TREASURY MANAGEMENT STRATEGY 2018/19

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 2018/19 Treasury Management Strategy before it is referred to the full Fire Authority for approval.

2. RECOMMENDATIONS

It is recommended that Members consider the recommended 2018/19 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 2016/17 Treasury Management outturn detailed in section 5 and Appendix A.

ii) Note the 2017/18 Treasury Management mid-year position detailed in section 6.

iii) Approve the prudential indicators outlined in Appendix B.

iv) Borrowing Strategy 2018/19
To note that in the event of a change in economic circumstances that the Treasurer may take out additional borrowing in advance of need if this secures the lowest long term interest cost.

v) Investment Strategy 2018/19
- Approve that Svenska Handelsbanken be brought into line with other category A counterparties and no longer identified separately.
- Approve the Counterparty limits as set out in paragraph 9.8, which incorporates the above recommendation.

vi) Minimum Revenue Provision (MRP) Statement
Approve the following MRP statement:
- For capital expenditure incurred before 1 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 1 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 2016/17
- Treasury Management Strategy 2017/18 mid-year review
- Treasury Management Strategy 2018/19
- Minimum Revenue Provision and Interest Cost and Other Regulatory Information 2018/19

4. ECONOMIC BACKGROUND AND OUTLOOK FOR INTEREST RATES

4.1 **Global Outlook –** World growth is currently on a trend of stronger performance with subdued but rising earnings and falling levels of unemployment. In October the International Monetary Fund (IMF) upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

4.2 In addition, the expectation of inflation increasing is generally low and in particular wage inflation has been subdued despite unemployment falling to historically very low levels in the UK and US. The likely reason for this is a combination of a shift towards flexible working, self-employment, falling union membership and increasing globalisation and specialism of individual countries. This has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the

two. Technology is exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to repetitive tasks being taken over by machines or computers.

4.3 **UK –** The UK surprised markets with strong economic growth in 2016 however growth in 2017 has proven weak with the forecast being revised down from 2% in March 2017 to 1.5% in the Autumn 2017 Budget Statement. The Office for Budget Responsibility's revised growth forecast up to 2022 are set out in the following table:

Year	March 2017 Growth Forecast	Autumn Budget 2017 Growth Forecast
2017	2.0%	1.5%
2018	1.6%	1.4%
2019	1.7%	1.3%
2020	1.9%	1.3%
2021	2.0%	1.5%
2022	-	1.6%

4.4 The Bank of England's (BoE) Monetary Policy Committee (MPC) surprised markets and forecasters at its meeting on 14 September 2017 by indicating that the Bank Rate may soon need to rise in response to their view that the amount of spare capacity in the economy was significantly diminishing. The Bank was also concerned that the withdrawal of the UK from the EU would cause additional inflationary pressures over the next few years.

4.5 At its 2 November 2017 meeting the MPC followed through with its earlier warning and delivered a 0.25% increase in Bank Rate raising it back to 0.5%. It also gave forward guidance that they only expect to raise Bank rate twice more in the next three years to reach 1.0% by 2020. This is in line with the Bank's previous statements that Bank Rate would only go up very gradually and to a limited extent.

4.6 However, there is uncertainty around Brexit negotiations, consumer confidence and business confidence on spending to invest, which means that it is possible that the Bank will vary from its forward guidance in response to emerging economic issues.

4.7 **EU –** Economic growth in the EU had been poor for several years following the financial crisis despite the European Central Bank (ECB) eventually cutting its main rate of interest to -0.4% and undertaking a massive programme of Quantitative Easing (QE). However growth picked up in 2016 and has now gathered strength and momentum as a result of this stimulus:

4.8 However, despite providing massive monetary stimulus the ECB is still struggling to increase inflation to its 2% target (inflation in October was 1.4%). Forecasters therefore do not believe it will increase rates until possibly 2019, though the ECB has announced it will slow down its QE purchases from January 2018.

