TREASURY MANAGEMENT STRATEGY 2015/16

REPORT OF THE TREASURER

For Approval

1. PURPOSE OF REPORT

1.1 To enable the Fire Authority to approve the recommended Treasury Management Strategy for 2015/16.

2. RECOMMENDATIONS

It is recommended that Members note the report and the recommendation from Audit and Governance Committee to approve the following detailed recommendations for the 2015/16 Treasury Management Strategy and related issues:

i) Borrowing Strategy 2015/16
  a. Approve the adoption of Option 3 to **delay long term borrowing linked to contract awards** – i.e. delay borrowing until there is a forecast increase in the amount to be funded or until there is a significant increase in long term interest rates;
  b. To note that in the event of a change in forecast interest rates the Treasurer may implement Option 2 to pre fund the borrowing requirement to fixed long term interest rates at an affordable level to protect the Authority's long term financial position;
  c. Approve the creation of a Capital Funding Reserve to manage the phasing of actual loan repayment costs over the period 2014/15 to 2028/29;

ii) Investment Strategy
  a. Approve the addition of three "AAA" rated Money Market Funds to the counterparty list, with a counterparty limit of £0.5m per fund, noting that funds will be liquid (i.e. instance access) therefore a time limit is not applicable.
  b. Approve that the time limits for investments for existing counterparties be extended to a maximum of 1 year.

iii) Minimum Revenue Provision (MRP) Statement
Approve the following MRP Statement:
  a. For capital expenditure incurred before 1st April, 2008 the Authority's MRP policy is to calculate MRP in accordance with former CLG Regulations. This is 4% of the Capital Financing Requirement except where the Authority makes Voluntary Revenue Payments which is in excess of the amount required by these regulations, based on asset life;
  b. From 1st April, 2008 the Authority calculates MRP based on asset life for all assets or where prudential borrowing is financed by a specific annuity loan, MRP will be calculated according to the actual annuity loan repayments.

iv) Prudential Indicators 2015/16
Approve the prudential indicators detailed in Appendix 2.

3. SUMMARY OF ISSUES

3.1 The Local Government Act 2003 requires the Fire Authority to 'have regard to' the CIPFA Prudential Code and to set prudential indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

3.2 The Act therefore requires the Authority to determine a Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy, which sets out the Authority's policies for managing investments and for giving priority to the security and liquidity of those investments. The Secretary of State has issued Guidance on Local Government Investments which came into force on 1st April, 2004. This guidance recommends that all Authorities produce an Annual Investment Strategy that is approved by full Fire Authority, which is also included in this report.

3.3 The Authority is required to nominate a body to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies, before making recommendations to the Fire Authority. This responsibility has been allocated to the Audit and Governance Committee.

3.4 The recommended Treasury Management Strategy was considered by the Audit and Governance Committee on the 14h November 2014 and this report is attached as Appendix 1.

3.5 The Audit and Governance Committee carefully scrutinised the proposed Treasury Management strategy and approved that the recommended strategy be referred to full Fire Authority.

3.6 At the time of the Audit and Governance Committee it was not possible to calculate supporting Prudential Indicators as this is reliant on Government Capital and Revenue Allocations which had not been issued. However, as the Treasury Management Strategy outlines the key principles covering the operation of the Authority's borrowing and investment strategy the unavailability of this information did not prevent the Audit and Governance Committee from considering and scrutinising the proposed strategy.

3.7 Prudential indicators and other regulatory information have now been completed and are attached as Appendix 2 and cover the following:

- Prudential Indicators;
- Capital Expenditure and Financing Requirement;
- Affordability Prudential Indicators;
- Borrowing Prudential Indicators;
- Investment Prudential Indicators and Other Limits on Treasury Activity.

CHRIS LITTLE
TREASURER TO THE AUTHORITY

TREASURY MANAGEMENT STRATEGY 2015/16

REPORT OF THE TREASURER

For Recommendation

1. PURPOSE OF REPORT

1.1 The purpose of the report is to enable the Audit and Governance Committee to scrutinise the recommend Treasury Management Strategy before it is referred to the full Fire Authority for approval.

2. RECOMMENDATIONS

That Members:

i) Note the 2013/14 Treasury Management Outturn detailed in section 5 and Appendix A.

ii) Note the 2014/15 Treasury Management Mid-year Position detailed in section 6.

iii) Note that detailed prudential indicators will be reported to full Fire Authority in February 2015.

iv) Borrowing Strategy 2015/16
   a. Recommend to the Authority the adoption of Option 3 to **delay long term borrowing linked to contract awards** – i.e. delay borrowing until there is a forecast increase in the amount to be funded or until there is a significant increase in long term interest rates;
   b. To note that in the event of a change in forecast interest rates the Treasurer may implement Option 2 to pre fund the borrowing requirement to fixed long term interest rates at an affordable level to protect the Authorities long term financial position;
   c. Recommend to the Authority the approval of the creation of a Capital Funding Reserve to manage the phasing of actual loan repayment costs over the period 2014/15 to 2028/29;

v) Investment Strategy
   a. Recommend the approval of the addition of three "AAA" rated Money Market Funds to the counterparty list, with a counterparty limit of £0.5m per fund, noting that funds will be liquid (i.e. instance access) therefore a time limit is not applicable.
   b. Recommend that the time limits for investments for existing counterparties be extended for a maximum of 1 year.

vi) Minimum Revenue Provision (MRP) Statement
   Recommend to the Authority the approval of the MRP statement outlined in paragraph 10.2.

3. BACKGROUND

3.1 The Treasury Management Strategy covers the:

- The Borrowing Strategy for the Authority's borrowing requirement arising from historic capital expenditure funded from Prudential Borrowing and the element of the approved Asset Management Plan to be funded from Prudential borrowing; and
- Annual Investment strategy relating to the Authority's cash flow.

3.2 The Treasury Management Strategy for the next three years needs to address the borrowing requirement arising from the approved Asset Management Plan to ensure the loan repayment costs do not exceed the available revenue budget.

3.3 The Local Government Act 2003 requires the Authority to 'have regard to' the CIPFA (Chartered Institute of Public Finance and Accountancy) Prudential Code and to set prudential indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

3.4 The Act therefore requires the Authority to set out a Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy, which sets out the policies for managing investments and for giving priority to the security and liquidity of those investments. The Secretary of State has issued Guidance on Local Government Investments which came into force on 1st April, 2004. This guidance recommends that all Local Authorities produce an Annual Investment Strategy that is approved by the Authority, which is also included in this report.

3.5 The Authority is required to nominate a body to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies, before making recommendations to the full Authority. This responsibility has been allocated to the Audit and Governance Committee.

3.6 This report covers the following areas:

- Economic background and outlook for interest rates
- Treasury management outturn position for 2013/14
- Treasury Management Strategy 2014/15 mid-year review
- Treasury Management Strategy 2015/16
- Minimum Revenue Provision and Interest Cost and Other Regulatory Information 2015/16

4. ECONOMIC BACKGROUND AND OUTLOOK FOR INTEREST RATES

4.1 The Global Economy

4.2 **U.S.A. economy** – The Federal Reserve has continued monthly reductions in Quantitative Easing (QE) throughout 2014 and it was announced that QE had ended in October. The U.S.A faces similar debt problems to those of the UK, although the annual Government deficit has been halved from its peak without appearing to do too much damage to growth. However, weak labour force participation remains a key concern for the Federal Reserve as this will continue to depress sustainable consumer lead growth. Therefore, the Federal Reserve faces a similar dilemma to the Bank of England regarding the timing and scale of future interest rate increases.

