Agenda Item No. 971

EAST SUSSEX FIRE AUTHORITY

Date	14 February 2017
Title of Report	Treasury Management Strategy for 2017/18
By	Treasurer
Lead Officer	Richard Carcas – Principal Finance Officer (Treasury Management) East Sussex County Council

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Background Papers

Fire Authority
11 February 2016 Treasury Management Strategy for 2016/17
16 June 2016 Treasury Management Stewardship Report 2015/16

Policy & Resources Panel
3 November 2016 Half year review for 2016/17

CIPFA Prudential Code

CIPFA Treasury Management in the Public Services – Code of practice

Local Government Act 2003 Local Government Investments – Guidance from the former Office of the Deputy Prime Minister

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Appendices

1: Treasury Management Scheme of Delegation
2: The Prudential and Treasury Indicators
3: Minimum Revenue Provision (MRP) Policy Statement
4: Approved countries for investments
5: Comment from Capita Asset Services on the outlook for 2017/18
6: Counterparty list

Implications

CORPORATE RISK		**LEGAL**	
ENVIRONMENTAL		**POLICY**	
FINANCIAL	✓	**POLITICAL**	
HEALTH & SAFETY		**OTHER (please specify)**	
HUMAN RESOURCES		**CORE BRIEF**	
EQUALITY IMPACT ASSESSMENT			

PURPOSE OF REPORT To approve the Treasury Management Strategy, Policy Statement and the Minimum Revenue Provision (MRP) Statement 2017/18

EXECUTIVE SUMMARY

This report contains recommendations on borrowing limits, the prudential indicators and limits, the investment strategy and policy as required by Section 3 (1) of the Local Government Act 2003 and the Prudential Code for Capital Finance 2004.

The emphasis continues to be on security (protection of the capital sum invested) and liquidity (keeping money readily available for expenditure when needed). The strategy and limits are consistent with the proposed capital programme and revenue budget dealt with elsewhere on the agenda. As will be clear from the global events, it is impossible in practical terms to eliminate all credit risk. The Fire Authority seeks to be prudent.

The Authority is recommended to approve borrowing limits to give flexibility for any future consideration in undertaking new external long-term / replacement borrowing should the need arise or market conditions prove favourable. The 2017/18 counterparty list for specified and non-specified investment is set out in Appendices 4 and 6.

The Fire Authority has always adopted a prudent approach on its investment strategy and, in the last few years, there have been regular changes to the list of the approved organisations used for investment of short term surpluses. This list is regularly reviewed to ensure that the Authority is able to invest at the best available rates consistent with low risk; the organisations are regularly monitored to ensure that their financial strength and low risk has been maintained. The 2017/18 strategy continues the prudent approach and ensures that all investments were only to the highest quality rated banks and financial institutions up to a period of one year.

The Authority is recommended to approve the 2017/18 investment strategy which includes the addition of Enhanced Cash Funds to use alongside Money Market Funds. Also, two additional UK banks are included, Goldman Sachs IB and Standard Chartered Bank. This update will provide opportunities to diversify the investment portfolio and reduce the level invested in instant access deposits.

The background information and the calculation of the Authorised Limit for Borrowing for 2017/18 of £13.83m are set out in the attached Appendix 2 (Table 8).

Self-imposed Prudential and Treasury Management indicators that are set on an annual basis are shown in Appendix 2.

The Capital Financing Requirement (CFR) and Minimum Revenue Provision (MRP) statement is set out in Appendices 2 and 3 to comply with best practice.

The Treasury Management policy statement for 2017/18 is set out in Section 5.

RECOMMENDATION The Fire Authority is recommended to:

(i) approve the Treasury Management Strategy and policy statement for 2017/18 (and adopted for the remainder of 2016/17);
(ii) determine that, for 2017/18, the Authorised Limit for borrowing shall be £13.83m;
(iii) adopt the prudential indicators as set out in the attached Appendix 2; and
(iv) approve the Minimum Revenue Provision (MRP) Statement for 2017/18 as set out in the attached Appendix 3.