4.9 **USA –** Growth in the USA has proven volatile in 2015 and 2016, and 2017 has continued this trend with quarter 1 growth of 1.2%, rising to 3% in quarter 3. Unemployment has fallen to 4.2%, the lowest level for many years and inflation pressures have been building. The Federal Reserve has started a gradual increase in interest rates with four increases in total (three since December 2016). There is an expectation that there will be a further four interest rate rises in 2018.

4.10 **Other Economies –** In China economic growth has continued to weaken despite repeated rounds of central bank stimulus with many commentators believing that risks to economic growth are increasing. Japan has been struggling to stimulate growth and meet its inflation target of 2% despite huge monetary and fiscal stimulus.

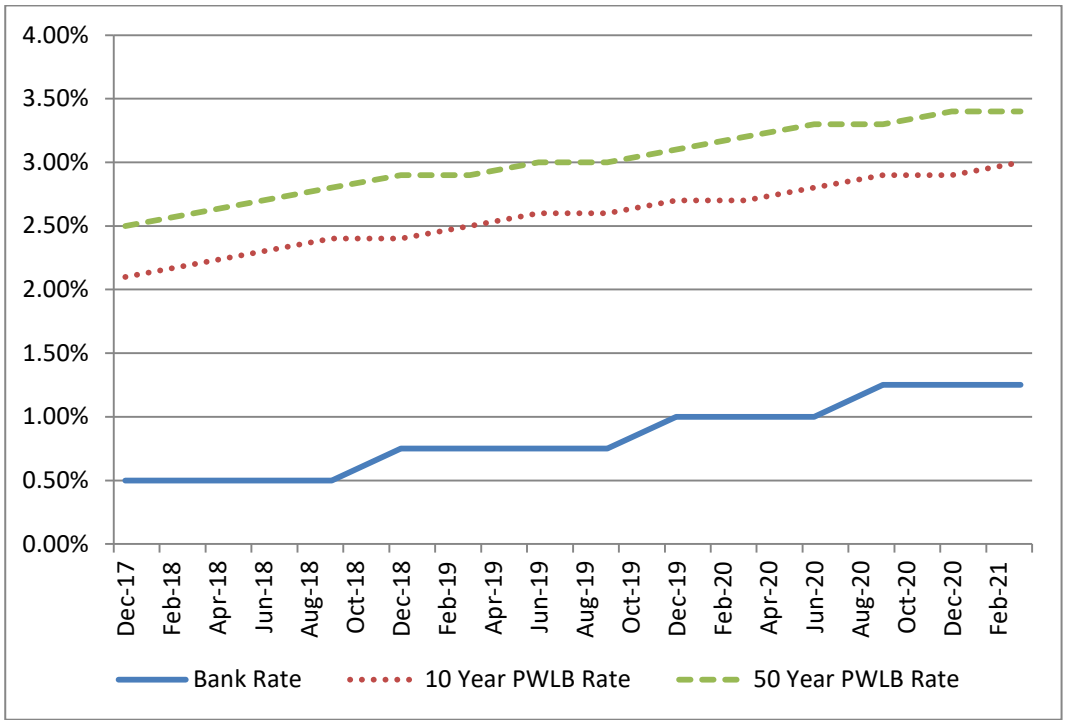
4.11 **Interest Rate Forecasts**

4.12 It has been almost ten years since the financial crash of 2008, when liquidity suddenly dried up in the financial markets. Many commentators assert that the monetary policy measures taken by central banks to counter a sharp worldwide recession were successful. The key measures being a combination of lowering central interest rates and using QE to flood the financial markets with liquidity.

4.13 The key issue now is that the period of stimulating economic recovery and warding off the threat of inflation is coming to an end and a new period has already started particularly in the US reversing those measures i.e. by raising central interest rates and reducing QE.

4.14 As outlined above the BoE have given forward guidance that theBank Rate will only go up very gradually and to a limited extent. However owing to many external factors influencing the UK economy and uncertainty surrounding Brexit, forecasting future interest rates remains extremely challenging. Link Asset Services (formerly known as 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 anticipates a further increase in the Bank Rate to 0.75% in December 2018 and a further increase to 1% in December 2019 in line with the forward guidance recently issued by the BoE. The following table summarises the interest rate forecast up to February 2021.

