrow in 2022/23. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £40 million. The liability benchmark shows that the Authority may need to borrow to maintain minimum investments of £10m, as required for 'professional' status of the European Union framework "MiFID II" (See MiFID II (europa.eu)). This varies from the prior year Treasury Management Strategy, which did not show a requirement to borrow in the next four years. The borrowing requirement in the current strategy is a result of additional capital expenditure forecast for 2024/25. For further detail, please refer to the 2022/23 Capital Strategy.

Objectives: The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority can reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal/short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages. The sources of borrowing available to the Authority are discussed below:

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire purchase
- Private Finance Initiative
- Sale and leaseback

The Authority has previously raised all of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

The revised CIPFA Prudential Code for Capital Finance in Local Authorities was issued on 20 December 2021 and will be effective from 1 April 2022. This introduces new rules for borrowing to fund the purchase of assets, primarily for a return (investment properties). The Service will fully comply with this requirement, and any future borrowing will be compliant with the Prudential Code.

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to the Commissioner.

Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity, but there is a penalty equal to the outstanding interest on the loan. It is therefore unlikely that the Authority will settle its loans early but may require new loans as existing loans expire.

6. Investment Strategy

The Authority holds modest levels of invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority’s treasury investment balance has ranged between £10 and £17 million; however, levels are expected to fall going forward.

Objectives: The CIPFA Code requires the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest 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. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Strategy: Given that investment balances are projected to fall and then remain low, the Authority aims to maintain an investment portfolio of high credit quality investments with a liquid maturity profile. All the Authority's surplus cash is currently invested in money market funds and UK Government Investments.

Business models: Under IFRS 9, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 4 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 4: Approved investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	10 years	Unlimited	Unlimited
Local authorities & other government entities	5 years	£2m	Unlimited
Secured investments *	6 months	£2m	Unlimited
Banks (unsecured) *	13 months	£1m	Unlimited
Building societies (unsecured) *	6 months	£1m	Unlimited
Registered providers (unsecured) *	n/a	£1m	Unlimited
Money market funds *	n/a	£3m	Maximum 50% of total investments
Strategic pooled funds	n/a	£2m	£5m

This table must be read in conjunction with the notes below.

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

*** Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be considered.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £1m per counterparty as part of a diversified pool e.g., via a peer-to-peer platform.

Banks unsecured Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money market funds: Pooled funds that offer same-day or short notice liquidity and typically low price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wider diversification of investment risks, coupled with the services of a professional fund manager. These funds come under pressure during early 2020 as the demand for liquidity grew due to external factors, and significant withdrawals were required. As it remains unclear how much the Bank of England would be willing to support MMF market participants in future, as well as the potential for further regulations to be introduced, the 50% sector limit has been maintained. Therefore, whilst the investment guidance for money market funds (MMF) is set out in Table 7 the guideline exposure for these funds will also incorporate the following:

1. Investment exposure of no more than 0.5% of the total MMF (if a government MMF then this can be 2%).

2. Investment exposure is diversified, as far as practical, over multiple MMF's, with a maximum of £3m being invested in a specific fund.

Strategic pooled funds: Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. 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 Authority's investment objectives will be monitored regularly.

Operational Bank Account: The Authority has an operational bank account with Lloyds, and an exception applies where forecast cash outflows (e.g. salaries or supplier payments) necessitate additional funds being held. In these instances, a balance of up to £8m is permitted.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Operational bank accounts: The Authority may incur operational exposures, for example, through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept in accordance with the criteria in Table 4. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Authority's treasury staff, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment limits: The Authority's revenue reserves available to cover investment losses are £17.8 million at 31st March 2021, being General plus Earmarked reserves. In order that no more than 15% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £3 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

Limits are also placed on fund managers, investments in brokers' nominee accounts, foreign countries, and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country since the risk is diversified over many countries.

Table 5: Investment limits

	Cash limit
Any group of pooled funds under the same management	£2m per manager
Negotiable instruments held in a broker's nominee account	£2m per broker
Foreign countries	£1m per country

Liquidity management: The Authority uses Microsoft Excel spreadsheets for cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial strategy and cash flow forecast.

7. Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators:

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the credit rating of its investment portfolio. This will be reported in the Finance Pack on a monthly basis.

