TREASURY MANAGEMENT STRATEGY 2017/18

REPORT OF THE TREASURER

CLEVELAND FIRE AUTHORITY

For Approval

1. PURPOSE OF REPORT

1.1 To enable the Fire Authority to approve the recommended Treasury Management Strategy for 2017/18.

2. RECOMMENDATIONS

It is recommended that Members note the report and the recommendation from the Audit and Governance Committee to approve the following detailed recommendations for the 2017/18 Treasury Management Strategy and related issues:

i) Investment Strategy

a. Approve the increase in the Counterparty Limit for Svenska Handelsbanken from £1m to £2m.
b. Approve the increase in the Counterparty Limit for County, Metropolitan or Unitary Councils from £2m to £3m.
c. Approve the increase in the Counterparty Limit for District Councils, Police or Fire Authorities from £1m to £1.5m
d. Approve the Counterparty limits as set out in Appendix 1 paragraph 9.8, which incorporates the above recommendations (a) to (c).

ii) Minimum Revenue Provision (MRP) Statement

Recommend to the Authority the approval of the MRP statement outlined in Appendix 1 paragraph 10.2.

iii) Prudential Indicators 2017/18
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 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 11th November 2016 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 2017/18

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 recommended 2017/18 Treasury Management Strategy before it is referred to the full Fire Authority for approval.

2. RECOMMENDATIONS

It is recommended that Members consider the recommended 2017/18 Treasury Strategy and note that if Members are content the following recommendations will be referred to the full Fire Authority for approval:

i) Note the 2015/16 Treasury Management outturn detailed in section 5 and Appendix A.

ii) Note the 2016/17 Treasury Management mid-year position detailed in section 6.

iii) Note that detailed prudential indicators for 2017/18 and future years will be reported to full Fire Authority in February 2017.

iv) Investment Strategy 2017/18

a. Approve the increase the Counterparty Limit for Svenska Handelsbanken from £1m to £2m.
b. Approve the increase the Counterparty Limit for County, Metropolitan or Unitary Councils from £2m to £3m.
c. Approve the increase the Counterparty Limit for District Councils, Police or Fire Authorities from £1m to £1.5m
d. Approve the Counterparty limits as set out in paragraph 9.8, which incorporates the above recommendations (a) to (c).

v) Minimum Revenue Provision (MRP) Statement
Recommend to the Authority the approval of the MRP 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.

3. BACKGROUND

3.1 The Treasury Management Strategy covers:

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

3.2 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.

3.3 The Act 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, and has subsequently been updated. This guidance recommends that all Local Authorities produce an Annual Investment Strategy that is approved by the Authority.

3.4 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.

3.5 This report covers the following areas:

- Economic background and outlook for interest rates
- Treasury management outturn position for 2015/16
- Treasury Management Strategy 2016/17 mid-year review
- Treasury Management Strategy 2017/18
- Minimum Revenue Provision and Interest Cost and Other Regulatory Information 2017/18

4. ECONOMIC BACKGROUND AND OUTLOOK FOR INTEREST RATES

4.1 At the time the 2016/17 Treasury Management Strategy was proposed most economists anticipated that interest rates in the USA and the UK would begin to increase during 2016. This position reflected underlying economic conditions and statements from both the Federal Reserve and the Bank of England.

4.2 However following the referendum vote to leave the EU in June this year there was a change in the outlook for UK interest rates and greater uncertainty.

4.3 The Bank of England cut the Bank Rate from 0.5% to a new historic low, 0.25% as part of a package of measures to address the expected slowdown in growth. The Governor of the Bank of England had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, owing to uncertainty of whether the UK would continue to have full access to the EU single market (i.e. without tariffs). The Governor indicated that monetary policy alone would not be sufficient to address emerging issues in the economy suggesting that the Government would need to help growth by increasing investment expenditure and possibly use fiscal tools such as taxation. The new Chancellor Phillip Hammond announced after the referendum result that the target of achieving a budget surplus in 2020 will be eased in the November 2016 Autumn Statement.

