Essex County Fire and Rescue Service Treasury Management Strategy

2023/24

Last updated on 17 February 2023

Contents

1. Background

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.

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 2021 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. Changes to the Code of Practice 2021 Edition

- Investment management practices and other recommendations relating to non-treasury investments are included within the Treasury Management Practices (TMPs) alongside existing TMPs.
- The guidance recommends the introduction of the Liability Benchmark as a treasury management indicator for local government bodies.
- Environmental, Social and Governance (ESG) risks are incorporated into TMP1 (Risk Management) rather than a separate TMP 13.
- The purpose and objective of each category of investments should be described within the Treasury Management Strategy.

3. Policy Statement

Treasury management activities are defined as the management of the organisation's borrowing, investments and cash flows, including 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.

The Authority regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage these risks.

The Authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable, comprehensive performance measurement techniques within the context of effective risk management.

4. Highlights

a. The Authority may need to borrow in 2025/26 to deliver the capital programme.

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

c. At the time of this report, 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.

5. Changes Since 2022/23 Treasury Management Strategy

a. The Capital Financing Requirement (CFR) is forecast to increase to £31.2m by 2024/25, which is £4.2m lower than under the previous strategy (£35.4m). This is due to changes reflected in the capital programme (see Capital Strategy).

b. As a result, the Authority may need to borrow £9.4m in 2025/26. Under the previous strategy, the Authority was forecast to borrow £1.6m in 2024/25.

c. The Liability Benchmark is forecast to increase to £40.9m. Under the previous strategy, this was forecast as £34.1m. 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 2022, the Authority held £24.5m of borrowing and £13m 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 - 31.3.22 figures are taken from the audited 2022 accounts]

Table 1: Balance sheet summary and forecast (further detail 31.3.22 at appendix D)

	Actual 2021/22 £Million	Forecast 2022/23 £Million	Forecast 2023/24 £Million	Forecast 2024/25 £Million	Forecast 2025/26 £Million	Forecast 2026/27 £Million	Forecast 2027/28 £Million	Forecast 2028/29 £Million	Forecast 2029/30 £Million	Forecast 2030/31 £Million	Forecast 2031/32 £Million
General Fund CFR	31.7	31.3	31.5	31.2	37.8	33.1	28.9	24.9	20.9	17.6	14.8
Less: External Borrowing [1]	(24.5)	(23.5)	(23.5)	(22.5)	(21.5)	(21.5)	(21.5)	(16.5)	(11.5)	(6.5)	(6.5)
Internal financing [2]	7.2	7.8	8.0	8.7	16.3	11.6	7.4	8.4	9.4	11.1	8.3
Earmarked and General Reserves [3]	(15.4)	(10.0)	(8.3)	(7.4)	(7.0)	(7.0)	(7.0)	(7.0)	(7.0)	(7.0)	(7.0)
Capital Receipts Reserve [3]	(13.2)	(13.3)	(11.4)	(6.7)	(1.9)	(1.9)	(1.9)	(1.9)	(1.9)	(1.9)	(1.9)
Plus: Working Capital	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Investments/ (external financing) [4]	19.0	13.4	9.8	3.3	(9.4)	(4.7)	(0.5)	(1.4)	(2.5)	(4.1)	(1.4)

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

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

[3] Earmarked, Capital and General Reserves are forecast to fall going forward as reserves are utilized for projects.

[4] 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 financing.

The Authority's capital expenditure plans may require additional external borrowing in 2025/26 based on the table above - 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* requires authorities to estimate and measure its liability benchmark over as a minimum, the next three years, however, recommends that the liability benchmark is produced for at least ten years and should ideally cover the full debt maturity profile of the authority. The Authority's total debt should be lower than its highest forecast CFR. Table 1 shows that the Authority expects to comply with this recommendation during 2023/24.

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.

The liability benchmark is an important tool to help establish whether the Service is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself 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 2: Prudential Indicator: Liability benchmark

Liability Benchmark	Actual 2021/22 £Million	Forecast 2022/23 £Million	Forecast 2023/24 £Million	Forecast 2024/25 £Million	Forecast 2025/26 £Million	Forecast 2026/27 £Million	Forecast 2027/28 £Million	Forecast 2028/29 £Million	Forecast 2029/30 £Million	Forecast 2030/31 £Million	Forecast 2031/32 £Million
Loans CFR	31.7	31.3	31.5	31.2	37.8	33.1	28.9	24.9	20.9	17.6	14.8
Less: Usable reserves	(28.5)	(23.2)	(19.8)	(14.0)	(8.9)	(8.9)	(8.9)	(8.9)	(8.9)	(8.9)	(8.9)
Plus: Working capital	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Plus: Minimum investments	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Liability Benchmark	15.5	20.1	23.7	29.2	40.9	36.2	32.0	27.9	24.0	20.6	17.9