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1. **INTRODUCTION**

1.1 The CIPFA Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires authorities to set the Treasury Management Strategy Statement (TMSS) for borrowing and to prepare an Investment Strategy each financial year. CIPFA has defined Treasury Management as:

"the management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.2 This Strategy takes into account the impact of the Authority's Revenue Budget, Medium Term Capital Programme and the Balance Sheet position. The Prudential Indicators and the outlook for interest rates are also considered within the strategy.

1.3 The Treasury Management Strategy for 2017-18 covers the following areas:

- economic overview (section 2);
- the treasury position (section 3);
- the borrowing strategy to finance the capital plans (section 4);
- the investment strategy (section 5);
- the Minimum Revenue Provision (MRP) strategy (section 6); and
- the policy on the use of external service provider (section 7)

1.4 The Authority regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. The Treasury Management Scheme of Delegation is shown in Appendix 1.

2. **ECONOMIC OVERVIEW**

2.1 The Authority uses Capita Asset Services as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. Table 2 below gives the Capita Asset Services central view for short term (Bank Rate) and longer fixed interest rates.

Table 2

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2017	0.25	1.60	2.90	2.70
Jun 2017	0.25	1.60	2.90	2.70
Sep 2017	0.25	1.60	2.90	2.70
Dec 2017	0.25	1.60	3.00	2.80
Mar 2018	0.25	1.70	3.00	2.80
Jun 2018	0.25	1.70	3.00	2.80
Sep 2018	0.25	1.70	3.10	2.90
Dec 2018	0.25	1.80	3.10	2.90
Mar 2019	0.25	1.80	3.20	3.00
Jun 2019	0.50	1.90	3.20	3.00

2.2 The Monetary Policy Committee (MPC) cut the Bank Rate from 0.50% to 0.25% on 4 August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut the Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half of 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, the Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth.

2.3 During the two-year period 2017–2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising the Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in the Bank Rate could be brought forward.

2.4 The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Investment returns are likely to remain relatively low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically low levels after the referendum and then even further after the MPC meeting of 4 August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when the Fire Authority will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

3. TREASURY MANAGEMENT POSITION

3.1 The Authority's projected treasury portfolio position at 31 March 2017, with forward estimates is summarised in Table 1 below. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

Table 1

	2016/17 Projected £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
External Borrowing				
Borrowing at 1 April	10,973	10,973	10,773	10,773
New Borrowing	-	-	-	-
Loan Redemption	-	(200)	-	-
Actual borrowing at 31 March	**10,973**	**10,773**	**10,773**	**10,773**
***CFR – the borrowing need**	**10,973**	**10,773**	**10,773**	**10,773**
Under/(over) borrowing	**-**	**-**	**-**	**-**

**The Authority's Capital Financing Requirement (CFR) is the total historical outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Authority's underlying borrowing need. Any capital expenditure, which has not immediately been paid for, will increase the CFR.*

3.2 Within the set of prudential indicators there are a number of key tests to ensure that the Authority operates its activities within well defined limits. One of these is that the Authority needs to ensure that its total borrowing does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for current and next two financial years.

3.3 The CFR forecast at the end of 2016/17 is £10.973m and remains in line with actual borrowing, after the repayment of debt and longer-term loan redemptions. The Authority is required to repay an element of the CFR each year through a revenue charge called the Minimum Revenue Provision (MRP).

3.4 The Authority has a number of long-term loans and could aim to reschedule these loans if interest rates increase and the premature repayment rates become favourable.

3.5 Any future loans will be arranged giving consideration to the various debt repayment options, including an Equal Instalments of Principal (EIP) arrangement, where each payment includes an equal amount in respect of loan principal. Therefore the interest due with each payment reduces as the principal is eroded, and the total amount reduces with each instalment.

4. <u>BORROWING STRATEGY</u>

4.1 This strategy is prudent as investment returns are low and counterparty risk is high, however, as interest rates are low the Authority may wish to take advantage of this by securing fixed rate funding and increase the over borrowed position.

