TREASURY MANAGEMENT STRATEGY 2019/20

REPORT OF THE TREASURER

FIRE AUTHORITY

For Approval

1. PURPOSE OF REPORT

1.1 The enable the Fire Authority to approve the Treasury Management Strategy for 2019/20.

2. RECOMMENDATIONS

It is recommended that Members approve the following recommendations in relation to the 2019/20 Treasury Strategy:

i) Approve the 2019/20 prudential indicators outlined in Appendix B.

ii) Note the 2017/18 Treasury Management outturn detailed in section 5 and Appendix A.

iii) Note the 2018/19 Treasury Management mid-year position detailed in section 6.

iv) Borrowing Strategy 2019/20
To note that in the event of a change in economic circumstances the Treasurer may take out additional borrowing in advance of need to fund the Asset Management Plan if this secures the lowest long term interest cost.

v) Investment Strategy 2019/20
a. Approve the Counterparty limits as set out in paragraph 9.7.

vi) Minimum Revenue Provision (MRP) Statement
Approve the following 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.

vii) Note that owing to the timing of meeting it was not possible to submit the report to the Audit and Governance Committee prior to this meeting, therefore the report will be submitted to the Audit and Governance Committee on 22nd February and should they make any recommendations these will be reported to the next Authority meeting.

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, most recently in 2017

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 2017/18
- Treasury Management Strategy 2018/19 mid-year review
- Treasury Management Strategy 2019/20
- Minimum Revenue Provision and Interest Cost and Other Regulatory Information 2019/20.

3.6 Owing to the timing of meetings it has not been possible to refer this strategy to the Audit and Governance Committee prior to it being presented to the Fire Authority. This report will be referred to the Audit and Governance Committee on 22nd February 2019. If any issues are identified by the Audit and Governance Committee they will be reported to the next Fire Authority meeting. In future years the report will be submitted to the Audit and Governance Committee prior to submission to the Fire Authority.

4. ECONOMIC BACKGROUND AND OUTLOOK FOR INTEREST RATES

4.1 **UK –** The first half of 2018/19 has seen modest UK economic growth which has enabled the Bank of England's Monetary Policy Committee (MPC) to increase the Base Rate to 0.75% from 0.5%, the first time interest rates have risen above 0.5% since March 2009. Growth is expected to be modest at around 1.5% for the current year and potentially pick up to 1.8% in 2019, depending on the arrangements in relation to withdrawal from the European Union.

4.2 Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value against both the US Dollar and the Euro. The Consumer Price Index (CPI) measure of inflation is currently 2.5% but is expected to fall back towards the Bank of England's 2% inflation target over the next two years which assumes minimal increases in Base Rate. The MPC has indicated the Base Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Base Rate for the second half of 2019. The Office for Budget Responsibility's revised growth forecast up to 2022 are set out in the following table:

Year	March 2018 Growth Forecast	November 2018 Growth Forecast
2018	1.5%	1.3%
2019	1.3%	1.6%
2020	1.3%	1.4%
2021	1.4%	1.4%
2022	1.5%	1.5%

4.3 Other economic factors to note are:

- According to the Independent Labour Organisation, unemployment is now 4%, which is a 43 year low. However wage inflation has been weak / neutral, which makes the UK sensitive to weakened consumer spending and lower economic growth.
- The housing market is currently weak, with price increases averaging 2-3% with reductions in London.

4.4 **EU –** Growth has been in the region of 2% and lower than expected, potentially because of the US tariffs on manufacturing exports such as cars.

4.5 **USA –** Easing of the fiscal policy is fuelling a (temporary) boost in consumption which has generated an increase in the Federal Reserve Interest Rate but also an upturn in inflationary pressures. With inflation moving towards 3%, the Federal Reserve has already increased its interest rate to 2% and further increases expected in 2019.

4.6 **Other Economies –** In China economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus and medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property. Japan is still struggling to stimulate economic growth and keep inflation within its 2% target.