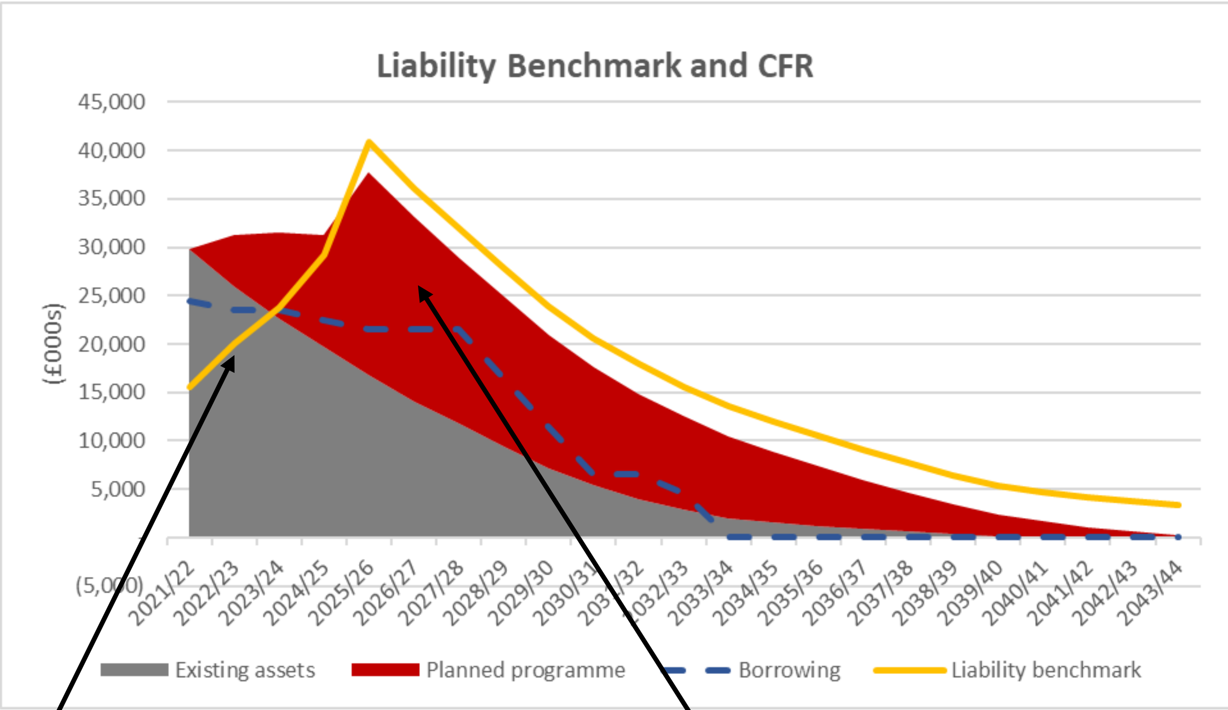
The table above shows that the liability benchmark of the Authority could increase to £40.9m by 2025/26. This indicates an underlying need to borrow due to a reduction in usable reserves and a significant increase in the capital finance requirement. The main conclusions to be drawn from this are:

a) The Service does not have sufficient existing borrowing to fund the existing Capital Programme.

b) The Service may need to increase the authorised limit on external debt of £40m given a liability benchmark of £40.9m in 2025/26. This is a forecast of the amount the Service could be required to borrow.

Graph 1: Liability benchmark

In the graph below, the capital financing requirement, existing borrowing and liability benchmark have been extrapolated across the life of the 4-year capital programme:



Borrowing higher than liability benchmark:
The Service has more debt that it requires, meaning excess cash is available to invest.

Borrowing lower than liability benchmark:
CFR increases in line with capital programme.

The Service needs more debt to finance the capital programme.

CIPFA Guidance:
CIPFA recommends that the liability benchmark should be produced to cover the full debt maturity profile of the Service.

The graph shows four balances:

Existing Assets:
This shows the impact on CFR of our existing asset base. These assets will be fully funded by MRP by 2039/40.

Planned Programme:
The planned capital programme is extrapolated over the life of those assets. These will be fully funded by MRP and reserves by 2043/44.

Borrowing:
The graph shows existing borrowing only, to show the additional borrowing requirements.

Liability Benchmark:
This shows the suggested borrowing requirement of the Service based on the factors above.

Table 3: Debt profile as at 31st March 2022

Total capital repayable	£million
Repayable within 1 year	1.0
Repayable within 2-5 years	2.0
Repayable within 5-10 years	17.0
Repayable within 10-15 years	4.5
Total	**24.5**

The table above shows high debt expiry in 5-10 years of £17m. The Authority will need to refinance to meet these repayments. The borrowing strategy is considered in the next section.