4.2 The net borrowing requirement within Table 1 above shows that, based on current estimates, the Authority does not currently need to take out a significant amount of new borrowing, to support the capital programme. However, any future new borrowing taken out will be completed with regard to the limits, indicators, the economic environment, the cost of carrying this debt ahead of need, and interest rate forecasts set out above. The Treasurer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

Policy on Borrowing in Advance of Need

4.3 The Authority will not borrow purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Authority can ensure the security of such funds.

4.4 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the reporting mechanism.

PWLB Transfer of Function

4.5 The Treasury launched a consultation over the summer proposing to abolish the PWLB in its current form and transfer the functions to another body. The government's preferred approach is to transfer the PWLB's powers to the Treasury, with operational responsibility delegated to the Debt Management Office. Capita Asset Services don't believe these changes will have any tangible impact on our ability to borrow with regard to the manner that we currently do.

Prudential & Treasury Indicators

4.6 There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the CIPFA Prudential Code) when setting and reviewing their Prudential Indicators. It should be noted that CIPFA undertook a review of the Code in early 2008 with a fully revised version being published in 2009 to incorporate changes towards implementing IFRS.

4.7 A full set of Prudential Indicators and borrowing limits is shown in Appendix 2.

Debt Rescheduling

4.8 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

4.9 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

4.10 Consideration will also be given to identifying if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

4.11 All debt rescheduling will be agreed by the Treasurer.

Sensitivity of the Forecast and Risk Analysis

4.12 Treasury management risks are identified in the Authority's approved Treasury Management Practices. The main risks to the Authority's treasury activities are:

- liquidity risk (inadequate cash resources);
- market or interest rate risk (fluctuations in interest rate levels and, thereby, in the value of investments);
- inflation risks (exposure to inflation);
- credit and counterparty risk (security of investments);
- refinancing risks (impact of debt maturing in future years); and
- legal and regulatory risk (non-compliance with statutory and regulatory requirements, risk of fraud)

4.13 Officers, in conjunction with the treasury advisers, will monitor these risks closely. Particular focus will be applied to:

- the global economy – indicators and their impact on interest rates will be monitored closely. Investment and borrowing portfolios will be positioned according to changes in the global economic climate;
- counterparty risk – the Authority follows a robust credit worthiness methodology and continues to monitor counterparties and sovereign ratings closely, particularly within the Eurozone: and
- the impact of the European Union's Markets in Financial Instruments Directive II (MiFID II) which is due to come into force on 8 January 2018 and may restrict the Authority's ability to invest its balances and the income it gains as a result.
- The EU parliament has been striving to reform MMFs that operate within the EU; the key proposal may require funds to move from Constant net asset value (CNAV) to Low Volatility net asset value (LVNAV). At the present time, there has been no issuance of draft regulations outlining the new reforms in significant detail. The expected time horizon for full implementation is likely to be up to two years. This would mean no changes to Investment Strategy documents at the moment but consideration should be given in future strategies.

5. INVESTMENT STRATEGY

5.1 The Authority's investment policy has regard to the CLG's Guidance on Local Government Investments (the Guidance), the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Capita Asset Services Guidance Notes (including CIPFA TM Code). The Authority's investment priorities will be security first, liquidity second, and then return.

5.2 Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

5.3 Investment instruments identified for use in the financial year are listed in section 5.18 and 5.21 under the 'Non-Specified and Specified' Investments categories. Counterparty limits will be as set through the Authority's Treasury Management Practices – Schedules.

Enhanced Money Market / Cash Funds

5.4 It is proposed to expand the range of investment instruments available in the 2017/18 strategy by including Enhanced Money Market / Cash Funds which are designed to produce an enhanced return compared to a traditional CNAV MMF which is designed for liquidity. The fund manager achieves greater return by investing their portfolio with a longer weighted average maturity (WAM). These funds can be AAA rated by credit rating agencies and would be used by the Fire Authority to hold funds in the 3-12 month duration. Notice to have funds returned can be given within 2-4 days (depending on the fund).These funds are usually priced at a variable net asset value (VNAV). The Fire Authority will use treasury advisors and conduct the necessary due diligence before selecting any fund to ensure it matches its prudent approach to investments.