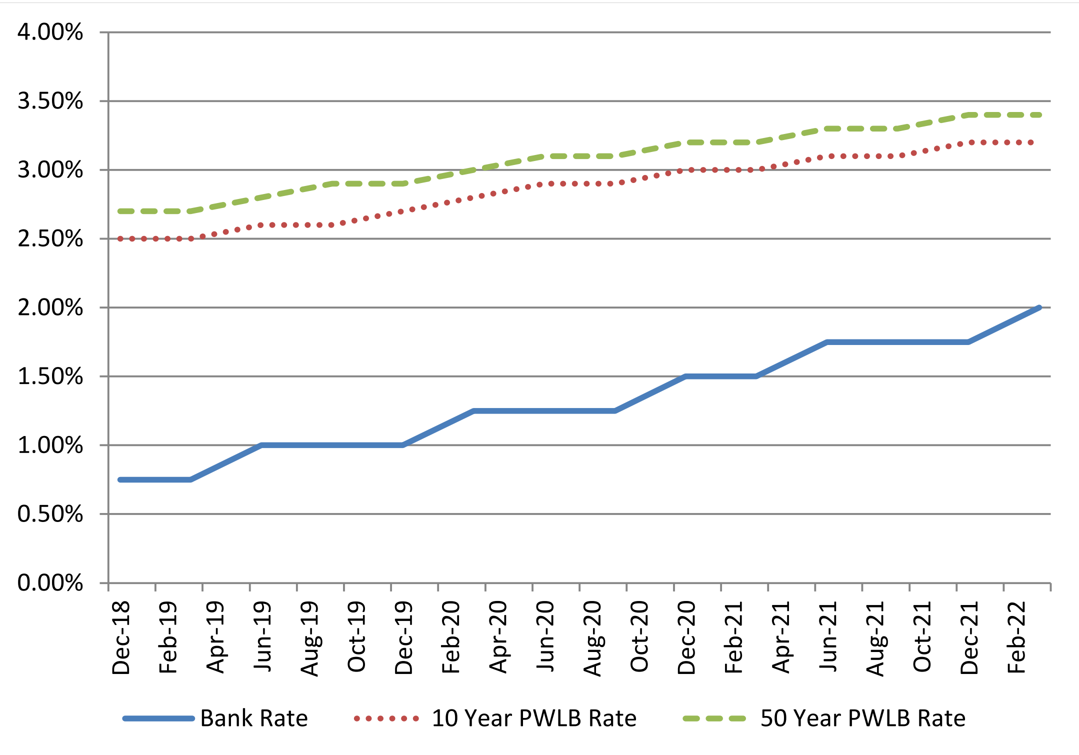
4.7 **Interest Rate Forecasts**

4.8 The recent increase in the Base Rate to 0.75% is only the second rise since the financial crash and the Bank of England has emphasised that future Base Rate increases would be gradual, rising to around 2.5% in ten years' time.

4.9 Link 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 the next increase in the Base Rate to be after Brexit in August 2019, with further increases of 0.25% in May and November 2020 to reach 1.5%. However, the pace of these limited increases is dependent on an orderly withdrawal from the EU.

4.10 Link Asset Services believe that the balance of risks to economic growth in the UK is probably neutral. The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly dependent on the strength of Gross Domestic Produce growth, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively. Other downside risks include the potential for a resurgence of the Eurozone debt crisis and protectionist trade policies.

4.11 <u>Interest Rate Forecast up to Feb 2022</u>



4.12 Since the late 1990s Bank Rate averaged 5% until 2009 when the Bank of England reduced it to the historically low level of 0.5% in response to the financial crisis and the reduced to 0.25% in 2016 following the EU referendum. Over the same period PWLB rates have been significantly higher than they are at present. In August 2018 the Bank of England raised the interest rate for only the second time in a decade. The rate has risen by a quarter of a percentage point, from 0.5% to 0.75% - the highest level since March 2009. 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 a low historic level.

5. TREASURY MANAGEMENT OUTTURN POSITION 2017/18

5.1 **Capital Expenditure and Financing 2017/18**

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 £6.331m, funded by a mix of Prudential Borrowing, 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 is not funded from revenue or capital resources. Each year the Authority is required to apply revenue resources to reduce this outstanding balance (termed the Minimum Revenue Provision).

5.5 Whilst the Authority's CFR sets a limit on the level of borrowing, 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 £8.968m 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. Further borrowing in April 2018 funded borrowing required up to March 2020.

5.8 The Authority's total long term external borrowing as at 31st March, 2018 was £9.5m, which funds the CFR up to 2019/20.

5.9 **Prudential Indicators and Compliance Issues 2017/2018**

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 2017/2018 the Authority has maintained gross borrowing within the Authorised Limit.