4.3 **Eurozone economy** – continues to face the most challenging economic position owing to the increasing threat from weak or negative growth and deflation. Therefore, whilst concerns in financial markets for the Eurozone subsided during 2013, the sovereign debt difficulties (i.e. Government debt levels) have not gone away. Consequently, major issues could return for countries which have not addressed the fundamental issues of low growth, international uncompetitiveness and the need for economic reform. These factors mean that sovereign debt concerns have not disappeared, but have only been postponed. This situation is likely to lead to continuing weak or negative growth over the next few years within the Eurozone.

4.4 **China** – Government action in 2014 to stimulate the economy is not working as well as anticipated and the growth target of 7.5% is increasingly unlikely to be met. There are also concerns regarding the creditworthiness of bank lending to the corporate sector and Chinese local government during the post 2008 credit expansion period and the potential impact of a significant reduction in houses prices drawing nearer. These factors could reduce future Chinese growth, which would have a negative impact on other economies.

4.5 **The UK Economy**

4.6 The UK economy grew in 2013 and is forecast to continue growing in 2014 and 2015. However, for the recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, particularly manufactured goods. This will be challenging owing to the outlook for the global economy, particularly in relation to the Eurozone.

4.7 One of the key issues for the UK economy and the Authority's Treasury Management Strategy is the outlook for interest rates. In August 2013 the Governor of the Bank of England initiated "forward guidance", with the intention of making the banks policies more effective and to provide businesses and households with greater clarity on future interest rates.

4.8 Forward Guidance has been updated on a regular basis by the Governor of the Bank of England to reflect changes in the economic outlook. In response to the frequency of changes in the outlook for interest rates announced by the Governor some economic commentators have suggested the Governor has changed from being the 'unreliable boyfriend', blowing hot one day and cold the next (i.e. will interest rates increase soon, or won't they), to being the 'fearful fiancée' who has popped the question but can't bring himself to name the day (i.e. interest rates will increase, but the size and timing of the increase(s) is uncertain).

4.9 The position facing the Governor is extremely complicated owing to the unprecedented challenges of managing interest increases from the current historically low level and of managing the unwinding of ‘Quantitative Easing’. The frequency of updated forward guidance reflects the Governors consistent approach that interest rate decisions will be driven by data and regular updates are designed to enable business and households to prepare for future changes in interest rates.

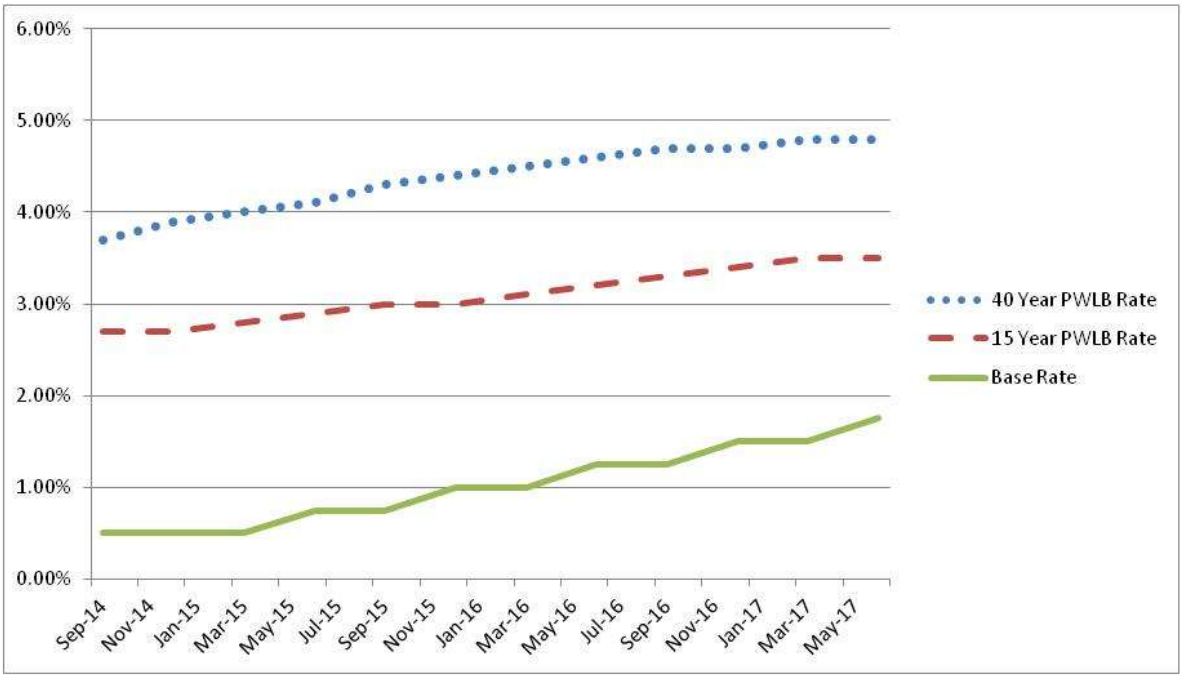
4.10 At this stage the outlook is for a steady and small increase in the Base Rate commencing in 2015, with a peak rate below the pre 2008 Base Rate of 5%, reflecting the negative impact increased interest rates will have on the economy. What remains uncertain is the timing of the first interest increase and the frequency/value of subsequent increases. The Governor has indicated these decisions will be subject to regular review to assess the impact of changes in the economy.

4.11 In terms of the impact on longer term borrowing rates it is currently anticipated that there will much smaller increases as longer terms rates have changed less and forecast rates already anticipate increases in the Base Rate.

4.12 **Interest Rate Forecasts**

4.13 As indicated above forecasting future interest rates remains extremely challenging as the base rate has remained unchanged for longer than most economists initially forecast. Capita Asset Services (the Authority’s Treasury Management advisors) continue to update their forecasts to reflect statements by the Governor and changes in the economy. The latest forecasts up to June 2017 are provided in the following graph.

Interest Rate Forecast up to June 2017



5. TREASURY MANAGEMENT OUTTURN POSITION 2013/14

5.1 **Capital Expenditure and Financing 2013/14**

5.2 The Authority's approved capital programme is funded from a combination of capital grants, revenue contributions and prudential borrowing.

5.3 Part of the Authority's treasury management activities is to address the prudential borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Authority. The wider treasury activity also includes managing the Authority's day to day cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then optimise performance.

5.4 Actual capital expenditure forms one of the required prudential indicators. As shown at Appendix A, the total amount of capital expenditure for the year was £3.422m, of which £1.321m was funded by prudential borrowing. The balance was funded by a mix of Capital Receipts, Government Grants and planned revenue contributions.

5.5 The Authority's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is the accumulated value of capital expenditure which has been financed from Prudential Borrowing. Each year the Authority is required to apply revenue resources to reduce this outstanding balance.

5.6 Whilst the Authority's CFR sets a limit on underlying need to borrow, the Authority can manage the actual borrowing position by either;

- borrowing externally to the level of the CFR; or
- choosing to use temporary internal cash flow funds instead of borrowing; or
- a combination of the two.

5.7 The Authority's CFR for the year was £4.436m as shown at Appendix A. This is slightly higher than forecast owing to the rephasing of expenditure.

5.8 The Authority can also borrow for future planned increases in the CFR up to 3 years in advance, when this is deemed to be appropriate. This was not the case in 2013/2014.

5.9 The Authority's total long term external borrowing as at 31st March, 2014 was £2.0m. This is currently less than the CFR as a result of being able to use the Authority's balances to internalise the funding of capital expenditure. This strategy was approved in February 2013 and enabled the Authority to reduce counterparty risk by reducing the level of external investments.