4.4 Inflation is forecast to rise in 2018 and 2019 to around 2.4%. The Consumer Prices Index (CPI) started rising during 2016 as the fall in the price of oil and food twelve months earlier dropped out of the calculation during the year. In addition, the fall in the value of sterling following the referendum is likely to result in a further increase in CPI over a time period of three to four years. Since the referendum in June the pound has fallen about 18% against the dollar. This reflects the market view that growth is likely to be stronger in the US than the UK and that UK interest rates are falling while US interest rates are expected to increase.

4.5 **U.S.A. economy** – Following overall growth of 2.4% in 2015 the US economy disappointed in the first quarter of 2016 with annualised growth at 0.8% but improving to 1.4% in the second quarter. However, forward indicators are pointing to a pickup in growth for the remainder of 2016. After holding interest rates at near 0% for seven years the Federal Reserve increased rates by 0.25% in December 2015. At that point it was anticipated that there would be four more rate rises to come in 2016. However, more downbeat international economic news has delayed the timing of the second increase which is now not expected until December 2016 at the earliest.

4.6 **Eurozone economy** – In an effort to stimulate the Eurozone economy the European Central Bank (ECB) initiated a €1.1 trillion quantitative easing (QE) programme in January 2015, buying up high quality government debt of selected Eurozone countries at a rate of €60 billion per month. This programme was expected to run until September 2016 but was extended by the ECB to March 2017. The ECB progressively cut its deposit facility interest rate with it reaching -0.4% in March 2016. At the same meeting the ECB also increased its monthly asset purchase rate to €80 billion per month. These measures have struggled to make an impact in boosting economic growth. GDP growth rose by 0.6% in the first quarter of 2016 but slowed to an increase of 0.3% in the second quarter. This has led to many commentators stating that central banks around the world are running out of tools to stimulate economic growth. This position highlights the need for national governments to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in their economies and stimulate economic growth.

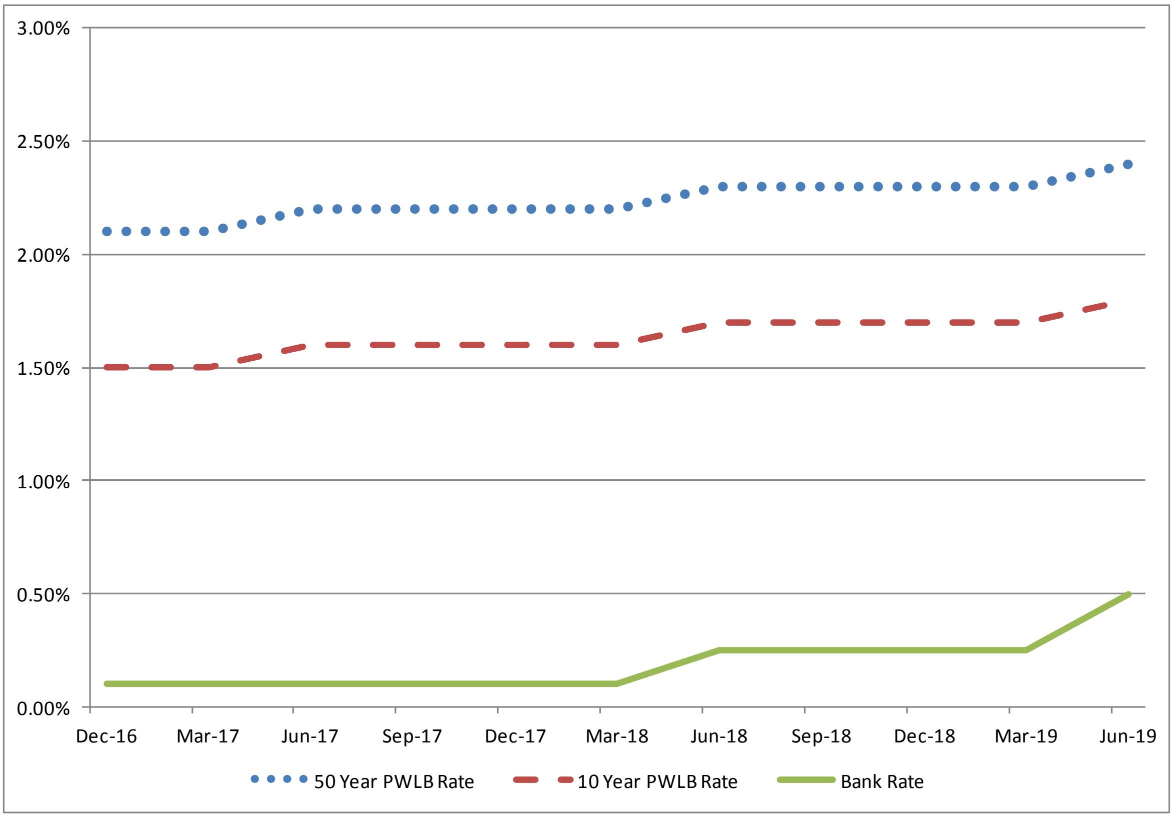
4.7 **Other economies** – Japan continues to struggle with very weak economic growth and is making little progress on fundamental reform of its economy. Chinese economic growth has been weakening and medium term risks have been increasing with many commentators worried about the adverse affect this may have on the already weak global economic recovery.