Additional UK Banks

5.5 The addition of both Goldman Sachs IB and Standard Chartered Bank will provide the Authority with opportunities to further diversify its investment portfolio with UK banking names. This update will give options to reduce funds placed in Money Market Funds to a sensible liquidity level for cashflow and increase yield without taking any undue risk.

Credit worthiness Policy

5.6 Officers regularly review the investment portfolio, counterparty risk and construction, market data, information on government support for banks and the credit ratings of that government support. Latest market information is arrived at by reading the financial press and through city contacts as well as access to the key brokers involved in the London money markets.

5.7 Additionally, the Authority will make use of the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- credit default swap (CDS) spreads to give early warning of likely changes in credit ratings; and
- sovereign ratings to select counterparties from only the most creditworthy countries.

5.8 The modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative credit worthiness of counterparties. These colour codes are used by the Authority to determine the duration for investments. The strategy provides scope to invest in AAA rated foreign banks. However the Authority proposes to only use counterparties (Appendix 6) within the following durational bands that are domiciled in the UK.

- Yellow 2 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour, not to be used

Y	*P*	*B*	*O*	*R*	*G*	*N/C*
Up to 2 years	*Up to 2 years*	*Up to 1 year*	*Up to 1 year*	*Up to 6 months*	*Up to 100 days*	*No Colour*

5.9 The Capita Asset Services credit worthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue influence to just one agency's ratings.

5.10 Typically the minimum credit ratings criteria the Authority use, will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

5.11 All credit ratings will be monitored daily. The Authority is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services credit worthiness service.

- if a downgrade results in the counterparty or investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Authority will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

5.12 The primary principle governing the Authority's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Authority will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified investment sections; and
- It has sufficient liquidity in its investments.

5.13 The Capita Asset Services methodology was revised in October 2014 and determines the maximum investment duration under the credit rating criteria. Key features of Capita Asset Services credit rating policy are:

- A mathematical based scoring system is used taking ratings from all three credit rating agencies.
- Negative and positive watches and outlooks used by the credit rating agencies form part of the input to determine a counterparty's time band (i.e. 3, 6, 9, 12 months etc.).
- CDS spreads are used in Capita Asset Services creditworthiness service as it is accepted that credit rating agencies lag market events and thus do not provide investors with the most instantaneous and "up to date" picture of the credit quality of a particular institution. CDS spreads provide perceived market sentiment regarding the credit quality of an institution.
- After a score is generated from the inputs a maximum time limit (duration) is assigned and this is known as the Capita Asset Services colour which is associated with a maximum suggested time boundary.

5.14 The Capita Asset Services colours and the maximum time periods are shown para 5.5 above. In the Capita Asset Services methodology if counterparty has no colour then they are not recommended for investment and this would remove these counterparties from the Authority's counterparty list.

5.15 Whilst the Capita Asset Services methodology categorises counterparty time limits up to two years, the Authority's policy remains only to make investments up to a maximum of one year.

Country Limits

5.16 The Authority has determined that it will only use approved counterparties based in the UK.

5.17 The UK currently holds an AA sovereign rating. However the credit rating agencies will be carefully monitoring the rate of growth in the economy as a disappointing performance in that area could lead to a major derailment of the plans to contain the growth in the total amount of Government debt over the next few years. The impact of the EU referendum and the path chosen with regard to 'hard' or 'soft' Brexit could have a bearing on sovereign ratings in the months ahead.

Specified Investments

5.18 An investment is a specified investment if all of the following apply:

- the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;
- the investment is not a long term investment (i.e. up to 1 year);
- the making of the investment is not defined as capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended];
- the investment is made with a body or in an investment scheme of high credit quality (see below) or with one of the following public-sector bodies:
    - The United Kingdom Government;
    - A local authority in England or Wales (as defined under section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland; and

- High credit quality is defined as a minimum credit rating as outlined in section 5.15 of this strategy.