5.10 **Prudential Indicators and Compliance Issues 2013/2014**

5.11 Details of each Prudential Indicator are shown at Appendix A. Some of the prudential indicators provide either an overview or specific limits on treasury activity. The key Prudential Indicators to report at outturn are described below.

5.12 The **Authorised Limit** is the "Affordable Borrowing Limit" required by Section 3 of the Local Government Act 2003. The Authority does not have the power to borrow above this level. Appendix A demonstrates that during 2013/2014 the Authority has maintained gross borrowing within its Authorised Limit.

5.13 **Net Borrowing and the CFR** - In order to ensure that borrowing levels are prudent, over the medium term the Authority's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not have exceed the CFR for 2013/2014 plus the expected changes to the CFR over 2014/2015 and 2015/2016. The Authority has complied with this Prudential Indicator.

5.14 **The treasury position 31st March 2014**

5.15 The table below shows the treasury position for the Authority as at the 31st March, 2014 compared with the previous year:

Treasury position	31st March 2013		31st March 2014	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt				
- Market Loans	£2.0m	3.95%	£2.0m	3.95%
Total Long Term Debt	**£2.0m**	**3.95%**	**£2.0m**	**3.95%**
Total Investments	**£14.8m**	**0.37%**	**£16.0m**	**0.36%**
Net Investment Position	**£12.8m**		**£14.0m**	

5.16 A key performance indicator shown in the above table is the low average rate of external debt of 3.95% for debt held as at 31st March, 2014, compared to historic and current long term PWLB rates.

5.17 The Authority's investment policy is governed by Department of Communities and Local Government (DCLG) guidance, which has been implemented in the annual investment strategy approved by Authority on 15th February, 2013.

5.18 The Authority also continued to exclude all foreign banks, including Irish banks from the list following the downgrading of the country's sovereign rating.

5.19 By not relying solely on credit ratings the Authority sought to take a more pragmatic and broad based view of the factors that impact on counterparty risk. As part of the approach to maximising investment security the Authority has also kept investment periods short (i.e. in most cases up to 3 months but a maximum of 6 months). The downside of this prudent approach is that the Authority achieved slightly lower investment returns than would have been possible if investments were placed with organisations with a lesser financial standing and for longer investment periods.

However, during 2013/14 the risk associated with these higher returns would not have been prudent.

5.20 A prudent approach will continue to be adopted in order to safeguard the Authority's resources, although some changes are recommended later in the report.

5.21 **Regulatory Framework, Risk and Performance 2013/14**

5.22 The Authority's treasury management activities are regulated by a variety of professional codes, statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Authority or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made since this power was introduced);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act, and requires the Authority to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Authority to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the DCLG has issued Investment Guidance to structure and regulate the Authority's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November, 2007.

5.23 The Authority has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with Treasury Management activities. In particular the adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means that capital expenditure is prudent, affordable and sustainable and treasury practices demonstrate a low risk approach.

6. TREASURY MANAGEMENT STRATEGY 2014/15 MID-YEAR REVIEW

6.1 The 2014/15 Treasury Management Strategy was approved on the 14th, February, 2014. The Authority's borrowing and investment position as at 31st September 2014 is summarised as follows:

	£m	**Average Rate**
LOBO Loans	2.0	3.95%
Gross Debt	**2.0**	3.95%
Investments	23.6	0.33%
Net Investment	**21.6**	

6.2 The Authority's 2014/15 Treasury Management Strategy remains unchanged from the Strategy approved on the 14th February 2014 and continues the strategy of netting down investments against borrowing and remains under-borrowed against the CFR. The timing of new borrowing up to the level of the CFR will need to be managed carefully to enable the Authority to secure affordably long term interest rates and this is covered in more detail elsewhere in the report.

6.3 As part of the Treasury Strategy for 2014/2015 the Authority set a number of prudential indicators. Compliance against these indicators is monitored on a regular basis and there are no breaches to report.

6.4 The CFR and Capital Expenditure Financed by Borrowing will vary from the original estimate approved by the Fire Authority in February 2014 owing to planned capital expenditure being rephased between financial years. Initial assessment indicates that there will be no net impact on the total borrowing forecast for the period of the MTFS although there will be timing differences around individual financial years.

7. TREASURY MANAGEMENT STRATEGY 2015/16

7.1 Owing to the timing of the Audit and Governance Committee meeting it is not possible to provide detailed prudential indicators as part of the Treasury Management Strategy for 2015/16 prior to this being reported to the full Fire Authority as part of the Medium Term Financial Strategy process as detailed Capital Allocations have not yet been released by the Government. However this does not prevent the Committee from scrutinising the proposed Treasury Management Strategy which is presented below.

7.2 The key elements of the Treasury Management Strategy which Members need to consider are the Borrowing and Investment Strategies, detailed in section 8 and 9.

8. BORROWING STRATEGY 2015/16

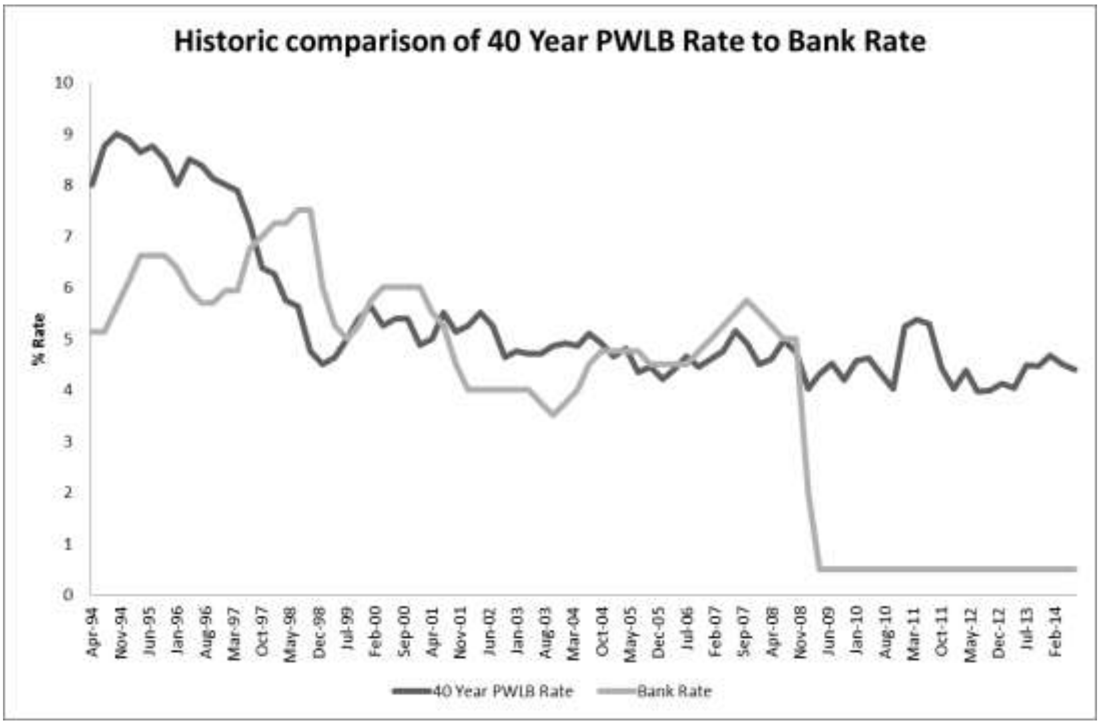
8.1 The Authority has historically had a limited borrowing requirement (technically referred to as the Capital Financing Requirement) reflecting the previous capital programme being linked to the replacement of operational vehicles. The Authority's Treasury Management Strategy previously aimed to fund the annual borrowing requirement at the lowest possible long term interest rate.