4.8 **Interest Rate Forecasts**

4.9 Forecasting future interest rates remains extremely challenging. Prior to the EU referendum Bank Rate had remained unchanged for significantly longer than most economists initially forecast but an increase in interest rates was widely anticipated. However, following the EU referendum the Bank Rate was reduced to a new historic low of 0.25%. Capita Asset Services (the Authority's Treasury Management advisors) continue to update their forecasts to reflect statements made by the Governor of the Bank of England and changes in the economy. Their latest forecast incorporates forward guidance which indicates that there may be a further rate cut to 0.1% in November 2016. An increase back to 0.25% is not anticipated until May 2018.

4.10 The Governor of the Bank of England has repeatedly stated that increases in Bank Rate will be slow and gradual once they do start. The Monetary Policy Committee is concerned about the impact of increases on heavily indebted consumers, especially when growth in average disposable income is still weak and could turn negative if inflation rises as forecast. Capita Asset Services' latest forecasts up to June 2019 are provided in the following graph.

<u>Interest Rate Forecast up to June 2019</u>



4.11 Since the late 1990s Bank Rate has been on average 5% until 2009 when the Bank of England reduced it to the historically low 0.5% in response to the financial crisis. Over the same period PWLB rates have been significantly higher than they are at present. The rates for 10 year loans were on average 5% prior to the financial crisis but subsequently fell to between 3% and 4%. The rates for 50 year loans were also on average 5% although this trend continued throughout the financial crisis. PWLB interest rates fell to historically low levels in early 2015 predominantly as a consequence of falling oil prices. They fell further following the EU referendum to the current levels. In the context of previous interest rates, current rates are at an unprecedented low level.

5. TREASURY MANAGEMENT OUTTURN POSITION 2015/16

5.1 **Capital Expenditure and Financing 2015/16**

5.2 The Authority's approved capital programme was funded from a combination of capital grants and the Capital Investment Programme Reserve. Expenditure planned to be funded by prudential borrowing was rephased into 2016/17

5.3 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 £7.278m, funded by a mix of Capital Receipts, Government Grants and use of the Capital Investment Programme Reserve.

5.4 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.

5.5 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.