5.19 **The use of Specified Investments –** Investment instruments identified for use in the financial year are as follows:

- Table 3 below sets out the types of investments that fall into each category, counterparties available to the Authority, and the limits placed on each of these. A detailed list of each investment type is available in the Treasury Management Practices guidance notes.

5.20 Criteria for Specified Investments:

Table 3

Counterparty	Country/ Domicile	Instrument	Maximum investments	Max. maturity period
Counterparties in UK				
Debt Management and Depost Facilities (DMADF)	UK	Term Deposits	unlimited	1 yr
Government Treasury bills	UK	Term Deposits	unlimited	1 yr
Local Authorities	UK	Term Deposits	unlimited	1 yr
RBS/NatWest Group • Royal Bank of Scotland • NatWest	UK	Term Deposits (including callable deposits), Certificate of Deposits	£4m	1 yr
Lloyds Banking Group • Lloyds Bank • Bank of Scotland	UK		£4m	1 yr
Barclays	UK		£4m	1 yr
Santander UK	UK		£4m	1 yr
HSBC	UK		£4m	1 yr
Goldman Sachs IB	UK	Term Deposits	£4m	1 yr
Standard Chartered Bank	UK	Term Deposits	£4m	1 yr
Individual Money Market Funds	UK/Ireland/ domiciled	AAA rated Money Market Funds	£4m	Liquidity/instant access
Enhanced Money Market / Cash Funds (EMMFs)	UK/Ireland/ EU domiciled	AAA Bond Fund Rating	£4m	Liquidity

Non Specified Investments

5.21 The Fire Authority does not have any Non Specified Investments which are ones of more than one-year maturity or with institutions which have a lesser credit quality

Investment Position and Use of Authority's Resources

5.22 Bank Rate is forecast to stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%

5.23 The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace

5.24 The Capita Asset Services suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows:

- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%
- 2020/21 0.75%

5.25 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on investments unless resources are supplemented each year from new sources (asset sales etc.).

5.26 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short term interest rates (i.e. rates for investments up to 12 months).

5.27 For its cash flow generated balances, the Authority will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits in order to benefit from the compounding of interest.

6. MINIMUM REVENUE PROVISION

6.1 The Authority is required to repay an element of the CFR through a revenue charge (MRP), although it is also allowed to undertake additional voluntary payments if required.

6.2 CLG Regulations have been issued which require the Authority to approve an MRP Statement in advance of each year. A variety of options is provided to authorities, so long as there is a prudent provision. The Authority is recommended to approve the MRP Policy in Appendix 3.

6.3 The Authority, in conjunction with its Treasury Management advisors, has considered the MRP policy to be prudent.

7. POLICY ON THE USE OF EXTERNAL SERVICE PROVIDERS

7.1 The Authority uses Capita Asset Services as its external treasury management advisors.

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

7.3 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.

APPENDIX 1

Treasury Management Scheme of Delegation

1. **Fire Authority**

1.1 In line with best practice, The Fire Authority is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are:

a) Prudential and Treasury Indicators and Treasury Strategy (This report)
The first and most important report covers:
- the capital plans (including prudential indicators);
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

b) A Mid Year Treasury Management Report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and indicating whether the treasury strategy is meeting the strategy or whether any policies require revision.

c) An Annual Treasury Management Stewardship Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

2. **The Treasury Management Role of the Section 151 Officer**

2.1 The Section 151 (responsible) Officer:
- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit; and
- recommending the appointment of external service providers.

3. **Training –** Treasury Management training for Authority members will be delivered as required to facilitate more informed decision making and challenge processes.

1. The Prudential and Treasury Indicators

1.1 The Fire Authority's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

1.2 **Capital Expenditure**. This prudential Indicator shows the Authority's capital expenditure plans; both those agreed previously, and those forming part of this budget cycle. Capital expenditure excludes spend on PFI and leasing arrangements, which are now shown on the balance sheet.