5.12 **Gross Borrowing and the CFR** – In order to ensure that borrowing levels are prudent, over the medium term the Authority's external borrowing, must only be for a capital purpose. Gross borrowing should not exceed the CFR for 2017/18 plus the expected changes to the CFR over 2018/19 and 2019/20. The Authority has complied with this Prudential Indicator.

5.13 **The Treasury position at 31st March 2018**

5.14 The table below shows the treasury position for the Authority as at the 31st March, 2018 compared with the previous year:

Treasury position	31st March 2017		31st March 2018	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt				
- PWLB	£5.1m	3.06%	£7.6m	2.90%
- Market Loans (LOBOs) #	£2.0m	3.95%	£2.0m	3.95%
Total Long Term Debt	**£7.1m**	**3.31%**	**£9.6m**	**3.12%**
Total Investments	**£10.3m**	**0.39%**	**£7.6m**	**0.57%**
Net Investments/ (net debt)	**£3.2m**		**(£2.0m)**	

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%.

5.15 A key performance indicator shown in the above table is the exceptionally low average rate of external debt of 3.12% for debt held as at 31st March, 2018, 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 17th February, 2017.

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 2017/18 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.

5.19 **Regulatory Framework, Risk and Performance 2017/18**

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. <u>TREASURY MANAGEMENT STRATEGY 2018/19 MID-YEAR REVIEW</u>

6.1 The 2018/19 Treasury Management Strategy was approved on the 23rd, February, 2018. The Authority's borrowing and investment position as at 30th September 2018 is summarised as follows:

	£m	Average Rate
LOBO Loan #	2.0	3.95%
PWLB Loans	7.5	2.90%
Gross Debt	**9.5**	**3.12%**
Investments	15.1	0.68%
Net Investment	**5.6**	

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 2018/19 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 2018 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 2019/20

7.1 Prudential Indicators and other regulatory information in relation to the 2019/20 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 2019/20

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, decisions to borrow to the forecast CFR in 2019/20 have already been made.

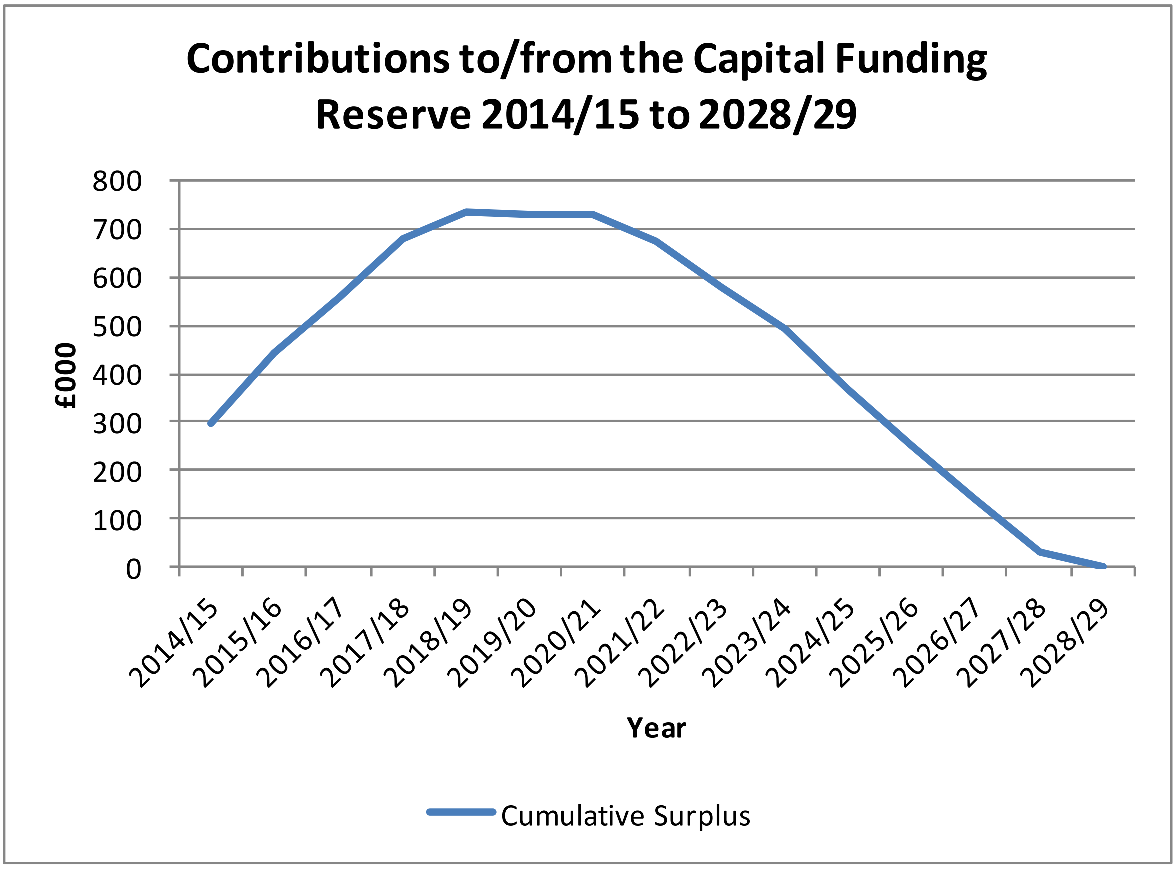
8.3 These decisions ensures the borrowing costs associated with AMP are minimised in the long term and can be sustained within the existing revenue budget of £0.8m (including using the recommended Capital Funding Phasing Reserve) over:
- the period of the current Medium Term Financial Strategy and Integrated Risk Management Plan; and,
- the period beyond 2020/21 to ensure the longer term financial sustainability of the Authority.

