Agenda Item No. 835

EAST SUSSEX FIRE AUTHORITY

Date:	**12 February 2015**
Title of report:	**Fire Authority Treasury Management Strategy 2015/16**
By:	**Treasurer**
Purpose of report:	**To approve the treasury management strategy, policy statement and the Minimum Revenue Provision (MRP) Statement 2015/16.**

RECOMMENDATION: The Fire Authority is recommended to:

i approve the treasury management strategy and policy statement for 2015/16 (and adopted for the remainder of 2014/15);

ii. determine that for 2015/16 the Authorised Limit for borrowing shall be £13.831m;

iii. adopt the prudential indicators as set out in the attached Appendix 2; and

iv. approve the Minimum Revenue Provision (MRP) Statement for 2015/16 as set out in the attached Appendix 3.

---

1. MAIN ISSUE

1.1 This report contains recommendations about the 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.

1.2 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.

1.3 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.

1.4 The 2015/16 counterparty list for specified and non-specified investment is set out in the Appendices 4 and 6.

1.5 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, and the organisations are regularly monitored to ensure that their financial strength and low risk has been maintained. The 2015/16 strategy continues the prudent approach and ensures that all investments were only to the highest quality rated banks and only up to a period of one year.

1.6 The Authority is recommended to approve an increase in investment with any approved counterparty from £3m to £4m. This allows the Authority to be more flexible with its cash balances during the year.

1.7 The background information and the calculation of the Authorised Limit for borrowing for 2015/16 of £13.831m are set out in the attached Appendix 2 (Table 8).

Prudential indicators and Treasury Management indicators

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

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

1.10 The Treasury Management policy statement for 2015/16 remains unchanged from the current year and is set out in Section 5.

DUNCAN SAVAGE
Treasurer
3 February 2015

BACKGROUND DOCUMENTS
See Paragraph 8

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 2015-16 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
- policy on 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 2015	0.50	2.20	3.40	3.40
Jun 2015	0.50	2.20	3.50	3.50
Sep 2015	0.50	2.30	3.70	3.70
Dec 2015	0.75	2.50	3.80	3.80
Mar 2016	0.75	2.60	4.00	4.00
Jun 2016	1.00	2.80	4.20	4.20
Sep 2016	1.00	2.90	4.30	4.30
Dec 2016	1.25	3.00	4.40	4.40
Mar 2017	1.25	3.20	4.50	4.50
Jun 2017	1.50	3.30	4.60	4.60

2.2 UK GDP growth surged during 2013 and the first half of 2014. Since then it appears to have subsided somewhat but still remains strong by UK standards and is expected to continue likewise into 2015 and 2016. There needs to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this recovery to become more firmly established. One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling disposable income and living standards to start improving. The plunge in the price of oil brought CPI inflation down to a low of 0.50% in January, the lowest rate since September 2002. Inflation is expected to stay around or below 1.0% for the best part of a year; this will help improve consumer disposable income and so underpin economic growth during 2015. However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer disposable income and economic growth. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen early in 2015.

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

- Greece: following the general election on 25 January 2015 the Syriza party were elected on an anti-EU and anti-austerity mandate. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strenthening of anti-EU and anti-austerity political parties throughout the EU is much more difficult to quantify;

- As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks, therefore, remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2015/16 and beyond;
- Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in

financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the likelihood that the ECB will commence quantitative easing (purchase of EZ government debt) in early 2015. 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 authorities will not be able to avoid new borrowing to finance new 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 2015, 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

	2014/15	**2015/16**	**2016/17**	**2017/18**
	Projected	**Estimate**	**Estimate**	**Estimate**
	£000	**£000**	**£000**	**£000**
External Borrowing				
Borrowing at 1 April	11,123	11,123	10,973	10,973
New Borrowing	-	-	-	-
Loan Redemption	-	(150)	-	(200)
Actual borrowing at 31 March	**11,123**	**10,973**	**10,973**	**10,773**
***CFR – the borrowing need**	**11,123**	**10,973**	**10,973**	**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 2014/15 has reduced to £nil and then 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. Borrowing Strategy

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.

Prudential & Treasury Indicators

4.5 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.

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

Debt Rescheduling

4.7 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).

4.8 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 (amend the maturity profile and/or the balance of volatility).

4.9 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.

4.10 All debt rescheduling will be agreed by the Treasurer.

Sensitivity of the Forecast and Risk Analysis

4.11 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).

4.12 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; and
- counterparty risk – the Authority follows a robust credit worthiness methodology and continues to monitor counterparties and sovereign ratings closely particularly within the Eurozone.

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 5.15 and 5.18 under the 'Non-Specified and Specified' Investments categories. Counterparty limits will be as set through the Authority's Treasury Management Practices – Schedules.

Credit worthiness Policy

5.4 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

5.5 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.