1.3 The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Table 5

Description	**2016/17 Projected**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
	£m	**£m**	**£m**	**£m**
Capital Expenditure	2.645	4.676	5.937	2.553
Financed by:				
Capital receipts	(1.549)	(3.181)	(4.526)	(0.351)
Capital grants & Contributions	(0.132)	-	-	-
Revenue Financing	(0.495)	(0.536)	(0.980)	(0.582)
Capital Reserves	(0.030)	(0.720)	-	(1.189)
Net financing need for the year	**0.439**	**0.239**	**0.431**	**0.431**

1.4 The Authority's borrowing need (the Capital Financing Requirement) - The second prudential indicator is the Authority's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Authority's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

1.5 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

1.6 Following accounting changes, the CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought on the balance sheet. Whilst these increase the CFR, and therefore the Authority's borrowing requirement, these types of scheme include a borrowing facility and so the Authority is not required to separately borrow for these schemes. As of 31st March 2013 the Authority had no finance leases or PFI Schemes.

Table 6

Capital Financing Requirement	2016/17 Projected	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
	£m	£m	£m	£m
Opening CFR	10.973	10.973	10.773	10.773
Net Financing (as above)	0.439	0.239	0.431	0.431
MRP	(0.439)	(0.439)	(0.431)	(0.431)
Closing CFR	**10.973**	**10.773**	**10.773**	**10.773**

1.7 **The Operational Boundary.** This is the limit beyond which external borrowing is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual borrowing.

Table 7

Description	2016/17 Projected	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
	£m	£m	£m	£m
Borrowing	11.441	11.241	11.241	11.241
PFI/Leases	-	-	-	-
Total	**11.441**	**11.241**	**11.241**	**11.241**

1.8 **The Authorised Limit for external borrowing**. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external borrowing is prohibited, and this limit needs to be set or revised by the full Authority. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

- This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all authority's plans, or those of a specific authority, although this power has not yet been exercised; and
- The Authority is asked to approve the following Authorised Limit:

Table 8

Description	2016/17 Projected	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
	£m	£m	£m	£m
Borrowing	13.830	13.830	13.830	13.830
PFI/Leases	-	-	-	-
Total	**13.830**	**13.830**	**13.830**	**13.830**

2. Treasury Management Limits on Activity

2.1 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs or improve performance. The indicators are:

- upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- maturity structure of borrowing. These gross limits are set to reduce the Authority's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Table 9

	2017/18	2018/19	2019/20
Interest rate exposures	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt*	100%	100%	100%
Limits on variable interest rates based on net debt*	0%	0%	0%
*Net debt is borrowings less investments			
Maturity structure of fixed interest rate borrowing 2017/18			
	Lower	**Upper**	**Actual**
Under 12 months	0%	25%	2%
12 months to 2 years	0%	40%	0%
2 years to 5 years	0%	60%	4%
5 years to 10 years	0%	80%	21%
10 years to 20 years	0%	80%	37%
20 years to 30 years	0%	80%	3%
30 years to 40 years	0%	80%	32%
40 years to 50 years	0%	80%	0%

2.2 **Affordability Prudential Indicators -** The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Authority's overall finances. The Authority is asked to approve the following indicators:

2.3 **Actual and estimates of the ratio of financing costs to net revenue stream**. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in this budget report.

Table 10

Description	**2016/17 Projected**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
	%	**%**	**%**	**%**
Ratio	2.29	2.32	2.29	2.27

2.4 **Estimates of the incremental impact of capital investment decisions on council tax**. This indicator identifies the revenue costs associated with proposed changes to the four year capital programme recommended in this budget report compared to the Authority's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a four year period.