Interest Rate Forecast up to Feb 2021



4.15 Since the late 1990s Bank Rate averaged 5% until 2009 when the Bank of England reduced it to the historically low 0.5% in response to the financial crisis and again to 0.25% in 2016 following the EU referendum. 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 though have increased since the low levels seen 2016.

5. TREASURY MANAGEMENT OUTTURN POSITION 2016/17

5.1 Capital Expenditure and Financing 2016/17

5.2 The Authority's approved capital programme was funded from a combination of capital grants, prudential borrowing and the Capital Investment Programme Reserve.

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 £5.972m, funded by a mix of Prudential Borrowing, 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 £6.888m 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 £7.1m, which funds the CFR up to 2016/17.

5.9 **Prudential Indicators and Compliance Issues 2016/2017**

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 2016/2017 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 31 March 2017**

5.14 The table below shows the treasury position for the Authority as at the 31 March, 2017 compared with the previous year:

Treasury position	31st March 2016		31st March 2017	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt				
- PWLB	£5.2m	3.05%	£5.1m	3.06%
- Market Loans (LOBOs)	£2.0m	3.95%	£2.0m	3.95%
Total Long Term Debt	**£7.2m**	**3.30%**	**£7.1m**	**3.31%**
Total Investments	**£17.9m**	**0.48%**	**£10.3m**	**0.39%**
Net Investment Position	**£10.7m**		**£3.2m**	

5.15 A key performance indicator shown in the above table is the exceptionally low average rate of external debt of 3.31% for debt held as at 31st March, 2017, compared to historic PWLB (Public Works Loans Board) rates.

5.16 The Authority's investment policy is governed by Ministry of Housing, Communities and Local Government (MHCLG) guidance, which has been implemented in the annual investment strategy approved by Authority on 12th February, 2016.

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 no investments were made for 1 year. 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 2016/17 the risk associated with these higher returns would not have been prudent.

5.18 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.

5.19 **Regulatory Framework, Risk and Performance 2016/17**

5.20 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 MHCLG 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.

5.21 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 2017/18 MID-YEAR REVIEW

6.1 The 2017/18 Treasury Management Strategy was approved on the 17th, February, 2017. The Authority's borrowing and investment position as at 30th September 2017 is summarised as follows:

	£m	Average Rate
LOBO Loan #	2.0	3.95%
PWLB Loans	7.6	2.90%
Gross Debt	**9.6**	**3.12%**
Investments	13.0	0.28%
Net Investment	**3.4**	

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 The increase in borrowing includes £2.2m of borrowing approved by the Authority on 31 March 2017, which enabled this amount to be released to create the Budget Support Fund for 2020/21. As reported in March the borrowing costs associated with this amount can be funded from within the existing budget provision / interest rates savings already achieved and will not increase the budget deficits forecast for 2017/18 to 2019/20. As detailed in the Medium Term Financial Strategy the Budget Support Fund for 2020/21 is earmarked to manage potential financial risks arising from implementation of 75% Business Rates Retention and the Fair Funding Review.

6.3 As part of the Treasury Strategy for 2017/18 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 2017 owing to planned capital expenditure being re-phased between financial years. Initial assessment indicate 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 2018/19

7.1 Prudential Indicators and other regulatory information in relation to the 2018/19 Treasury Management Strategy is set out in Appendix B.

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 2018/19

8.1 Following the development and implementation of the Asset Management Plan (AMP) the Authority's CFR has risen 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 ensures 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 2019/20 to ensure the longer term financial sustainability of the Authority.