5.6 The Authority's CFR for the year was £4.068m as shown at Appendix A.

5.7 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. As previously reported, in line with the approved Treasury Management Strategy a decision was made in 2014/15 to lock out borrowing to cover the forecast borrowing requirement up to and including 2016/17. At the time interest rates were exceptionally low and allowed the Authority to secure the business case for the Asset Management Plan.

5.8 The Authority's total long term external borrowing as at 31st March, 2016 was £7.2m, which funds the CFR up to 2016/17.

5.9 **Prudential Indicators and Compliance Issues 2015/2016**

5.10 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.

5.11 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 2015/2016 the Authority has maintained gross borrowing within the Authorised Limit.

5.12 **Net Borrowing and the CFR** – In order to ensure that borrowing levels are prudent the Authority's external borrowing, net of investments, must only be for a capital purpose. The Authority has complied with this Prudential Indicator.

5.13 **The Treasury position at 31st March 2016**

5.14 The table below shows the treasury position for the Authority as at the 31st March, 2016 compared with the previous year:

Treasury position	31st March 2015		31st March 2016	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt				
- PWLB	£5.3m	3.04%	£5.2m	3.05%
- Market Loans (LOBOs)	£2.0m	3.95%	£2.0m	3.95%
Total Long Term Debt	**£7.3m**	**3.29%**	**£7.2m**	**3.30%**
Total Investments	**£19.7m**	**0.40%**	**£17.90**	**0.48%**
Net Investment Position	**£12.4m**		**£10.7m**	

5.15 A key performance indicator shown in the above table is the exceptionally low average rate of external debt of 3.30% for debt held as at 31st March, 2016, compared to historic PWLB (Public Works Loans Board) rates.

5.16 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 13th February, 2015.

5.17 The Authority does not rely solely on credit ratings and takes 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 6 months but to a maximum of 1 year. In practice only £1.5m was invested for 1 year. This was placed with Lloyds bank which is currently part owned by the Government. 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 2015/16 the risk associated with these higher returns would not have been prudent.

5.22 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.

5.23 **Regulatory Framework, Risk and Performance 2015/16**

5.24 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.

5.25 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.

6. TREASURY MANAGEMENT STRATEGY 2016/17 MID-YEAR REVIEW

6.1 The 2016/17 Treasury Management Strategy was approved on the 12th, February, 2016. The Authority's borrowing and investment position as at 30th September 2016 is summarised as follows:

	£m	Average Rate
LOBO Loan #	2.0	3.95%
PWLB Loans	5.2	3.05%
Gross Debt	**7.2**	**3.30%**
Investments	20.0	0.40%
Net Investment	**12.8**	

A LOBO (Lender Option, Borrower Option) loan was taken out in March 2007 at which time interest rates for comparative PWLB loans were 4.3%.

6.2 As part of the Treasury Strategy for 2016/17 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.

6.3 The CFR and Capital Expenditure Financed by Borrowing will vary from the original estimate approved by the Fire Authority in February 2016 owing to planned capital expenditure being re-phased 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 2017/18

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 2017/18 prior to this being reported to the full Fire Authority as part of the Medium Term Financial Strategy process. This is because the Council Tax Base has not yet been set and the Net Revenue Budget has not yet been set. 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 2017/18

8.1 Following the development and implementation of the Asset Management Plan (AMP) the Authority's CFR has begun to rise and is forecast to continue to rise over the course of the Medium Term Financial Strategy. Therefore it was recognised that a proactive borrowing strategy would need to be adopted to finance the borrowing element of the AMP and to secure historically low interest rates.

8.2 As outlined in paragraph 5.7, owing to exceptionally low interest rates in 2014/15 a decision to borrow to the forecast CFR in 2016/17 has already been made.