8.4 Owing to the borrowing decisions in previous years to pre fund the borrowing requirement, no additional borrowing is anticipated in 2019/20. 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 will be manage using the approved 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 2019/20

9.1 The Ministry for Housing, Communities and Local Government (MHCLG) issued investment guidance in 2010, updated in 2017, 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 publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes and applies its principles to all investment activity. In accordance with the Code, the Treasurer has produced Treasury Management Practices covering investment counterparty policy which requires approval each year.

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

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

9.3 **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 There are no proposed changes to existing counter parties and the table below shows the proposed limits in 2019/20 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 - £1.5 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)

9.8 **Specified and Non-Specified Investments**

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

9.10 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.

9.11 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.

9.12 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 2019/20

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 Capital Financing Requirement (CFR) each year through a revenue charge called the Minimum Revenue Provision (MRP).

10.2 MHCLG 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.

10.3 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.

10.4 **CIPFA Treasury Management Code of Practice**

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

10.6 **Treasury Management Advisors**

10.7 The Authority uses Link Asset Services – Treasury Solutions as its external treasury management advisors.

10.8 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.

10.9 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.

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

10.11 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. The Fire Authority opted up to professional status in order to maintain the Authority's ability to operate effectively under the new regime.

11. CONCLUSION

11.1 Against the uncertain national background and the requirement to make significant budget reductions to balance the 2019/20 and 2020/21 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 and this it is recommended this approach continues for 2019/20.

CHRIS LITTLE
TREASURER TO THE AUTHORITY

APPENDIX A

Prudential Indicators 2017/18 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. This is slightly higher that the estimate owing to a change in the profile of funding sources compared to what was originally forecast.

2017/18 Estimate £'000		2017/18 Outturn £'000
2.43%	Ratio of Financing costs to net revenue stream	2.53%

2. Capital Expenditure

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

2017/18 Estimate £'000		2017/18 Outturn £'000
7,994	Capital Expenditure	6,331

3. Capital Expenditure Financed from Borrowing

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

2017/18 Estimate £'000		2017/18 Outturn £'000
789	Capital Expenditure Financed by Borrowing	2,553

The outturn is higher than originally forecast owing to a change in the profile of funding sources used. 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.

2017/18 Estimate £'000		2017/18 Outturn £'000
7,388	Capital Financing Requirement	8,968

The outturn is higher than originally forecast owing to a change in the profile of funding sources used. 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.

2017/18 Limit £'000		2017/18 Peak £'000
12,000	Authorised limit for external debt	9,643

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.

2017/18 Limit £'000		2017/18 Peak £'000
10,000	Operational boundary for external debt	9,643

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.