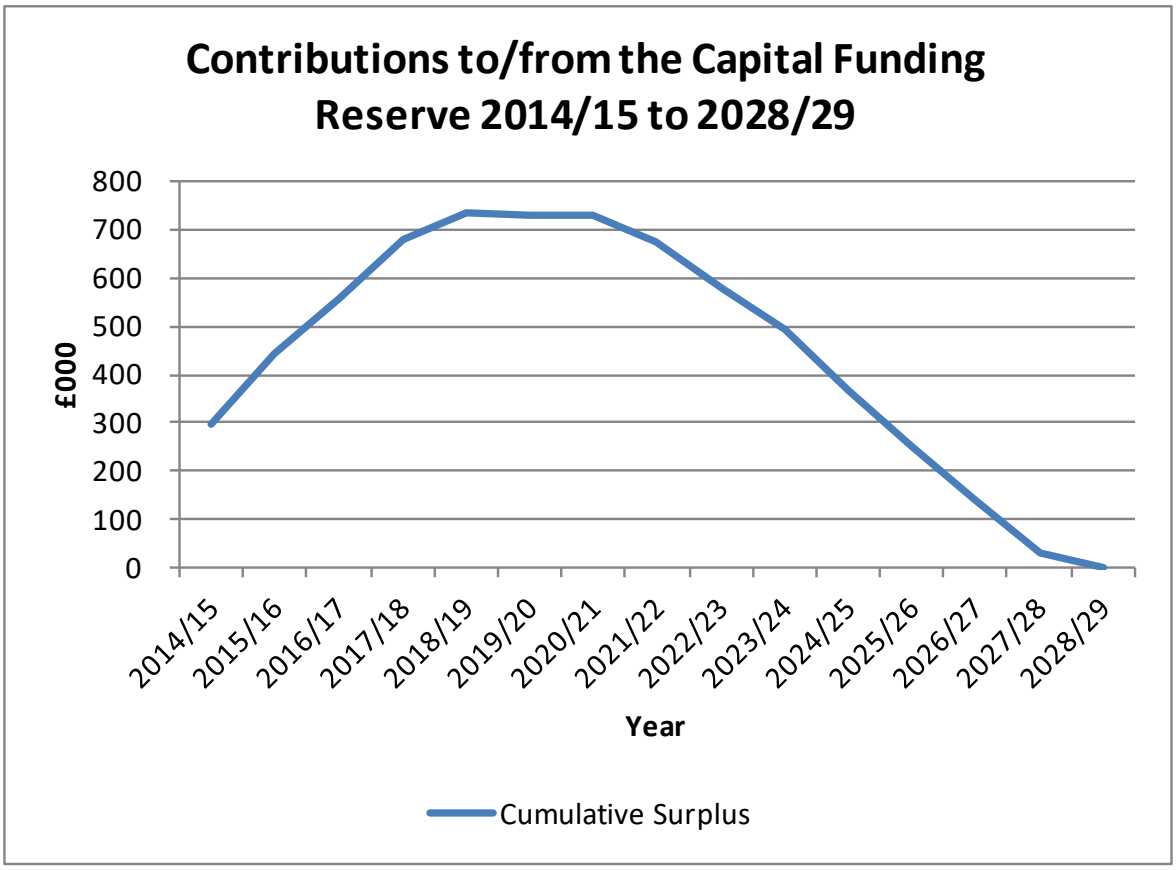
8.4 It is anticipated that planned expenditure funded by borrowing in 2018/19 can be met by existing loans and no further borrowing is anticipated. However owing to the unprecedented financial environment it may be appropriate to take out further borrowing to secure the future borrowing requirement and the position will be kept under constant review. A decision to borrow in advance of need may be taken by the Treasurer if it is in the best interests of the Authority to do so.

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 previously approved Strategy reports 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 2018/19

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 In 2016/17 Members approved the addition of Svenska Handelsbanken (a high credit quality Swedish bank) to the counterparty list. Their credit ratings remained strong throughout the financial crisis and have continued to remain strong never falling below the category A rating in the table of investment criteria outlined below. The counterparty limit was initially set at £1m with an investment time limit of 3 months. For the 2017/18 Treasury Management Strategy Members approved an increase in the counterparty limit to £2m. It is now recommended that Svenska Handelsbanken is brought into line with other category A counterparties and no longer identified separately i.e. counterparty limit raised to £5m and the duration of investments increased to a maximum of one year

9.8 The following table shows the proposed limits in 2018/19 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)

* Including Svenska Handelsbanken

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 2018/19

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 the existing 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 Link Asset Services – Treasury Solutions (formerly known as Capita Asset Services) 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.