8.2 Since the unprecedented reduction in the Base Rate to 0.5% in March 2009 (the lowest level in more than 300 years) the Treasury Management Strategy has been to net down investments and borrowings. This approach has been adopted by many other Authorities. In simplistic terms this approach is the equivalent of a household having an offset mortgage, although the regulations for the Authority's Treasury Management arrangements are significantly more complex and the Authority is managing public money.

8.3 This approach was implemented to reduce investment counterparty risk and to provide the lowest cost to the Authority for the last 5 years. Reducing investment counterparty risk was particularly important during the early stages of the banking crisis as it reduced the value of external investments at a time of significant financial uncertainty. This approach continued the Authority's cautious investment approach, which also avoided investing in foreign banks, including Icelandic banks.

8.4 The approach also avoided committing to longer term interest rates for loans, which have typically remained at about 4.2% for 40-year debt, as opposed to generating only around 0.6% on investments, therefore saving on the cost of 'carrying' debt of 3.6% per annum. The resulting savings have been used to help create the Capital Investment Programme Reserve.

8.5 The existing Treasury Management Strategy always recognised that this approach was not sustainable in the longer term as one-off resources will be used up. Therefore, at some point the Authority will need to fund the borrowing requirement from longer term loans. The timing of borrowings decision will need to reflect the outlook for the Base Rate and the impact this will have on longer term interest rates. Whilst, current long term interest rates are significantly higher than the current Base Rate they are still historically low, as highlighted in the following graph:



8.6 Recent announcements by the Governor of the Bank of England indicate that increases in the current Base Rate of 0.5% are now getting closer, although the timing and scale of increases is still uncertain. Whilst, most economists and financial commentators are not expecting the Base Rate to return to 5%, they had not forecast the unprecedented cut to 0.5%. This underlines the financial challenge facing authorities in making future borrowing decisions.

8.7 The development and implementation of the approved Asset Management Plan (AMP) makes the timing of long term borrowing decisions even more significant as the Authority's borrowing requirement will increase from £4.436m at 31.03.14 to approximately £9.7m at 31.03.16 based on approved AMP.

8.8 It is clear that long term borrowing decisions will in due course be subject to scrutiny with the benefit of hindsight. However, these decisions need to be made over the next 12 to 24 months based on an assessment of current information to secure the lowest long term cost for the Authority. The following options are available:

- **Option 1 – Delay long term borrowing linked to base rate increasing** - under this option long term borrowing will be delayed until there is a significant increase in the base rate;

- **Option 2 – pre-fund the borrowing requirement for 2014/15 to 2017/18** - under this option long term borrowing will be taken out in advance of approved capital expenditure being incurred to secure fixed at current long term interest rates;

- **Option 3 – delay long term borrowing linked to contract awards** – under this option long term borrowing will be delayed until there is a significant increase in the amount to be funded or until there is an increase in forecast long term rates. The borrowing position will be reviewed when individual contracts are let and a decision made to either lock out the loan or continue to delay borrowing if this is the lowest long term cost option.

8.9 The advantages and disadvantages of these alternatives are summarised below:

Option	Advantages	Disadvantages
1	• Maximises potential short-term interest cost savings (i.e. with next 3 years). • Potential to maximise medium term savings (i.e. 3 to 5 years) if Base rate remains below current long term interest rate.	• Greater risk than other options that when long term borrowing is undertaken interest rates are higher than current long term interest rates, resulting in higher overall cost and unbudgeted revenue pressure.
2	• Provides greatest certainty of long term interest costs and ensures costs within budget.	• Significant cost of 'carry' from interest rates on borrowings costs exceeding interest rates earned on investments and costs would exceed available budget.
3	• Maximises potential short-term interest cost savings (i.e. with next 3 years). • Provides a balance between certainty of future interest costs and benefits of potential short-term savings.	• Potential lower benefit from short-term interest savings (i.e. within the next 3 years) compared to option 1.

8.10 In recommending one of the above options the key requirement is to ensure the borrowing costs associated with AMP are minimised in the long term and can be sustained within the existing revenue budget of £0.8m (including using the recommended Capital Funding Phasing Reserve) over:

- the period of the current Medium Term Financial Strategy and Integrated Risk Management Plan; and,
- the period beyond 2018/19 to ensure the longer term financial sustainability of the Authority.

8.11 Borrowing costs will need to be secured by locking into long term interest rates at the appropriate time and before there is any significant increase in current long term interest rates.

8.12 At the same time the Authority will need to avoid incurring costs of 'carrying' long terms loans before they are needed which would arise as a result of the significant difference between long term interest rates and the forecast base rate. In normal financial circumstances this is not an issue as long term rates and short-term interest rates are typically much closer. Historically there have been significant period when short-terms interest rate exceeded long-term interest rates which means there are no costs of ‘carrying’ long terms loans in advance of need. However, owing to forecast interest rates for short and long term loans to June 2017 there are significant potential costs of ‘carrying’ long terms loans before they are needed. The graph in paragraph 4.13 highlights the difference in forecast interest rates.

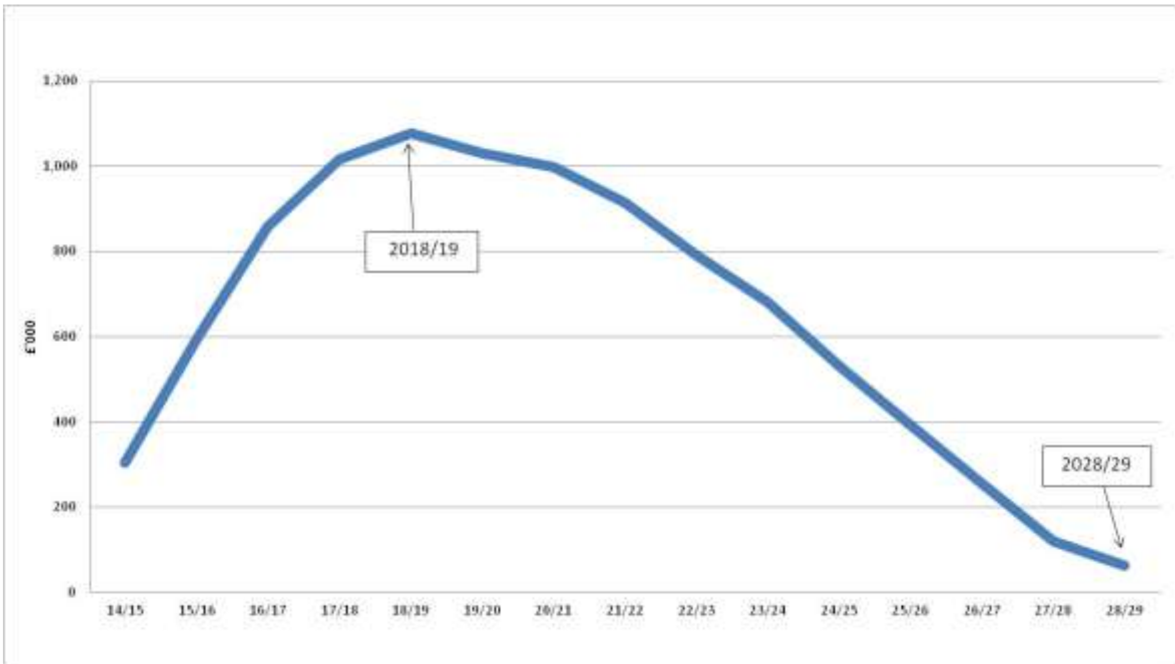
8.13 On this basis of the issues detailed in the previous paragraphs it is recommended that **Option 3 - delay long term borrowing linked to contract awards** is implemented.