8.3 This decision meets the key requirement outlined in the 2016/17 Treasury Management Strategy i.e. 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:

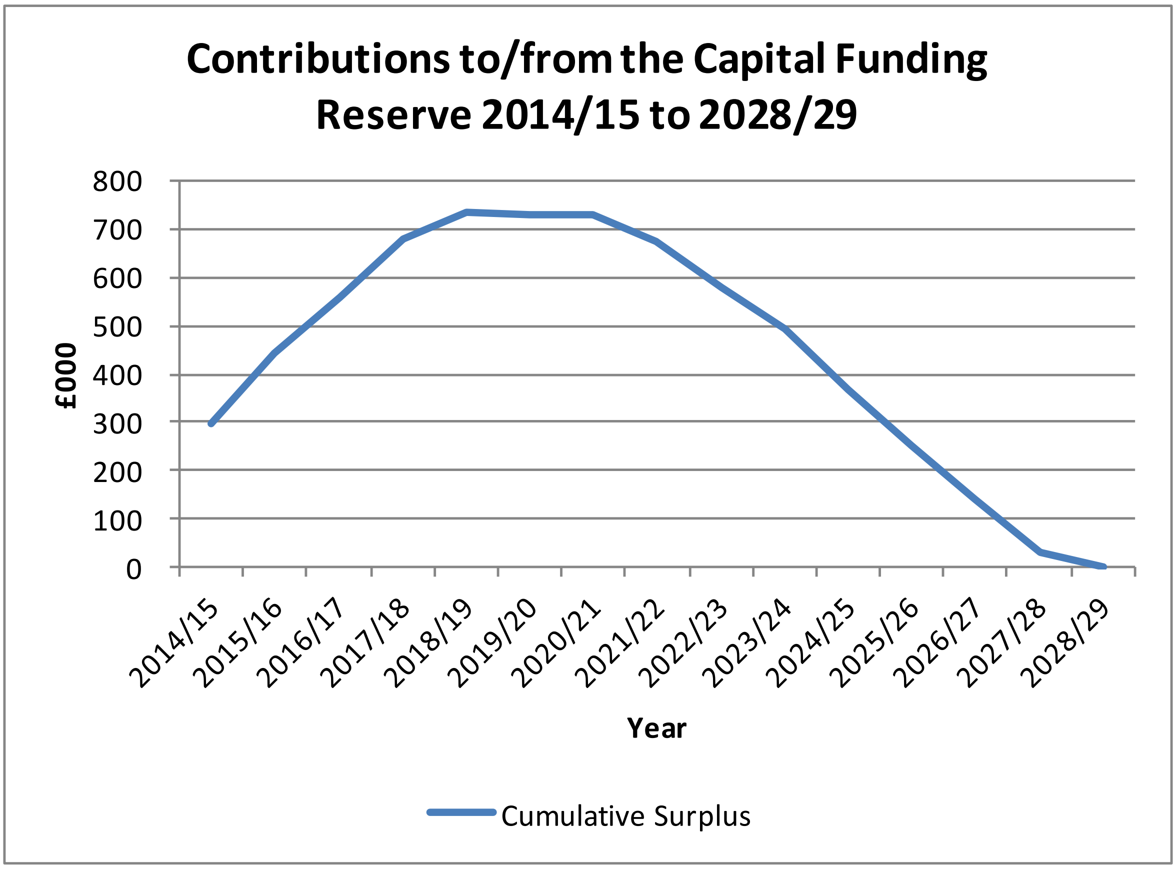
- the period of the current Medium Term Financial Strategy and Integrated Risk Management Plan; and,
- the period beyond 2018/19 to ensure the longer term financial sustainability of the Authority.

8.4 Following the EU referendum interest rates have reduced further and are at a new historic low. Further borrowing decisions may be made in 2016/17 to pre-fund future capital expenditure.

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

8.6 As previously reported detailed financial modelling has been undertaken to assess the impact of the capital programme on the revenue budget. This analysis indicated that in the short term, loan repayment costs will be less than the approved budget which reflects the phasing of the capital programme and the exceptionally low interest rates secured.