2.5 **Incremental impact of capital investment decisions on the band D council tax**

Table 11

Description	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
	£	£	£
Council tax – Band D	0.01	0.07	0.07

3. **Treasury Management Budget**

Table 12

Description	**2016/17**	**2017/18**	**2018/19**	**2019/20**
	£m	**£m**	**£m**	**£m**
Interest Payable	0.506	0.504	0.496	0.496
Interest Receipts	(0.115)	(0.075)	(0.075)	(0.075)
Minimum Revenue Provision	0.439	0.439	0.431	0.431
TOTAL	**0.830**	**0.868**	**0.852**	**0.852**

Minimum Revenue Provision Policy Statement

1. Policy Statement

1.1 The statutory requirement for local authorities to charge the Revenue Account each year with a specific sum for debt repayment has been replaced with a more flexible statutory guidance. A variety of options is provided to authorities to replace the existing Regulations, so long as there is a prudent provision.

1.2 The statutory duty is that a local authority shall determine for the financial year an amount of Minimum Revenue Provision (MRP) that it considers to be prudent. This replaces the previous prescriptive requirement that the minimum sum should be 4% of the Authority's Capital Financing Requirement (CFR).

1.3 To support the statutory duty the Government also issued a guidance, which requires that a Statement on the Authority's policy for its annual MRP should be submitted to The Fire Authority for approval before the start the financial year to which the provision will relate. The Authority is therefore legally obliged to have regard to this MRP guidance in the same way as applies to other statutory guidance such as the CIPFA Prudential Code, the CIPFA Treasury Management Code and the CLG guidance on Investments.

1.4 The MRP guidance offers four options under which MRP might be made, with an overriding recommendation that The Fire Authority should make prudent provision to redeem its debt liability over a period which is commensurate with that over which the capital expenditure is estimated to provide benefits (i.e. estimated useful life of the asset being financed).

1.5 The guidance also requires an annual review of MRP policy being undertaken and it is appropriate that this is done as part of this annual review of the Treasury Management Strategy.

1.6 The move to International Financial Reporting Standards (IFRS) involves Private Finance Initiative (PFI) contracts and potentially some leases (being reclassified as finance leases instead of operating leases) coming onto the Balance Sheet as long term liabilities. The accounting treatment would impact on the Capital Financing Requirement with the result that an annual MRP provision would be required.

1.7 To ensure that this change has no overall financial impact on Local Authorities, the Government has updated their "Statutory MRP Guidance" which allows MRP to be equivalent to the existing lease rental payments and "capital repayment element" of annual payments to PFI Operators. There are no implications for the authority's MRP policy.

The policy for 2017/18 is therefore as follows:

1.8 For capital expenditure incurred before 1 April 2008 or which in the future will be Government Supported Capital Expenditure, the MRP policy will be:

- Based on based on the non-housing CFR, i.e., The Authority currently set aside a Minimum Repayment Provision based on basic MRP of 4% each year to pay for past capital expenditure and to reduce its CFR.

1.9 From 1 April 2008 for all unsupported borrowing the MRP policy will be:

- Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option will be applied for any expenditure capitalised under a Capitalisation Direction).

- Asset Life Method (annuity method) The Authority will also be adopting the annuity method, - MRP calculated according to the flow of benefits from the asset, and where the principal repayments increase over the life of the asset. The policy is being adopted as a result of any PFI's assets coming on the balance sheet and any related MRP will be equivalent to the "capital repayment element" of the annual service charge payable to the PFI Operator and for finance leases, MRP will also be equivalent to the "capital repayment (principal) element" of the annual rental payable under the lease agreement. It should be noted that the Authority do not currently have any PFI assets or finance leases.

Under both methods, the Authority has the option to charge more than the statutory MRP each year through a Voluntary Revenue Provision (VRP).

1.10 This approach also allows the Authority to defer the introduction of an MRP charge for new capital projects/land purchases until the year after the new asset becomes operational rather than in the year borrowing is required to finance the capital spending. This approach is beneficial for projects that take more than one year to complete and is therefore included as part of the MRP policy. Half-yearly review of the Authority's MRP Policy will be undertaken and reported to Members as part of the Half-yearly Treasury Management Strategy review.

APPENDIX 4

Illustrative list of Approved Countries for Investments

The list below shows the countries that would currently meet these criteria:

AAA

- Australia
- Canada
- Denmark
- Germany
- Netherlands
- Singapore
- Sweden
- Switzerland

AA

- U.K.