8.14 However, owing to the unprecedented financial environment and the uncertainty over the timing and scale of future interest rate increases this strategy will be kept under constant review. If circumstances change and it is anticipated interest rates will increase sooner and to a higher level than currently anticipated it may then be appropriate to implement **Option 2 – pre-fund 2014/15 to 2017/18 borrowing** to fix long term interest costs at an affordable level.

8.15 **Impact of Capital Programme on the Revenue Budget**

8.16 Detailed financial modelling has been undertaken to assess the impact of the capital programme on the revenue budget. This analysis indicates that in the short term, and by adopting option 3 outlined above, loan repayment costs will be less than the approved budget which reflects the phasing of the capital programme and short term interest rate savings. However, over the period 2019/20 to 2028/29 annual loan repayment costs will exceed the approved revenue budget. This position can be managed by establishing a capital phasing reserve which will balance loan repayment costs over the period 2014/15 to 2028/29. The following graph summarises the contributions to/from the Capital Phasing Reserve over the period 2014/15 to 2028/29. The graph shows that the Capital Phasing Reserve enables loan repayment costs to be funded on a sustainable basis.

Contributions to/from the Capital Funding Reserve 2014/15 to 2028/29



8.17 It is recommended that underspends as a result of the savings outlined above are earmarked as a Capital Funding Phasing reserve to fund increased loan repayment costs of the AMP in future years. This is the principle which would have been adopted if the Authority had secured a Public Finance Scheme (PFI), as a PFI Payments Phasing reserve would have been needed. Without the establishment of the Capital Phasing Reserve the existing Capital Programme is not affordable.

8.18 **Municipal Bonds Agency**

8.19 The Local Government Association are looking to establish a Municipal Bonds Agency predominantly for the purpose of potentially offering lower interest rates to local authorities. As the Authority's borrowing and investment Strategies hinge around netting down, involvement in the Municipal Bonds Agency is not something that will be progressed at present. This approach avoids incurring a share of the initial set-up costs for the Municipal Bonds Agency. This position will be reviewed if the Authority's position changes in the future.

9. INVESTMENT STRATEGY 2015/16

9.1 The Department for Communities and Local Government (CLG) issued investment guidance in 2010 and this forms the structure of the Authority's policy. The key intention of the Guidance is to maintain the current requirement for authorities to invest prudently and that priority is given to security and liquidity before interest return. This Authority has adopted the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes and applies its principles to all investment activity. In accordance with the Code, the

Treasurer has produced Treasury Management Practices covering investment counterparty policy which requires approval each year.

9.2 The primary objectives of the Authority's investment strategy in order of importance are:

- safeguarding the re-payment of the principal and interest of its investments on time;
- ensuring adequate liquidity;
- investment return.

9.3 In the current economic climate the investment strategy has one over-riding risk consideration which is safeguarding the principal invested. As a result of this underlying concern the existing investment strategy nets down investments and borrowing. This strategy restricts both the institutions the Authority will invest in and the period of Investment.

9.4 **Counterparty Selection Criteria**

9.5 The Authority's criteria for providing a pool of high quality investment counterparties uses the credit rating information produced by the three major ratings agencies (Fitch, Moody's and Standard & Poor's) and is supplied by our treasury consultants. All active counterparties are checked against criteria outlined below to ensure that they comply with the criteria. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered on a daily basis before investments are made. For instance a negative rating watch applying to a counterparty at the minimum criteria will be suspended from use, with all others being reviewed in light of market conditions.

9.6 The **lowest common denominator** method of selecting counterparties and applying limits is used. This means that the application of the Authority's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Authority's criteria, the other does not, the institution will fall outside the lending criteria

9.7 Owing to the continued level of risk and uncertainty the Treasurer will continue to adopt a vigilant approach resulting in what is effectively a 'named' list. This consists of a select number of counterparties that are considered to be the lowest risk.

9.8 As the market is beginning to return to more "normal" conditions a review of the current counterparty list has been completed. The current counterparty list is very limited especially as the Co-operative Bank has been removed as a counterparty and the Authority has temporary cash to invest on a daily basis. This often means that Authority investments are being increasingly made with the Government's Debt Management Office which offers extremely low investment rates. Recommended changes to the list are outlined below:

- The use of three AAA Money Market Funds (MMFs) to further spread counterparty risk. AAA MMFs are highly liquid pooled investments that only invest in other highly rated institutions and products (at least 50% of which must meet category A and none of which can be lower than category B outlined in the table of investment criteria below). Investment risk is further reduced as AAA MMFs invest in a large number of institutions never having more than 5% exposure for more than 7 days with any single institution i.e. their investments are highly diverse and highly liquid. Investments with individual MMFs will initially be limited to £0.5m per fund (a total of £1.5m). Investments with money market funds are highly liquid (i.e. instant access), therefore a time limit for investment is not necessary. There are currently over 20 MMFs used by local authorities.

- For existing institutions on the list it is recommended that the time limit for investments be extended from three months (six in the case of Local Authorities) to a maximum of one year. This reflects a reduction in risk in the financial market.

9.9 The table below shows the current and proposed limits in 2015/16 for the Authority:

Category	Fitch	Moody's	Standard & Poor's	Current Counterparty Limit	Current Time Limit	Proposed Counterparty Limit	Proposed Time Limit
A	F1+/AA-	P-1/Aa3	A-1+/AA-	£3.0m	3 months	£3.0m	1 year
B	F1/A-	P-1/A3	A-1/A-	£1.5m	3 months	£1.5m	1 year
C	Debt Management Office			£13m	3 months	£13m	1 year
D	Nationalised Banks and Banks covered by UK Government Guarantee			£3m	3 months	£3m	1 year
E	Other Local Authorities Individual Limits per Authority: - £2m County, Metropolitan or Unitary Councils - £1m District Councils, Police or Fire Authorities.			£10m	6 months	£10m	1 year
F	Three Money Market Funds (AAA) with maximum investment of £0.5m per fund			0	0	£1.5m	Liquid (instante access)

9.10 The credit rating of counterparties is monitored regularly. The Authority receives credit rating advice from its advisers, Capita Asset Services, on a daily basis, and as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Treasurer and if required new counterparties which meet the criteria will be added to the list.

9.11 **Specified and Non-Specified Investments**

9.12 CLG regulations classify investments as either Specified or Non-Specified. Specified Investment is any investment not meeting the Specified definition.

9.13 The investment criteria outlined above is different to that used to define Specified and Non-Specified investments. This is because it is intended to create a pool of high quality counterparties for the Authority to use rather than defining what its investments are.

9.14 Specified Investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Authority has the right to be repaid within twelve months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is small. These would include investments with:

- The UK Government (such as the Debt Management Office, UK Treasury Bills or a Gilt with less than one year to maturity).
- Other Local Authorities.
- Pooled investment vehicles (such as Money Market Funds) that have been awarded a high credit rating by a credit rating agency. This covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies
- A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society. This covers bodies with a minimum rating of A- (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies. Within these bodies, and in accordance with the Code, the Authority has set additional criteria to set the time and amount of monies which will be invested in these bodies.

9.15 Non-specified Investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any investments with:

- Building societies not meeting the basic security requirements under the specified investments. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings.
- Any bank or building society that has a minimum long term credit rating of A- for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).