5.6 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 2yrs	*Up to 2yrs*	*Up to 1yr*	*Up to 1yrs*	*Up to 6 mths*	*Up to 100days*	*No Colour*

5.7 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.

5.8 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.

5.9 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.

5.10 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.

5.11 The Capita Asset Services methodology was revised in October 2013 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.

5.12 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.

5.13 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

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

5.15 The UK continues to enjoy 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.

Specified Investments

5.16 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:
    - o The United Kingdom Government;
    - o 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;
    - o High credit quality is defined as a minimum credit rating as outlined in section 5.15 of this strategy.

5.17 **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;

5.18 Criteria for Specified Investments:

Table 3

<table>
<tr><th>Counterparty</th><th>Country/ Domicile</th><th>Instrument</th><th>Maximum investments</th><th>Max. maturity period</th></tr>
<tr><td colspan="5">Counterparties in UK</td></tr>
<tr><td>Debt Management and Depost Facilities (DMADF)</td><td>UK</td><td>Term Deposits</td><td>unlimited</td><td>1 yr</td></tr>
<tr><td>Government Treasury blls</td><td>UK</td><td>Term Deposits</td><td>unlimited</td><td>1 yr</td></tr>
<tr><td>Local Authorities</td><td>UK</td><td>Term Deposits</td><td>unlimited</td><td>1 yr</td></tr>
<tr><td>RBS/NatWest Group
• Royal Bank of Scotland
• NatWest</td><td>UK</td><td rowspan="5">Term Deposits (including callable deposits), Certificate of Deposits</td><td>£4m</td><td>1 yr</td></tr>
<tr><td>Lloyds Banking Group
• Lloyds Bank
• Bank of Scotland</td><td>UK</td><td>£4m</td><td>1 yr</td></tr>
<tr><td>Barclays</td><td>UK</td><td>£4m</td><td>1 yr</td></tr>
<tr><td>Santander UK</td><td>UK</td><td>£4m</td><td>1 yr</td></tr>
<tr><td>HSBC</td><td>UK</td><td>£4m</td><td>1 yr</td></tr>
<tr><td>Individual Money Market Funds</td><td>UK/Ireland/ domiciled</td><td>AAA rated Money Market Funds</td><td>£4m</td><td>Liquidity/instant access</td></tr>
</table>

Non Specified Investments

5.18 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

5.19 Investment returns expectations**.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2014/15 0.50%
- 2015/16 0.70%
- 2016/17 1.25%
- 2017/18 2.00%

5.20 There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk, particularly if Bank of England inflation forecasts for the rate of fall of unemployment were to prove to be too optimistic.

5.21 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:

- 2015/16 0.60%
- 2016/17 1.25%
- 2017/18 1.75%
- 2018/19 2.25%

5.22 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.).

5.23 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).

5.24 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 Fire 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.

8. **Background Documents**

Fire Authority
14 February 2014 Treasury Management Strategy for 2014/15
5 June 2014 Treasury Management Stewardship Report 2013/14
Policy & Resources Panel
13 November 2014 Half year review for 2014/15
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

9. List of Appendices

Appendix 1: Treasury Management Scheme of Delegation
Appendix 2: The Prudential & Treasury Indicators
Appendix 3: Minimum Revenue Provision (MRP) Policy Statement
Appendix 4: Approved countries for investment
Appendix 5: Comment from Capita Asset Services on the outlook for 2014/15
Appendix 6: New Counterparty list

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.

APPENDIX 2

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	**2014/15 Projected**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
Capital Expenditure	2.800	5.855	2.784	1.645	2.070
Financed by:					
Capital receipts	(0.114)	(3.801)	(0.649)	(1.017)	(1.639)
Capital grants	(2.089)	-	-	-	-
Contributions	(0.152)	(0.672)	(0.011)	-	-
Revenue Financing	-	(1.087)	(0.935)	(0.389)	-
Capital Reserves	-	-	(0.750)	-	-
Net financing need for the year	**0.445**	**0.295**	**0.439**	**0.239**	**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

	2014/15 Projected	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
Capital Financing Requirement					
	£m	**£m**	**£m**	**£m**	**£m**
Opening CFR	11.122	11.123	10.973	10.973	10.773
Net Financing (as above)	0.445	0.295	0.439	0.239	0.431
MRP	(0.444)	(0.445)	(0.439)	(0.439)	(0.431)
Closing CFR	**11.123**	**10.973**	**10.973**	**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	**2014/15 Projected**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
Borrowing	11.591	11.441	11.441	11.241	11.241
PFI/Leases	-	-	-	-	-
Total	**11.591**	**11.441**	**11.441**	**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	**2014/15 Projected**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
Borrowing	13.981	13.831	13.831	13.631	13.631
PFI/Leases	-	-	-	-	-
Total	**13.981**	**13.831**	**13.831**	**13.631**	**13.631**