Credit risk indicator	Target
Minimum credit rating	A

Should the average portfolio credit rating falls below this measure, the Police, Fire and Crime Commissioner will be notified

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£8.5m

Interest rate exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	-£120,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	-£120,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

Maturity structure of borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	75%	0%
5 years and within 10 years	75%	0%
10 years and within 15 years	100%	0%
15 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the 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 for a period longer than a year are:

Price risk indicator	2022/23	2023/24	2024/25
Limit on principal invested beyond one year	£2m	£1m	£1m

8. Related Matters

The CIPFA Code requires the Authority to include the following in its treasury management strategy.

Financial Derivatives: In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures, and options). Derivatives embedded into loans and investments, including pooled funds, and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

Markets in Financial Instruments Directive: The Authority has retained professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a smaller range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

Financial Implications

The forecast for investment income in 2022/23 is £10k, based on an average investment portfolio of £15 million at an interest rate of 0.07%. The forecast for debt interest paid in 2022/23 is £1.15 million, based on an average debt portfolio of £24.5 million at an average interest rate of 4.7%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecasts, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the Commissioner, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A – Arlingclose Economic & Interest Rate Forecast – March 2022

Underlying assumptions

Underlying assumptions:

- The post COVID global economy has entered a higher inflationary phase, driven by a combination of resurgent demand and supply bottlenecks in goods and energy markets. Geopolitics are also playing a role, driving energy prices upwards which are being passed onto consumers. Tighter labour markets due to reduced participation rates have prompted concerns about wage-driven inflation, leading central banks to tighten policy to ensure inflation expectations remain anchored.
- Global inflation is riding high. While some indicators suggest supply bottlenecks in goods markets are easing, oil and gas prices have risen significantly and threaten a more sustained level of uncomfortably high inflation than previously expected. In the UK, Ofgem has confirmed a significant rise in retail energy prices, which will maintain relatively high CPI rates throughout 2022.
- Supply constraints are also evident in the labour market. Underlying wage growth is running above pre-COVID levels despite employment being lower now than in early 2020. Evidence suggests that labour pools have diminished. Higher wage growth will be a contributory factor to sustained above-target inflation this year.
- The lower severity of Omicron means that the economic impact should be limited. The UK economy had a weak Q4 2021 due to the virus, but growth is likely to bounce back in Q1 2022.
- However, higher inflation will dampen demand. In the UK, households face a difficult outlook. Fiscal and monetary headwinds alongside a sharp reduction in real income growth will weigh on disposable income, ultimately leading to slower growth.
- The Bank of England will tighten policy further over the next few months to ensure that aggregate demand slows to reduce business pricing power and labour wage bargaining power. Markets have priced in a significant rise in Bank Rate, but we believe the MPC will be more cautious given the medium term outlook, assessing the impact of the first round of rises rather than following the market higher.
- Bond yields have risen sharply to accommodate tighter monetary policy, including the run off of central bank bond portfolios. The interplay between slowing growth and falling inflation, and tightening policy, will likely keep yields relatively flat.

Forecast:

- The MPC will raise Bank rate further to dampen aggregate demand and reduce the risk of sustained higher inflation.
- Arlingclose therefore expects Bank Rate to rise to 0.75% in March and 1.0% in May. Despite this expectation, risks to the forecast remain weighted to the upside for 2022, becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.
- Gilt yields will remain broadly flat from current levels, which have risen sharply since mid-December 2021. Significant volatility is, however, likely which should offer tactical opportunities for borrowing and investment.
- The risks around the gilt yield forecasts are broadly balanced. While gilt yields may face downward pressure as Bank Rate expectations ease from current levels, the run off of the Bank’s corporate bond portfolio, and later the gilt portfolio, as it reverses QE, could impact some upward pressure on yields.

Appendix B – Economic Background

Economic background: The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022/23.

The Bank of England's (BoE) increased Bank Rate to 0.25% in December 2021 and again in February 2022 to 0.5% and also announced a tailing down of its erstwhile Quantitative Easing programme. The Monetary Policy Committee (MPC) voted 5-4 to raise rates by 0.25% at the February meeting, the four dissenters had voted for an 0.5% rise at this meeting which means a very high likelihood of further rate rises in 2022.