9.16 In the normal course of the Authority's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

9.17 **Benchmarking**

9.18 A requirement in the revised Codes is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Security and liquidity benchmarks are new requirements and benchmarks in these areas are significantly less developed. The application of these is also more subjective in nature.

9.19 These benchmarks are simple targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is to assist monitoring and illuminate any changes to the strategy. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report

9.20 The benchmark for monitoring security is based on the historical risk of default associated with the credit rating of an organisation. The higher rated counterparties have a lower rate of historic default.

9.21 The table below sets out the historic default percentages for each type of credit rated institution and the period of deposit.

	Maturity Period				
Years	**1**	**2**	**3**	**4**	**5**
AAA	0.00%	0.02%	0.06%	0.09%	0.13%
AA	0.02%	0.04%	0.14%	0.28%	0.36%
A	0.09%	0.25%	0.43%	0.60%	0.79%
BBB	0.23%	0.65%	1.13%	1.70%	2.22%
BB	0.93%	2.47%	4.21%	5.81%	7.05%
B	3.31%	7.89%	12.14%	15.50%	17.73%
CCC	23.15%	32.88%	39.50%	42.58%	45.48%

9.22 The Authority has an extremely cautious investment strategy and this has avoided investment default. As a result the Authority has never suffered investment loss. It is expected that the recommended changes to the investment strategy will avoid investment default. However the Authority still needs to set a formal limit. It is therefore suggested that the Authority will aim to ensure that the historic default probability of its investment portfolio will not exceed 0.2%.

9.23 An additional proposed benchmark is the average risk of default. This is based on the historic risk of default multiplied by the value of each investment. It does not constitute the actual expectation of loss. Rather it is intended to give a guide as to the relative security of investments. For the forthcoming year this is expected not to exceed £100,000.

9.24 To ensure adequate Liquidity the Authority maintains a bank overdraft facility of £0.5m. In addition the Authority will make use of call accounts to enable cash to be obtained with immediate notice. The proposed benchmark for monitoring liquidity is ‘Weighted Average Life’. This reflects the average number of days to maturity for investments and therefore gives an indication of the liquidity profile of investments held. For the forthcoming year because of the lack of value obtainable for deposits exceeding 12 months and the need to ensure maximum security this benchmark is expected to be 0.5 years, with a maximum of 3 years.

10. MINIMUM REVENUE PROVISION AND INTEREST COSTS AND OTHER REGULATORY INFORMATION 2015/16

10.1 There are two elements to the Authority annual loan repayment costs – the statutory Minimum Revenue Provision (MRP) and interest costs. The Authority is required to pay off an element of the CFR each year through a revenue charge called the Minimum Revenue Provision (MRP).

10.2 CLG Regulations require the Authority to approve **an MRP Statement** in advance of each year. This will determine the annual loan repayment charge to the revenue account. The budget strategy is based on the following MRP statement and the Authority is recommended to formally approve this statement:

- For capital expenditure incurred before 1st April, 2008 the Authority's MRP policy is to calculate MRP in accordance with former CLG Regulations. This is 4% of the Capital Financing Requirement except where the Authority makes Voluntary Revenue Payments which is in excess of the amount required by these regulations, based on asset life;

- From 1st April, 2008 the Authority calculates MRP based on asset life for all assets or where prudential borrowing is financed by a specific annuity loan, MRP will be calculated according to the actual annuity loan repayments.

10.3 **CIPFA Treasury Management Code of Practice**

10.4 The Authority has adopted CIPFA Treasury Management Code of Practice. Confirmation of this is the first prudential indicator.

10.5 **Treasury Management Advisors**

10.6 The Authority uses Capita Asset Services – Treasury Solutions (formerly known as Sector) as its external treasury management advisors.

10.7 The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

10.8 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

11. BANKING CONTRACT UPDATE

11.1 Owing to concerns surrounding the Co-operative Bank (the Authority's bank) a proactive strategy was implemented in 2013/14 of clearing the Authority's bank account on a daily basis and placing deposits with more highly rated institutions. Later in the year the Co-operative Bank announced that after current local authority contracts expire, it will no longer be providing banking services to Local Authorities. The bank's stated aim is to simplify and rebuild the bank by focusing on individuals and small/medium sized businesses whilst ending relationships that require more complex banking requirements, such as with Local Authorities.

11.2 The Authority was already planning a tendering process for the banking contract when the Co-op made the announcement and in August 2014 a new contract was awarded to Lloyds Bank. It is intended that the contract with Lloyds will be fully implemented by 1 December 2014.

12. CONCLUSION

12.1 Against this uncertain national background and the requirement to make significant budget reductions to balance the 2015/16 to 2017/18 budget the Authority will need to make significant borrowing decisions over the next 12 to 24 months. These decisions will not only impact on the revenue budget in the short-term, they will also commit the Authority to costs for up to 40 years. Similar decisions will be made by many other authorities as they also seek to fund long term borrowing requirements.

12.2 It is anticipated that increases in the Base Rate are already largely factored in to longer terms interest rates, although this position cannot be guaranteed.

12.3 The report indicates that in order to deliver the full AMP it is necessary to create a Capital Funding Phasing Reserve. The Capital Funding Phasing Reserve will be used to balance loan repayment costs arising from AMP 14 over the period 2014/15 to 2028/29 by offsetting savings in the earlier years with higher costs in the later years. This is a similar position to PFI schemes.

12.4 The Authority's overall borrowing requirement, including the borrowing element of AMP, is forecast to be £9.7m by 31st March 2017, compared to £4.058m at 31st March 2014. If long term interest rates exceed the current forecast by 0.5% this will increase annual costs by approximately £50,000. This underlines the importance of the decisions facing the Authority.

12.5 The report outlines a strategy for managing interest rate risks with the aim of ensuring the borrowing requirement can be funded from the available revenue budget of £0.8m and use of the Capital Funding Phasing reserve.

12.6 In relation to the investment strategy the Authority has adopted an extremely prudent approach over the last few years. An updated assessment of potential risk has been completed and it is recommended that the Authority increases the duration of investments and also adds additional investment counterparties to the approved lending list. These recommendations are based on an updated assessment of potential risk and reflect improvements in the banking sector and banking regulations. In the short-term changes to the investment criteria will have a limited impact as the Authority overall approach will be to continue to net down investments and borrowings, as this is the lowest costs and lowest risk option.

CHRIS LITTLE
TREASURER TO THE AUTHORITY

Appendix A

Prudential Indicators 2013/14 Outturn

1. Ratio of Financing Costs to Net Revenue Stream

This indicator shows the proportion of the total annual revenue budget that is funded by the local tax payer and Central Government, which is spent on servicing debt. The outturn is lower than the estimate, mainly as a result of the very low rates of interest on and limited use of short term loans and under borrowing against the CFR.

2013/14 Estimate		2013/14 Outturn
1.58%	Ratio of Financing costs to net revenue stream	1.03%

2. Capital Expenditure

This indicator shows the total capital expenditure for the year.

2013/14 Estimate £'000		2013/14 Outturn £'000
5,482	Capital Expenditure	3,422

The actual is lower than the estimate as a result of re-profiling of expenditure within the capital programme including rephasing of expenditure between years. Capital expenditure was funded by a mix of Government Grants, planned revenue contributions and Prudential Borrowing.

3. Capital Expenditure Financed from Borrowing

This shows the borrowing required to finance the capital expenditure programme.

2013/14 Estimate £'000		2013/14 Outturn £'000
81	Capital Expenditure Financed by Borrowing	1,321

The actual is higher than the estimate owing to the re-profiling of expenditure within the capital programme including rephasing of expenditure between years.