Related Strategies

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

At the time of this report, the Authority 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 2023/24. 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. The borrowing requirement in the current strategy is a result of the planned capital programme. For further detail, please refer to the 2023/24 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.

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 2023/24 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. Future borrowing will be driven by business need, once Full Business Cases for key capital projects are available. 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 was 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 is fully compliant 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 and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

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 £13 and £28 million; however, levels are expected to fall going forward due to investment in the Capital Programme.

Investments over the past twelve months (January 2022 to December 2022):

Investment	Category	Average Invested	Average Interest %	Interest Received
Morgan Stanley	MMF	£3M	1.5%	£52.6K
Lloyds	Bank (unsecured)	£1M	0.7%	£0.5K
CCLA	MMF	£3M	1.5%	£62.9K
UK Debt Management Office	UK government	£17M	1.4%	£123.5K

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. The Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

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, UK Government Investments and fixed term deposits bank deposit.

ESG policy: Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Authority's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

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	£2m
Building societies (unsecured) *	6 months	£1m	£4m
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.

The Service uses bank deposits to generate a return on short term investments.

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.

The Service does not currently utilise secured bank 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.

The Service utilises Government investments to provide a guaranteed return over fixed periods (normally 1-6 months).

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 4, 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.

The Service utilises money market fund investments to generate a return while providing liquidity, as funds can be returned on the same day.

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.

The Service does not currently utilise Strategic Pooled Funds.

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.

The Service does not currently utilise real estate investment trusts.

Operational bank accounts: 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.

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 expected to be £15.4 million at 31st March 2023 and £10 million at 31st March 2024, being General plus Earmarked reserves. In order that no more than 20% 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

Investment Type	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.

The Authority will spread its liquid cash over at least four providers (e.g., bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

MiFID II Compliance: MiFID II is an EU regulatory framework designed to regulate financial markets and improve protections for investors. MiFID II aims to standardise practices throughout the EU and brings a larger number of firms under the supervision of an EU financial regulator. Local authorities are categorised as either “Retailer” or “Professional” investors – this categorisation give Local Authorities access to certain types of investments. In order to qualify as “Professional”, Local Authorities must meet the following criteria:

- financial instrument portfolio including cash deposits and investments, must exceed £10m;
  AND, either:
- engage in investment transactions on average ten times per quarter, over the previous four quarters; OR
- the authorised person to carry out transactions has worked in the financial sector for at least one year in a professional capacity; OR

The Authority held more than £10m in cash and investments of the previous twelve months, and members of the finance team hold professional qualifications with sufficient experience in financial services. Furthermore, the Authority has engaged with professional treasury management advisors Arlingclose for additional support.

The implications of dropping to ‘Retail’ status are:

1) The Authority engages with Institutional Cash Distributors Limited (ICD) as a broker for its money market fund investments. If the Authority is downgraded to ‘Retail’ status through a reduction in cash, ICD would no longer be able to trade on our behalf. This would create an administrative burden on the Finance team, as investments would need to be placed manually. The Authority may lose access to certain types of investment and preferential returns.

2) The PWLB have confirmed that dropping to ‘Retail’ status would not impact our ability to borrow.

Therefore, the Authority will aim to maintain compliance with MiFID II for 2023/24.

7. Treasury Management Prudential 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 is reported in the Finance Pack on a monthly basis.

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

Credit risk indicator	Target
Minimum credit rating	A

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. This is reported in the Finance Pack on a monthly basis.

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	£112,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	-£112,000

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

Expected 3 year impact of a 1% change in interest rates: The Service should understand the impact of a 1% rise of fall in interest rates across the next 3 years, as suggested by the Treasury Management Code. This is set out below:

Expected Investments:	Actual 2022/23 £million	Forecast 2023/24 £million	Forecast 2024/25 £million	Forecast 2025/26 £million
Money Market Funds	5.00	4.00	1.00	-
UK Government Investments	7.00	5.00	1.00	-
Bank Deposits	1.00	1.00	1.00	-
Total Investments	**13.00**	**10.00**	**3.00**	**-**
Expected Interest:	**0.34**	**0.30**	**0.09**	**-**
+1% Net Change in Interest	0.13	0.10	0.03	-
-1% Net Change in Interest	(0.13)	(0.10)	(0.03)	-

The Service holds fixed rate debt which is not impacted by a change in interest rates. The table to the left shows the impact of a 1% rise or fall in interest on the expected investments of the Service over the next three years. Note that the total investments equals the cash available to invest in Table 1, reducing over the next three years.