At the time of the MPC meeting in November 2021, the economic uncertainty surrounding the Omicron variant of coronavirus was much more prevalent and the forecast for growth was depressed as a result. Since then, the uncertainty surrounding this variant had declined and the negative effects that it might have had on the global economy were shown to be less damaging and more short lived than previously expected. On the other hand, exceptionally strong demand for goods combined with supply chain disruptions and rising energy prices have weighed on activity throughout the early parts of Q1 2022.

In its February 2022 Monetary Policy Report the Bank of England noted 12-month CPI inflation for December was 5.4% which is 1% above the expectations set out in its previous Report in November 2021. Rising energy prices and core goods prices are the leading drivers of this inflation.

The MPC projects CPI inflation will continue its upward trajectory in the coming months to around 6% in February and March before peaking at 7.25% in April. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

The most recent Labour Force Data for the period to November 2021 shows that the labour market continues to recover. The number of job vacancies in Q4 2021 rose to a new record of 1,247,000, and the unemployment rate fell to 4.1%.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. Looking ahead, Q4 growth (data for which will be released in February) is expected to be soft.

According to a first estimation of annual growth for 2021, GDP increased by 5.2% in both the euro area and the EU. Core CPI inflation was 5.1% y/y in December. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 6.9% in Q4 2021. CPI rose 7% in 2021, the largest 12 month increase since June 1982. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

Credit outlook: Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Authority's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates. Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.

Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 1.20%, 1.35%, and 1.55% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.

Appendix C – Existing Investment & Debt Portfolio Position

	31/03/2021 Actual Portfolio £m	31/03/2021 Average Rate %
External borrowing:		
Public Works Loan Board	24.5	4.7
Total external borrowing	24.5	4.7
Treasury investments		
Money Market Funds	10.0	0.04
Bank Accounts	2.0	0.02
Total treasury investments	12.0	0.03
Net debt	**12.5**	

Appendix D – Balance sheet analysis as at 31st March 2021

(Based on audited financial statements)

Balance Sheet Analysis 31st March 2021	Balance 31/03/2021	Capital Financing Requirement	Usable Reserves	Working Capital	Investments	External Borrowing	Balance 31/03/2021
Property, Plant & Equipment							
Land and buildings	125,232	125,232					-
Vehicles, plant and equipment	11,404	11,404					-
Assets under construction	751	751					-
Long Term Assets	137,387	137,387	-	-	-	-	-
Inventories	642			642			-
Short term investments	94				94		
Short term debtors	7,333			7,333			-
Cash and cash equivalents	17,598			7,598	10,000		-
Assets held for sale	912	912					-
Current Assets	26,579	912	-	15,573	10,094	-	-
Short term borrowing	(250)			(250)			-
Short term creditors	(7,921)			(7,921)			-
Grant receipts in advance	(1,049)			(1,049)			-
Current Liabilities	(9,220)	-	-	(9,220)	-	-	-
Long term borrowing	(24,500)					(24,500)	-
Provisions	(1,162)			(1,162)			-
Other long term liabilities	(924,685)			(924,685)			-
Long Term Liabilities	(950,347)	-	-	(925,847)	-	(24,500)	-
Net Liabilities	(795,601)	138,299	-	(919,494)	10,094	(24,500)	-
General reserves	4,351		4,351				-
Earmarked general reserves	13,481		13,481				-
Usable capital receipts reserve	9,669		9,669				-
Usable Reserves	27,501	-	27,501	-	-	-	-
Revaluation reserve	38,180	38,180					-
Capital adjustment account	67,401	67,401					-
Holiday pay account	(828)			(828)			-
Collection fund adjustment account	(3,170)			(3,170)			-
Pension reserve	(924,685)			(924,685)			-
Unusable Reserves	(823,102)	105,581	-	(928,683)	-	-	-
Total Reserves	(795,601)	105,581	27,501	(928,683)	-	-	-
Analysis Total	-	32,718	(27,501)	9,189	10,094	(24,500)	-

LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985	
List of background documents – none.	
Proper Officer:	Chief Financial Officer (S151)
Contact Officer:	Neil Cross Essex County Fire and Rescue Service, Kelvedon Park, London Road, Rivenhall, Witham CM8 3HB Tel: 01376 576100