10.9 **Markets in Financial Instruments Directive (MIFID II)**

10.10 On 3rd January 2018 an updated version of the European Union's Markets in Financial Instruments Directive (known as MIFID II) came into effect. It is designed to offer greater protection for investors and inject more transparency into financial markets. Under MIFID II all local authorities will be classified as "retail" counterparties and will have to consider whether to opt up to "professional" status and for which type of investments

10.11 Local authorities that choose not to opt up or do not meet the minimum criteria for opting up (i.e. minimum investment balances of £10m) will face a reduction in the financial products available to them, a reduction in number of brokers and asset managers that will be able to engage with and may face increased fees.

10.12 Local authorities that choose to opt up must be able to satisfy some quantitative tests, and each Financial Institution will independently determine whether the Authority meet the qualitative test of being appropriately knowledgeable, expert and experienced. Financial Institutions also need to satisfy themselves that the Authority can make its own investment decisions and understands the risks involved.

10.13 It is the view of the Treasurer that the Authority meets the minimum requirements to opt up and therefore has chosen to opt up to professional status in order to maintain the Authority's ability to operate effectively under the new regime.

10.14 The process of opting up has been onerous and in response the Chartered Institute of Public Finance and Accountancy (CIPFA) have launched an online platform to assist local authorities who wish to opt up to professional status. This platform is dependent on Financial Institutions subscribing to the platform and many are either already live on the system or are in the process of signing up. However there are some institutions that have not subscribed to the platform and the Authority has had to complete a separate opting up process with these institutions.

11. CONCLUSION

11.1 Against the uncertain national background and the requirement to make significant budget reductions to balance the 2018/19 and 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. 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 2016/17 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.

2016/17 Estimate £'000		2016/17 Outturn £'000
2.13%	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.

2016/17 Estimate £'000		2016/17 Outturn £'000
9,025	Capital Expenditure	5,972

3. Capital Expenditure Financed from Borrowing

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

2016/17 Estimate £'000		2016/17 Outturn £'000
878	Capital Expenditure Financed by Borrowing	3,287

This is higher than originally forecast owing to a change in the profile of funding sources used compared to what was originally forecast. There is no net impact on the total borrowing forecast for the period of the MTFS.

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.

2016/17 Estimate £'000		2016/17 Outturn £'000
5,139	Capital Financing Requirement	6,888

This is higher than originally forecast owing to a change in the profile of funding sources used compared to what was originally forecast. There is no net impact on the total borrowing forecast for the period of the MTFS.

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.

2016/17 Limit £'000		2016/17 Peak £'000
12,000	Authorised limit for external debt	7,229

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.

2016/17 Limit £'000		2016/17 Peak £'000
10,000	Operational boundary for external debt	7,229

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.

2016/17 Limit £'000	Upper limits on fixed and variable interest rate exposure	2016/17 Peak £'000
100%	Fixed Rates	72%
75%	Variable Rates	28%

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 £'000	Lower Limit £'000	Actual by Maturity Date £'000	Actual by soonest call date £'000
Under 12 months	5,500	0	96	96
12 month to 2 years	6,000	0	98	2,098
2 years to 5 years	6,000	0	285	285
5 years to 10 years	6,000	0	295	295
10 years to 20 years	6,000	0	750	750
20 years to 30 years	6,000	0	1,025	1,025
30 years to 40 years	6,000	0	2,586	2,586
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. 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 a maximum of one year.

	1 year £000	2 year £000	3 year £000
Maximum Limit	10,000	0	0
Actual	0	0	0

Appendix B

Treasury Management Strategy 2018/19 Regulatory Information and Prudential Indicators

1. Introduction

1.1 The regulatory information and prudential indicators for the 2018/19 Treasury Management Strategy are set out below.

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).

3.3 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.