2017/18 Limit £'000	Upper limits on fixed and variable interest rate exposure	2017/18 Peak £'000
100% 75%	Fixed Rates Variable Rates	79% 21%

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	8,000	0	135	135
12 month to 2 years	10,000	0	139	2,139
2 years to 5 years	10,000	0	359	359
5 years to 10 years	10,000	0	526	526
10 years to 20 years	10,000	0	1,310	1,310
20 years to 30 years	10,000	0	1,751	1,751
30 years to 40 years	10,000	0	3,309	3,309
40 years to 50 years	10,000	0	0	0
50 years to 60 years	10,000	0	0	0
60 years to 70 years	10,000	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 2019/20 REGULATORY INFORMATION AND PRUDENTIAL INDICATORS

1. INTRODUCTION

1.1 The regulatory information and prudential indicators for the 2019/20 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 or other capital resources. 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	**2018/19 Revised £'000**	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**	**2021/22 Estimate £'000**
CFR at 1st April	**8,968**	**8,510**	**9,189**	**9,803**
Capital Expenditure Financed by Borrowing	0	1,127	1,080	943
Less Repayment of CFR	(458)	(448)	(466)	(528)
CFR at 31st March	**8,510**	**9,189**	**9,803**	**10,218**

3.5 As part of the Medium Term Financial Strategy the Authority is required to approve the 2019/20 capital programme summarised as follows:

Capital Expenditure	**2018/19 Revised £'000**	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**	**2021/22 Estimate £'000**
Capital Expenditure	910	2,770	1,080	943
Financed by:				
Capital Receipts	580	0	0	0
Capital Financing Reserve	330	1,643	0	0
Prudential Borrowing	0	1,127	1,080	943
Total Funding	**910**	**2,770**	**1,080**	**943**

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 <u>Ratio of Financing Costs to Net Revenue Stream</u>

4.3 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	2.81%	2.75%	2.84%	3.09%

5. BORROWING PRUDENTIAL INDICATORS

5.1 Debt Projections 2018/19 – 2021/22

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

Debt and Investment Projections	2018/19 Revised £'000	2019/20 Estimated £'000	2020/21 Estimated £'000	2021/22 Estimated £'000
Long Term Borrowing 1 April	9,629	9,494	9,355	9,212
Expected change in Long Term Debt	(135)	(139)	(143)	(120)
Debt at 31 March	**9,494**	**9,355**	**9,212**	**9,092**
CFR	**8,510**	**9,189**	**9,803**	**10,218**
Advance/(Under) Borrowing	**984**	**166**	**(591)**	**(1,126)**

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 2019/2020 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	2018/19 Revised £'000	2019/20 Estimated £'000	2020/21 Estimated £'000	2021/22 Estimated £'000
Gross Borrowing	9,494	9,355	9,212	9,092
Capital Financing Requirement	**8,510**	**9,189**	**9,803**	**10,218**

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	2018/19 Estimated £'000	2019/20 Estimated £'000	2020/21 Estimated £'000	2021/22 Estimated £'000
Operational Limit	10,000	12,000	12,000	12,000
Authorised limit	12,000	14,000	14,000	14,000

6. INVESTMENT PRUDENTIAL INDICATORS AND OTHER LIMITS ON TREASURY ACTIVITY

6.1 Investment Projections 2018/19 – 2021/22

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

2017/18 Outturn £'000	Year End Resources	2018/19 Revised £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
9,883	Balances and Reserves	8,311	6,255	5,517	4,426
214	Provisions	214	214	214	214
(115)	Collection fund Adjustment Account	0	0	0	0
9,982	**Total Core Funds**	**8,525**	**6,469**	**5,731**	**4,640**
(3,261)	Working Capital*	(2,035)	(2,035)	(2,035)	(2,035)
6,721	**Resources Available for Investment**	**6,490**	**4,434**	**3,696**	**2,605**
661	(Under)/Advance borrowing	984	166	(591)	(1,126)
7,382	**Expected Investments**	**7,473**	**4,599**	**3,104**	**1,478**

* 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 2019/20. 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	(87)	87
Net General Fund Borrowing Cost	**(87)**	**87**

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	2019/20 Upper £'000	2020/21 Upper £'000	2021/22 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	2019/20 Upper £'000	2020/21 Upper £'000	2021/22 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				
	2018/19 £000 Lower Limit	2018/19 £000 Upper Limit	2019/20 £000 Lower Limit	2019/20 £000 Upper Limit
Under 12 months	0	8,000	0	10,000
12 months to 2 years	0	10,000	0	12,000
2 years to 5 years	0	10,000	0	12,000
5 years to 10 years	0	10,000	0	12,000
10 years to 20 years	0	10,000	0	12,000
20 years to 30 years	0	10,000	0	12,000
30 years to 40 years	0	10,000	0	12,000
40 years to 50 years	0	10,000	0	12,000
50 years to 60 years	0	10,000	0	12,000
60 years to 70 years	0	10,000	0	12,000

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