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

	2015/16	**2016/17**	**2017/18**
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 2015/16			
		Lower	**Upper**
Under 12 months		0%	25%
12 months to 2 years		0%	40%
2 years to 5 years		0%	60%
5 years to 10 years		0%	80%
10 years to 20 years		0%	80%
20 years to 30 years		0%	80%
30 years to 40 years		0%	80%
40 years to 50 years		0%	80%

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	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
	%	%	%	%	%
Ratio	2.21	2.19	2.28	2.33	2.36

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	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
	£	£	£
Council tax – Band D	0.00	0.02	0.10

3. **Treasury Management Budget**

Table 12

Description	2014/15	2015/16	2016/17	2017/18	2018/19
	£m	£m	£m	£m	£m
Interest Payable	0.514	0.510	0.506	0.504	0.504
Interest Receipts	(0.052)	(0.075)	(0.075)	(0.075)	(0.075)
Minimum Revenue Provision	0.444	0.445	0.439	0.439	0.431
TOTAL	**0.906**	**0.880**	**0.870**	**0.868**	**0.860**

APPENDIX 3

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 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 for 2015/16.

1.8 The policy recommended for adoption from 1 April 2014 retains the key elements of the policy previously approved but now incorporates the IFRS changes (re PFI and finance leases) and the consequential updated Government Guidance. The policy for 2015/16 is therefore as follows:-

1.9 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.

1.10 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).

1.11 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
- Luxembourg
- Netherlands
- Norway
- 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.

.

APPENDIX 5

Capital Assets Services (our Treasury advisors) on the Economic Background outlook for 2015/16

1. The Global Economy

1.1 **The Eurozone**. The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November 2014, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. It now appears likely that the ECB will embark on full quantitative easing (purchase of EZ country sovereign debt) in early 2015.

Concern in financial markets for the Eurozone subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US.

1.2 **USA.** The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently forecast that the first increase in the Fed. rate will occur by the middle of 2015.

1.3 **China.** Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has indicated a marginally lower outturn for 2014, which would be the lowest rate of growth for many years. There are also concerns that the Chinese leadership has only started to address an unbalanced economy which is heavily over dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

1.4 **Japan.** Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession in Q2 and Q3. The Japanese government already has the highest debt to GDP ratio in the world.

2. The UK Economy

2.1 **Economic growth.** After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

2.2 Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

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 transpires over 2015. 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 Near-term, there is some residual risk of further QE - if there is a dip in strong growth or if the MPC takes action to do more QE in order to reverse the rapid increase in market rates, especially in gilt yields and interest rates up to 10 years. This could cause shorter-dated gilt yields and PWLB rates over the next year or two to significantly undershoot the forecasts in the table below. The failure in the US, (at the time of writing), over passing a Federal budget for the new financial year starting on 1 October, and the expected tension over raising the debt ceiling in mid-October, could also see bond yields temporarily dip until any binding agreement is reached between the opposing Republican and Democrat sides. Conversely, the eventual start of tapering by the Fed could cause bond yields to rise.

3.2 The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries.

3.3 Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

3.4 The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas. The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the larger countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

3.5 Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

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

3.6 The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government
- ECB either failing to carry through on recent statements that it will soon start quantitative easing (purchase of government debt) or severely disappointing financial markets with embarking on only a token programme of minimal purchases which are unlikely to have much impact, if any, on stimulating growth in the EZ.
- The commencement by the US Federal Reserve of increases in the central rate in 2015 causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, leading to a sudden flight from bonds to equities.
- A surge in investor confidence that a return to robust world economic growth is imminent, causing a flow of funds out of bonds into 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.

Appendix 6 - Counterparty list Banks	Country	Fitch Ratings				Moody's Ratings			S & P Ratings		CDS Price	Fire Authority Duration (Months)	Capita Duration Limit (Months)	Money Limit (£m)
		L Term	S Term	Viab.	Supp	L Term	S Term	FSR	L Term	S Term				
Lloyds Banking Group:														4
Lloyds Bank Plc	UK	A	F1	a-	1	A-	P-1	C-	A	A-1	51.5	12	12	
Bank of Scotland	UK	A	F1	a-	1	A1	P-1	C-	A	A-1	-	12	12	
RBS/NatWest Group:														4
NatWest Bank	UK	A	F1	bbb	1	Baa1	P-2	D+	A-	A-2	-	12	12	
Royal Bank of Scotland	UK	A	F1	bbb	1	Baa1	P-2	D+	A-	A-2	54.5	12	12	
HSBC Bank	UK	AA-	F1+	a+	1	Aa3	P-1	C	AA-	A-1+	46.7	12	12	4
Barclays Bank	UK	A	F1	a	1	A2	P-1	C-	A	A-1	52.5	6	6	4
Santander UK plc (not Spanish Santander)	UK	A	F1	a	1	A2	P-1	C-	A	A-1	-	3	3	4