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

Capital Financing & Borrowing Requirement	2017/18 Revised £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
CFR at 1st April	**6,888**	**9,261**	**9,205**	**8,727**
Capital Expenditure Financed by Borrowing	2,800	406	0	1,405
Less Repayment of CFR	(427)	(462)	(478)	(433)
CFR at 31st March	**9,261**	**9,205**	**8,727**	**9,699**

3.5 As part of the Medium Term Financial Strategy the Authority is required to approve the 2018/19 capital programme summarised as follows:

Capital Expenditure	2017/18 Revised £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Capital Expenditure	6,977	1,730	0	1,655
Financed by:				
Capital grants and contributions	0	0	0	0
Reserves	4,177	1,324	0	250
Prudential Borrowing	2,800	406	0	1,405
Total Funding	**6,977**	**1,730**	**0**	**1,655**

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
	2017/18 £'000	2018/19 £'000	2019/20 £'000	2020/21 £'000
CouncilTax - Band D	£0.44	£0.06	£0.00	£0.22

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.

%	2017/18 Revised	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Ratio	2.57%	2.86%	2.93%	2.77%

5. Borrowing Prudential Indicators

5.1 Debt Projections 2017/18 – 2020/21

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

Debt and Investment Projections	2017/18 Revised £'000	2018/19 Estimated £'000	2019/20 Estimated £'000	2020/21 Estimated £'000
Long Term Borrowing 1 April	7,136	9,529	9,394	9,255
Expected change in Long Term Debt	2,393	(135)	(139)	444
Debt at 31 March	**9,529**	**9,394**	**9,255**	**9,699**
CFR	**9,261**	**9,205**	**8,727**	**9,699**
Advance/(Under) Borrowing	**268**	**189**	**528**	**0**

5.3 Limits to Borrowing Activity

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

5.5 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 2018/2019 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	2017/18 Revised £'000	2018/19 Estimated £'000	2019/20 Estimated £'000	2020/21 Estimated £'000
Gross Borrowing	9,529	9,394	9,255	9,699
Capital Financing Requirement	**9,261**	**9,205**	**8,727**	**9,699**

5.6 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	2017/18 Estimated £'000	2018/19 Estimated £'000	2019/20 Estimated £'000	2020/21 Estimated £'000
Operational Limit	13,000	13,000	13,000	13,000
Authorised limit	16,000	16,000	16,000	16,000

6. Investment Prudential Indicators and Other Limits on Treasury Activity

6.1 Investment Projections 2017/18 – 2020/21

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

2016/17 Outturn £'000	Year End Resources	2017/18 Revised £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
12,764	Balances and Reserves	8,098	6,380	6,185	4,869
210	Provisions	210	210	210	210
(132)	Collection fund Adjustment Account	0	0	0	0
12,842	**Total Core Funds**	**8,308**	**6,590**	**6,395**	**5,079**
(2,045)	Working Capital*	(750)	(750)	(750)	(750)
10,797	**Resources Available for Investment**	**7,558**	**5,840**	**5,645**	**4,329**
248	(Under)/Advance borrowing	268	189	528	0
11,045	**Expected Investments**	**7,826**	**6,029**	**6,173**	**4,329**

* 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 2018/19. For investments they are based on a prudent view of the total amount invested.

Impact on Revenue Budgets	2018/19 Estimated 1% £'000	2018/19 Estimated -1% £'000
Interest on Borrowing	0	0
Investment income	(60)	60
Net General Fund Borrowing Cost	**(60)**	**60**

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	**2018/19 Upper £'000**	**2019/20 Upper £'000**	**2020/21 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 Authority's borrowing and investments that are held with fixed interest rates.

Limits on Fixed Interest Rates	**2018/19 Upper £'000**	**2019/20 Upper £'000**	**2020/21 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 following table:

Maturity Structure of fixed interest rate borrowing				
	2017/18 £000 Lower Limit	2017/18 £000 Upper Limit	2018/19 £000 Lower Limit	2018/19 £000 Upper Limit
Under 12 months	0	8,000	0	10,000
12 months to 2 years	0	10,000	0	13,000
2 years to 5 years	0	10,000	0	13,000
5 years to 10 years	0	10,000	0	13,000
10 years to 20 years	0	10,000	0	13,000
20 years to 30 years	0	10,000	0	13,000
30 years to 40 years	0	10,000	0	13,000
40 years to 50 years	0	10,000	0	13,000
50 years to 60 years	0	10,000	0	13,000
60 years to 70 years	0	10,000	0	13,000

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 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