8.7 However, over the period 2020/21 to 2028/29 annual loan repayment costs will exceed the approved revenue budget. As outlined in the approved 2016/17 Strategy this position is being 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.



9. INVESTMENT STRATEGY 2017/18

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. The Authority has adopted the CIPFA Treasury Management Code. 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 Counterparty Selection Criteria

9.4 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.

9.5 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

9.6 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.

9.7 Following the deterioration of market conditions as a result of the EU referendum a review of the current counterparty list has been completed. The current counterparty list continues to be limited and the surplus cash flow continues to be invested with high quality institutions. However interest rates on some instant access accounts have reduced to near 0% and the following amendments are recommended in order to increase flexibility and secure investment income with existing high quality counterparties:

- Increase the Counterparty Limit for Svenska Handelsbanken from £1m to £2m.
- Increase the Counterparty Limit for County, Metropolitan or Unitary Councils from £2m to £3m.
- Increase the Counterparty Limit for District Councils, Police or Fire Authorities from £1m to £1.5m.

9.8 The following table shows the proposed limits in 2017/18 for the Authority:

Category	Fitch	Moody's	Standard & Poor's	Proposed Counterparty Limit	Proposed Time Limit
A	F1+/AA-	P-1/Aa3	A-1+/AA-	£5m	1 year
B	F1/A-	P-1/A3	A-1/A-	£3m	1 year
C	Debt Management Office/Treasury Bills/Gilts			£14m	1 year
D	Nationalised Banks and Banks covered by UK Government Guarantee			£5m	1 year
E	Other Local Authorities Individual Limits per Authority: - £3m County, Metropolitan or Unitary Councils - £1.5m District Councils, Police or Fire Authorities.			£15m	1 year
F	Three Money Market Funds (AAA) with maximum investment of £1.5m per fund			£4.5m	Liquid (instant access)
G	Svenska Handelsbanken			£2m	3 months

9.9 **Specified and Non-Specified Investments**

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

9.11 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.

9.12 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 (AAA) by a credit rating agency.
- 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.

9.13 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).

10. MINIMUM REVENUE PROVISION AND INTEREST COSTS AND OTHER REGULATORY INFORMATION 2017/18

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 the Minimum Revenue Provision (MRP) which is a charge to the revenue budget.

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 budget. 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 the 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 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. CONCLUSION

11.1 Against the uncertain national background and the requirement to make significant budget reductions to balance the 2017/18 to 2019/20 budget the Authority has secured long term borrowing at historically low interest rates. This has secured the financing of the Asset Management Plan and has protected the authority against increases in longer term interest rates.

11.2 The report confirms the previously approved 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.

11. 3 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 in response to reductions in investment counter parties it is recommended that the Authority approves the revised counterparty criteria as set out in paragraphs 9.7 and 9.8.

CHRIS LITTLE
TREASURER TO THE AUTHORITY

Appendix A

Prudential Indicators 2015/16 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.

2015/16 Estimate £'000		2015/16 Outturn £'000
2.06%	Ratio of Financing costs to net revenue stream	2.05%

2. Capital Expenditure

This indicator shows the total capital expenditure for the year and the outturn reflects the actual phasing of capital expenditure.

2015/16 Estimate £'000		2015/16 Outturn £'000
7,623	Capital Expenditure	7,278

3. Capital Expenditure Financed from Borrowing

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

2015/16 Estimate £'000		2015/16 Outturn £'000
561	Capital Expenditure Financed by Borrowing	0

Planned capital expenditure funded by borrowing was rephased into the 2016/17.

4. Capital Financing Requirement (CFR)

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.

2015/16 Estimate £'000		2015/16 Outturn £'000
4,675	Capital Financing Requirement	4,068

The CFR was lower than forecast as planned Capital expenditure funded by borrowing was rephased into 2016/17.

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.

2015/16 Limit £'000		2015/16 Peak £'000
8,000	Authorised limit for external debt	7,320

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.