4. Capital Financing Requirement

CFR is used to determine the minimum annual revenue charge for capital expenditure repayments (net of interest). It is calculated from the Authority's Balance Sheet and is shown below. Forecasts for future years are directly influenced by the capital expenditure decisions taken and the actual amount of revenue that is set aside to repay debt.

2013/14 Estimate £'000		2013/14 Outturn £'000
4,307	Capital Financing Requirement	4,436

The actual is higher than the estimate as a net result of the expenditure financed by borrowing being higher and the opening CFR being lower than originally estimated.

5. Authorised Limit for External Debt

The authorised limit determines the maximum amount the Authority may borrow at any one time. The authorised limit covers both long term borrowing for capital purposes and borrowing for short term cash flow requirements. The authorised limit is set above the operational boundary to provide sufficient headroom for operational management and unusual cash movements. In line with the Prudential Code, the level has been set to give the authority flexibility to borrow up to three years in advance of need if more favourable interest rates can be obtained.

2013/14 Limit £'000		2013/14 Peak £'000
7,500	Authorised limit for external debt	2,000

No additional borrowing was undertaken during the year and therefore the above Authorised Limit was not exceeded during the year.

6. Operational Boundary for External Debt

The operational boundary is the most likely prudent, but not worst case scenario, level of borrowing without the additional headroom included within the authorised limit. The level is set so that any sustained breaches serve as an early warning that the Authority is in danger of overspending or failing to achieve income targets and gives sufficient time to take appropriate corrective action.

2013/14 Limit £'000		2013/14 Peak £'000
5,500	Operational boundary for external debt	2,000

No additional borrowing was undertaken during the year and therefore the above Authorised Limit was not exceeded during the year.

7. Interest Rate Exposures

This indicator is designed to reflect the risk associated with both fixed and variable rates of interest, but must be flexible enough to allow the Authority to make best use of any borrowing opportunities.

2013/14 Limit £'000	Upper limits on fixed and variable interest rate exposure	2013/14 Peak £'000
100% 75%	Fixed Rates Variable Rates	100% 0%

The figures represent the peak values during the period.

8. Maturity Structure of Borrowing

This indicator is designed to reflect and minimise the situation whereby the Authority has a large repayment of debt needing to be replaced at a time of uncertainty over interest rates, but as with the indicator above, it must also be flexible enough to allow the Authority to take advantage of any borrowing opportunities.

	Upper Limit	Lower Limit	Actual by Maturity Date	Actual by soonest call date
Under 12 months	100%	0%	0%	0%
12 month to 2 years	100%	0%	0%	0%
2 years to 5 years	100%	0%	0%	100%
5 years to 10 years	100%	0%	0%	0%
10 years to 20 years	100%	0%	0%	0%
20 years to 30 years	100%	0%	0%	0%
30 years to 40 years	100%	0%	0%	0%
40 years to 50 years	100%	0%	0%	0%
50 years to 60 years	100%	0%	0%	0%
60 years to 70 years	100%	0%	100%	0%

The Authority's current outstanding borrowing takes the form of LOBO (Lender Option Buyer Option) loans which provide fixed interest rates for defined periods and also defined dates for reviewing interest rates, known as ‘call dates’. A recent change to the Prudential Code requires that the call date is reflected in the Maturity Structure indicator above rather than maturity date. However the likelihood of a LOBO being ‘called’ at present is very low and both methods are presented above for completeness.

9. Investments over Maturing over One Year

This sets an upper limit for amounts invested for periods longer than 364 days. The limit was not exceeded as a prudent approach to investment has been taken owing to uncertainties in the economy this is in line with the Treasury Management Strategy. Consequently all investments made during the year were limited to less than one year.

	1 year £000	2 year £000	3 year £000
Maximum Limit	0	0	0
Actual	0	0	0

APPENDIX 2

TREASURY MANAGEMENT STRATEGY 2015/16 REGULATORY INFORMATION AND PRUDENTIAL INDICATORS

1. INTRODUCTION

1.1 The Audit and Governance Committee considered the Treasury Management Strategy for 2015/16 on 14th November 2014. The Audit and Governance Committee approved the recommended Borrowing and Investment Strategy. However, owing to the timing of the Audit and Governance Committee meeting and of capital and revenue funding announcements from the Government, it was not possible to present detailed prudential indicators. The Audit Governance Committee noted that these would be reported to the full Fire Authority and are presented in this Appendix. The late announcement of this information does not impact on the recommended strategy as the capital funding announcements relate to capital grant allocations which fully fund defined Government capital spending priorities.

2. PRUDENTIAL INDICATORS

2.1 The Local Government Act 2003 requires the Authority to adopt the CIPFA Prudential Code and set prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity.

2.2 The first prudential indicator is confirmation that the Authority has adopted the CIPFA Treasury Management Code of Practice, which the Treasury Management Strategy report confirms.

2.3 Details of the proposed prudential limits are set out in the following sections.

3. CAPITAL EXPENDITURE AND FINANCING REQUIREMENT

3.1 The Authority's Borrowing Strategy is driven by the Capital Financing Requirement (CFR) and the Authority's view of interest rates. The CFR is simply the total outstanding capital expenditure which has not yet been paid for from revenue budgets. It is essentially a measure of the Authority's underlying borrowing need based on capital programmes approved by the Authority in previous years.

3.2 The Government no longer issues supported borrowing allocations. Consequently all borrowing is now made under the Prudential Borrowing Code. Capital spending decisions need to have regard to the following;

- Service objectives (e.g. strategic planning);
- Stewardship of assets (e.g. asset management planning);
- Value for money (e.g. option appraisal);
- Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
- Affordability (e.g. implications for the Council Tax);
- Practicality (e.g. the achievability of the forward plan).

3.4 The Authority ultimately needs to fund the CFR by borrowing money from the Public Works Loan Board (PWLB) or banks. The CFR is then repaid over a number of years reflecting the long term benefits of capital expenditure. In simple terms the CFR represents the Authority's outstanding mortgage, although the legislation and accounting requirements are significantly more complex.

3.5 As part of the Medium Term Financial Strategy the Authority is required to approve the 2015/16 capital programme as summarised below:

Capital Expenditure	**2014/15 Revised £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**
Capital Expenditure	5,556	11,741	6,556	2,363
Financed by:				
Capital grants and contributions	3,003	6,072	0	0
Reserves	2,033	5,166	4,049	1,515
Prudential Borrowing	520	503	2,507	848
Total Funding	**5,556**	**11,741**	**6,556**	**2,363**

3.6 The estimated Capital Finance & Borrowing Requirement is shown in the table below:

Capital Financing & Borrowing Requirement	**2014/15 Revised £'000**	**2015/16 Estimate £'000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**
CFR at 1st April	**4,436**	**4,578**	**4,698**	**6,824**
Capital Expenditure Financed by Borrowing	520	503	2,507	848
Less Repayment of CFR	(378)	(383)	(381)	(399)
CFR at 31st March	**4,578**	**4,698**	**6,824**	**7,273**

4. AFFORDABILITY PRUDENTIAL INDICATORS

4.1 The affordability of the approved Capital Investment Programme was assessed when the investment programme was approved and revenue costs are built into the Medium Term Financial Strategy. The 'Affordability Prudential Indicators' are detailed below and are intended to give an indication of the affordability of the planned capital expenditure financed by borrowing in terms of the impact on Council Tax and the Net Revenue Stream.

4.2 Incremental Impact of Capital Expenditure on Council Tax

4.3 This indicator identifies the revenue costs associated with new schemes included in the three year Capital Programme recommended in the budget strategy report compared to the Authority's existing approved commitments and current plans. The incremental impact of capital expenditure on Council Tax is expected to increase in line with the anticipated increase in prudential borrowing.