Note: There are other three countries with AA, but the Authority will only be using UK because of the best understanding of the UK market.

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APPENDIX 5

Capita Assets Services (our Treasury advisors) on the Economic Background outlook for 2017/18

1. **The Global Economy**

1.1 **The Eurozone**. the ECB commenced, in March 2015 a €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%.

Eurozone Elections. Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

Key Dates 2017:

- Spring: Dutch General Election / French Presenditial Election
- Summer: French National Assembley
- Autumn: German Federal Election

1.2 **USA.** The result of the presidential election in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election has had a profound effect on the bond market and bond yields have risen sharply in the week since his election. Time will tell if this is a temporary over reaction, or a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

The election does not appear likely to have much impact on the Fed. in terms of holding back further on increasing the Fed. Rate. Accordingly, the next rate rise is still widely expected to occur in December 2016, followed by sharper increases thereafter, which may also cause Treasury yields to rise further. If the Trump package of policies is fully implemented, there is likely to be a significant increase in inflationary pressures which could, in turn, mean that the pace of further Fed. Rate increases will be quicker and stronger than had been previously expected.

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1.3 **Asia.** Economic growth in China has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

Economic growth in Japan is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

2. The UK Economy

2.1 UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.3%.

2.2 The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1% in the second half of 2016. Indeed, the increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013.

Nevertheless, despite average weekly earnings ticking up to 3.0% y/y in the three months ending in September, this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate in the near future as labour productivity growth has meant that net labour unit costs appear to be rising by about only 1% y/y. Having said that, at the start of October, data came out that indicated annual labour cost growth had jumped sharply in quarter 2 from +0.3% to +2.2%: time will tell if this is just a blip or the start of a trend.

2.3 There is, therefore, considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, therefore, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

2.4 The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q2 2016 and increases after that will be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

2.5 The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20.

3. Capita Asset Services forward view

3.1 Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

3.2 The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.

3.3 The overall balance of risks to economic recovery in the UK remains to the downside, particularly with the current uncertainty over the final terms of Brexit.

3.4 Downside risks currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak Capitalisation of European banks.
- Monetary policy action failing to stimulate sustainable growth and combat the treat of deflation in western economies, especially the Eurozone and Japan.

3.5 The potential for upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include:

- Uncertainty around the terms of a UK exit from the EU.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

3.6 **Brexit timetable and process:**

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members i.e. not that likely.
- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

Appendix 6 - Counterparty list

Banks	Country	Fitch Ratings				Moody's Ratings		S & P Ratings		CDS Price	Fire Authority Duration	Capita Duration Limit	Money Limit
		L Term	S Term	Viab.	Sup p.	L Term	S Term	L Term	S Term		(Months)	(Months)	(£m)
Lloyds Banking Group:													4
Lloyds Bank Plc	UK	A+	F1	a	5	A1	P-1	A	A-1	71.9	6	6	
Bank of Scotland	UK	A+	F1	a	5	A1	P-1	A	A-1	65.4	6	6	
RBS/NatWest Group:													4
NatWest Bank	UK	BBB+	F2	Bbb+	2	A3	P-2	BBB+	A-2	-	12	12	
Royal Bank of Scotland	UK	BBB+	F2	Bbb+	2	Ba1	P-2	BBB+	A-3	118.3	12	12	
Other UK Banks:													
HSBC Bank	UK	AA-	F1+	a+	1	Aa2	P-1	AA-	A-1+	71.4	12	12	4
Barclays Bank	UK	A	F1	a	5	A1	P-1	A-	A-2	80.4	6	6	4
Santander UK	UK	A	F1	a	2	Aa3	P-1	A	A-1	-	6	6	4
Goldman Sachs IB	UK	A	F1	-	-	A+	P-1	A+	A-1	91.2	6	6	4
Standard Charted Bank	UK	A+	F1	a	5	Aa3	P-1	A	A-1	107.4	1	1	4

For colour codings refer to Para. 5.6