2015/16 Limit £'000		2015/16 Peak £'000
7,500	Operational boundary for external debt	7,320

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.

2015/16 Limit £'000	Upper limits on fixed and variable interest rate exposure	2015/16 Peak £'000
7,500	Fixed Rates	5,320
5,500	Variable Rates	2,000

8. <u>Maturity Structure of Borrowing</u>

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 £'000	Lower Limit £'000	Actual by Maturity Date £'000	Actual by soonest call date £'000
Under 12 months	5,500	0	93	2,093
12 month to 2 years	6,000	0	96	96
2 years to 5 years	6,000	0	303	303
5 years to 10 years	6,000	0	313	313
10 years to 20 years	6,000	0	727	727
20 years to 30 years	6,000	0	994	994
30 years to 40 years	6,000	0	2,704	2,704
40 years to 50 years	6,000	0	0	0
50 years to 60 years	6,000	0	0	0
60 years to 70 years	6,000	0	2,000	0

The Authority's current outstanding borrowing includes a LOBO (Lender Option Buyer Option) loan which provide fixed interest rates for defined periods and also defined dates for reviewing interest rates, known as 'call dates'. A 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. <u>Investments over Maturing over One Year</u>

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 a maximum of one year.

	1 year £000	2 year £000	3 year £000
Maximum Limit	8,000	0	0
Actual	1,500	0	0

TREASURY MANAGEMENT STRATEGY 2017/18 REGULATORY INFORMATION AND PRUDENTIAL INDICATORS

1. INTRODUCTION

1.1 The Audit and Governance Committee considered the Treasury Management Strategy for 2017/18 on 11th November 2016. The Audit and Governance Committee approved the recommended Borrowing and Investment Strategy. However, owing to the timing of funding announcements from the Government, it was not possible to present detailed prudential indicators to the Audit and Governance Committee. The Audit Governance Committee noted that these would be reported to the full Fire Authority and are detailed in this Appendix. The late announcement of this information does not impact on the recommended strategy which outlines the key principles covering the operation of the Authority's borrowing and investment strategy.

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

Capital Financing & Borrowing Requirement	**2016/17 Revised £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**
CFR at 1st April	**4,068**	**7,011**	**7,388**	**7,162**
Capital Expenditure Financed by Borrowing	3,357	789	242	0
Less Repayment of CFR	(414)	(412)	(468)	(476)
CFR at 31st March	**7,011**	**7,388**	**7,162**	**6,686**

3.6 As part of the Medium Term Financial Strategy the Authority is required to approve the 2017/18 capital programme summarised as follows:

Capital Expenditure	**2016/17 Revised £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**
Capital Expenditure	5,698	7,994	631	0
Financed by:				
Capital grants and contributions	137	0	0	0
Reserves	2,204	7,205	389	0
Prudential Borrowing	3,357	789	242	0
Total Funding	**5,698**	**7,994**	**631**	**0**

4. AFFORDABILITY PRUDENTIAL INDICATORS

4.1 The affordability of the approved Capital Investment Programme was assessed when the Asset Management Plan 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 reflects the phasing of prudential borrowing.

	Revised	Forward Projection	Forward Projection	Forward Projection
	2016/17 £'000	2017/18 £'000	2018/19 £'000	2019/20 £'000
CouncilTax - Band D	£0.51	£0.12	£0.04	£0.00

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 and the forecast annual increases reflect the phasing of borrowing to partly fund the Asset Management Plan.

%	2016/17 Revised	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Ratio	2.35%	2.43%	2.67%	2.68%

5. BORROWING PRUDENTIAL INDICATORS

5.1 Debt Projections 2016/17 – 2019/20

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

Debt and Investment Projections	2016/17 Revised £'000	2017/18 Estimated £'000	2018/19 Estimated £'000	2019/20 Estimated £'000
Long Term Borrowing 1 April	7,136	7,043	6,947	6,848
Expected change in Long Term Debt	(93)	(96)	(99)	(102)
Debt at 31 March	**7,043**	**6,947**	**6,848**	**6,746**
CFR	**7,011**	**7,388**	**7,162**	**6,686**
Advance/(Under) Borrowing	**32**	**(441)**	**(314)**	**60**

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 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 2017/2018 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.