	Forward Projection	**Forward Projection**	**Forward Projection**	**Forward Projection**
	2014/15 £'000	**2015/16 £'000**	**2016/17 £'000**	**2017/18 £'000**
CouncilTax - Band D	£0.95	£0.96	£1.19	£1.03

4.4 Ratio of Financing Costs to Net Revenue Stream

4.5 This shows the net cost of capital borrowing as a percentage of the net budget.

%	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Ratio	1.95%	2.05%	2.43%	2.64%

5. BORROWING PRUDENTIAL INDICATORS

5.1 Debt Projections 2014/15 – 2017/18

5.2 The table below sets out the Authority's projected Capital Financing Requirement (CFR) and level of debt:

Debt and Investment Projections	**2014/15 Revised £'000**	**2015/16 Estimated £'000**	**2016/17 Estimated £'000**	**2017/18 Estimated £'000**
Long Term Borrowing 1 April	2,000	3,820	3,820	3,820
Expected change in Long Term Debt	1,820	0	0	0
Debt at 31 March	**3,820**	**3,820**	**3,820**	**3,820**
CFR	**4,578**	**4,698**	**6,824**	**7,273**
Under Borrowing	**(758)**	**(878)**	**(3,004)**	**(3,453)**

5.3 The table shows that for the period of the Medium Term Financial Strategy the Authority can temporarily defer long term borrowing by continuing to use its balance sheet resources. This Strategy continues to reduce investment counterparty risk and also shelter against the low investment returns.

5.4 Limits to Borrowing Activity

5.5 Within the prudential indicators there are a number of key indicators to ensure the Authority operates its activities within well defined limits.

5.6 The Authority needs to ensure that its total borrowing does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2015/2016 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. The table below demonstrates that net borrowing will not exceed the CFR.

External Debt	**2014/15 Revised £'000**	**2015/16 Estimated £'000**	**2016/17 Estimated £'000**	**2017/18 Estimated £'000**
Gross Borrowing	3,820	3,820	3,820	3,820
Capital Financing Requirement	**4,578**	**4,698**	**6,824**	**7,273**

5.7 The table below shows two key limits for the monitoring of debt. The Operational Limit is the likely limit the Authority will require and is aligned closely with the actual CFR on the assumption that cash flow is broadly neutral. The Authorised Limit for External Debt is a further key prudential indicator to control the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Authority. In practice it needs to take account of the range of cash flows that might occur for the Authority in addition to the CFR. This also includes the flexibility to enable advance refinancing of existing loans.

Borrowing Limits	**2014/15 Estimated £'000**	**2015/16 Estimated £'000**	**2016/17 Estimated £'000**	**2017/18 Estimated £'000**
Operational Limit	6,000	6,000	8,000	8,000
Authorised limit	8,000	8,000	10,000	10,000

6. INVESTMENT PRUDENTIAL INDICATORS AND OTHER LIMITS ON TREASURY ACTIVITY

6.1 Investment Projections 2014/15 – 2017/18

6.2 The table below sets out the estimates for the expected level of resource for investment or use to defer long term borrowing.

2013/14 Outturn £'000	Year End Resources	2014/15 Estimate £'000	2015/16 Estimate £'000	2016/17 Estimate £'000	2017/18 Estimate £'000
15,670	Balances and Reserves	12,845	6,905	2,690	1,245
162	Provisions	0	0	0	0
423	Collection fund Adjustment Account	0	0	0	0
16,255	**Total Core Funds**	**12,845**	**6,905**	**2,690**	**1,245**
2,184	Working Capital*	2,200	2,200	2,200	2,200
18,439	**Resources Available for Investment**	**15,045**	**9,105**	**4,890**	**3,445**
(2,435)	(Under)/over borrowing	(758)	(878)	(3,004)	(3,453)
16,004	**Expected Investments**	**14,287**	**8,227**	**1,886**	**(8)**

6.3 <u>Sensitivity to Interest Rate Movements</u>

6.4 Sensitivity to Interest Rate Movements is a prudential indicator that the Authority is required to disclose. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. These forecasts are based on a prudent view of a +/- 1% change in interest rates for the full CFR. Equally for investments they are based on a prudent view of the total amount invested. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by short interest rate changes.

Impact on Revenue Budgets	2015/16 Estimated 1% £'000	2015/16 Estimated -1% £'000
Interest on Borrowing	47	(47)
Investment income	(82)	82
Net General Fund Borrowing Cost	**(35)**	**35**

6.5 There are four further treasury activity limits and the purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates.

6.6 The limits are:

i) Upper limits on variable interest rate exposure – This identifies a maximum limit for the percentage of the Authority’s borrowing and investments that are held with variable interest rates. The proposed limits are detailed in the table below.

Limits on Variable Interest Rates	2015/16 Upper £'000	2016/17 Upper £'000	2017/18 Upper £'000
Borrowing	75%	75%	75%
Investments	100%	100%	100%

ii) Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit for the percentage of the Authority's borrowing and investments that are held with fixed interest rates.

Limits on Fixed Interest Rates	2015/16 Upper £'000	2016/17 Upper £'000	2017/18 Upper £'000
Borrowing	100%	100%	100%
Investments	100%	100%	100%

iii) Maturity structure of borrowing – Limits for the 'Maturity Structure of Borrowing' are intended to reduce exposure to large fixed rate sums falling due for refinancing. In the opinion of the Treasurer limits on fixed and variable rates for **borrowing** are unhelpful and could lead to higher costs of borrowing. Previous experience has shown that it is possible to move from a position of predominantly fixed rate borrowing to variable rate borrowing and then back to fixed rate borrowing over a period of two years. In the Treasurer's professional opinion this proactive management of investments and borrowing continues to provide the most cost effective strategy for the Authority, whilst not exposing the Authority to unnecessary risk. The Authority should ensure maximum flexibility to minimise costs to the revenue budget in the medium term. These limits are detailed in the table below:

Maturity Structure of fixed interest rate borrowing				
	2014/15 £000 Lower Limit	2014/15 £000 Upper Limit	2015/16 £000 Lower Limit	2015/16 £000 Upper Limit
Under 12 months	0	5,500	0	5,500
12 months to 2 years	0	6,000	0	6,000
2 years to 5 years	0	6,000	0	6,000
5 years to 10 years	0	6,000	0	6,000
10 years to 20 years	0	6,000	0	6,000
20 years to 30 years	0	6,000	0	6,000
30 years to 40 years	0	6,000	0	6,000
40 years to 50 years	0	6,000	0	6,000
50 years to 60 years	0	6,000	0	6,000
60 years to 70 years	0	6,000	0	6,000

The limits allow for borrowing up to the Capital Financing Requirement at either variable or fixed rates. The intention is to move to fixed rate borrowing when rates are at an appropriate level and may require the temporary use of variable rate borrowing in the interim.

iv) Maximum principal sums invested – Total principal funds invested for greater than 364 days – These limits are set with regard to the Authority's liquidity requirements and reflect the current recommended advice that investments are limited to short term investments i.e. up to 1 year.

Limit for Maximum Pincipal Sums Invested > 364 days			
	1 year £000	**2 years £000**	**3 years £000**
Maximum	8,000	0	0

6.7 Performance Indicators

6.8 The Code of Practice on Treasury Management requires the Authority to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. The Authority will produce the following performance indicators for information and explanation of previous treasury activity:

- Average rate of borrowing for the year compared to average available
- Debt – Average rate movement year on year
- Investments – returns compared to the 7 day LIBID rate