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:

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.

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	50%	0%
12 months to 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%

Long-term treasury management investments: 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 prudential limits on the long-term treasury management investments will be:

Price risk indicator	2022/23	2023/24	2024/25	No fixed date
Limit on principal invested beyond one year	£2m	£1m	£1m	£2m

Long-term investments with no fixed maturity date include strategic pooled funds and real estate investment trusts but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

8. Related Matters

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

Liquidity Management: The Authority prepares a rolling 12-month cashflow report which is presented as part of the Finance Pack monthly. The forecast is reviewed daily to ensure short term fluctuations in cashflow are identified and mitigating plans are put in place. The Authority holds an appropriate level of highly liquid investments to mitigate liquidity risk.

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 2023/24 is £330k, based on an average investment portfolio of £11 million at an interest rate of 3.0%. The forecast for debt interest paid in 2023/24 is £1.1 million, based on an average debt portfolio of £23.5 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 – December 2022

Underlying assumptions:

- The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.
- Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.
- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power – recent data suggests the UK has passed peak inflation.
- The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.
- Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.
- While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

Forecast:

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.
- The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.

- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	**3.50**	**4.00**	**4.25**	**4.25**	**4.25**	**4.25**	**4.00**	**3.75**	**3.50**	**3.25**	**3.25**	**3.25**	**3.25**
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	**3.00**	**4.40**	**4.40**	**4.40**	**4.35**	**4.30**	**4.25**	**4.00**	**3.75**	**3.50**	**3.40**	**3.40**	**3.40**
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	**3.43**	**3.60**	**3.80**	**3.80**	**3.80**	**3.70**	**3.60**	**3.50**	**3.40**	**3.30**	**3.30**	**3.30**	**3.30**
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	**3.47**	**3.50**	**3.60**	**3.60**	**3.60**	**3.60**	**3.50**	**3.50**	**3.50**	**3.50**	**3.50**	**3.50**	**3.50**
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	**3.86**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**	**3.85**
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	**3.46**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**	**3.60**
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B – Economic Background

The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023/24.

The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.
The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3%

(from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

Credit outlook:
Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Appendix C – Existing Investment & Debt Portfolio Position

	31/03/2022 Actual Portfolio £m	31/03/2022 Year End Rate %
External borrowing:		
Public Works Loan Board	24.5	4.7
Total external borrowing	24.5	4.7
Treasury investments		
Money Market Funds	6.0	0.49
Bank Accounts	1.0	0.02
UK Government Investments	6.0	0.67
Total treasury investments	13.0	
Net debt	**11.5**	

Appendix D – Balance sheet analysis as at 31st March 2022

(Based on audited financial statements)

Balance Sheet Analysis 31st March 2022	Balance 31/03/2022	Capital Financing Requirement	Usable Reserves	Working Capital	Investments and Cash	External Borrowing	Balance 31/03/2022
Property, Plant & Equipment							
Land and buildings	126,527	126,527					-
Vehicles, plant and equipment	10,089	10,089					-
Assets under construction	1,985	1,985					-
Long Term Assets	138,601	138,601	-	-	-	-	-
Inventories	424			424			-
Short term investments	-				-		
Short term debtors	8,747			8,747			-
Cash and cash equivalents	20,473			1,473	19,000		-
Assets held for sale	1,445	1,445					-
Current Assets	31,089	1,445	-	10,644	19,000	-	-
Short term borrowing	(1,250)			(250)		(1,000)	-
Short term creditors	(7,557)			(7,557)			-
Grant receipts in advance	(1,233)			(1,233)			-
Current Liabilities	(10,040)	-	-	(9,040)	-	(1,000)	-
Long term borrowing	(23,500)					(23,500)	-
Provisions	(994)			(994)			-
Other long term liabilities	(902,453)			(902,453)			-
Long Term Liabilities	(926,947)	-	-	(903,447)	-	(23,500)	-
Net Liabilities	(767,297)	140,046	-	(901,843)	19,000	(24,500)	-
General reserves	4,341		4,341				-
Earmarked general reserves	11,035		11,035				-
Usable capital receipts reserve	13,153		13,153				-
Usable Reserves	28,529	-	28,529	-	-	-	-
Revaluation reserve	41,336	41,336					-
Capital adjustment account	66,978	66,978					-
Holiday pay account	(1,269)			(1,269)			-
Collection fund adjustment account	(418)			(418)			-
Pension reserve	(902,453)			(902,453)			-
Unusable Reserves	(795,826)	108,314	-	(904,140)	-	-	-
Total Reserves	(767,297)	108,314	28,529	(904,140)	-	-	-
Analysis Total	-	31,732	(28,529)	2,297	19,000	(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