External Debt	2016/17 Revised £'000	2017/18 Estimated £'000	2018/19 Estimated £'000	2019/20 Estimated £'000
Gross Borrowing	7,043	6,947	6,848	6,746
Capital Financing Requirement	**7,011**	**7,388**	**7,162**	**6,686**

5.7 The following table 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	2016/17 Estimated £'000	2017/18 Estimated £'000	2018/19 Estimated £'000	2019/20 Estimated £'000
Operational Limit	10,000	10,000	10,000	10,000
Authorised limit	12,000	12,000	12,000	12,000

6. INVESTMENT PRUDENTIAL INDICATORS AND OTHER LIMITS ON TREASURY ACTIVITY

6.1 Investment Projections 2016/17 – 2019/20

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

2015/16 Outturn £'000	Year End Resources	2016/17 Revised £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
15,702	Balances and Reserves	14,113	4,956	3,872	3,427
204	Provisions	0	0	0	0
381	Collection fund Adjustment Account	(350)	60	60	60
16,287	**Total Core Funds**	**13,763**	**5,016**	**3,932**	**3,487**
(800)	Working Capital*	(800)	(800)	(800)	(800)
15,487	**Resources Available for Investment**	**12,963**	**4,216**	**3,132**	**2,687**
3,068	(Under)/Advance borrowing	32	(441)	(314)	60
18,555	**Expected Investments**	**12,995**	**3,775**	**2,818**	**2,747**

* The working capital balance is an estimate of debtors and creditors at year end.

6.3 Sensitivity to Interest Rate Movements

6.4 Sensitivity to Interest Rate Movements is a prudential indicator that the Authority is required to disclose. The following table 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. As borrowing has already been undertaken to fund the majority of the CFR there is limited risk in relation to the impact of borrowing on revenue budgets for 2017/18. For investments they are based on a prudent view of the total amount invested.

Impact on Revenue Budgets	**2017/18 Estimated 1% £'000**	**2017/18 Estimated -1% £'000**
Interest on Borrowing	4	(4)
Investment income	(38)	38
Net General Fund Borrowing Cost	**(33)**	**33**

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 Authority's borrowing and investments that are held with variable interest rates. The proposed limits are detailed in the following table.

Limits on Variable Interest Rates	**2017/18 Upper £'000**	**2018/19 Upper £'000**	**2019/20 Upper £'000**
Borrowing	7,500	7,500	7,500
Investments	25,000	20,000	15,000

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

Limits on Fixed Interest Rates	2017/18 Upper £'000	2018/19 Upper £'000	2019/20 Upper £'000
Borrowing	10,000	10,000	10,000
Investments	25,000	20,000	15,000

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 following table:

Maturity Structure of fixed interest rate borrowing				
	2016/17 £000 Lower Limit	2016/17 £000 Upper Limit	2017/18 £000 Lower Limit	2017/18 £000 Upper Limit
Under 12 months	0	8,000	0	8,000
12 months to 2 years	0	10,000	0	10,000
2 years to 5 years	0	10,000	0	10,000
5 years to 10 years	0	10,000	0	10,000
10 years to 20 years	0	10,000	0	10,000
20 years to 30 years	0	10,000	0	10,000
30 years to 40 years	0	10,000	0	10,000
40 years to 50 years	0	10,000	0	10,000
50 years to 60 years	0	10,000	0	10,000
60 years to 70 years	0	10,000	0	10,000

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	5,000	0	0

6.7 <u>Performance Indicators</u>

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