REPORT REFERENCE NO.	**DSFRA/17/3**
MEETING	**DEVON & SOMERSET FIRE & RESCUE AUTHORITY (Budget Meeting)**
DATE OF MEETING	**17 FEBRUARY 2017**
SUBJECT OF REPORT	**TREASURY MANAGEMENT STRATEGY (INCLUDING PRUDENTIAL AND TREASURY INDICATORS REPORT 2017-18 TO 2019-20)**
LEAD OFFICER	**Treasurer**
RECOMMENDATIONS	***(a). the Treasury Management Strategy and the Annual Investment Strategy as set out in this report be approved;*** ***(b). the Minimum Revenue Provision (MRP) statement for 2017-18, as contained as Appendix B to this report be approved.***
EXECUTIVE SUMMARY	This report sets out a treasury management strategy and investment strategy for 2017-18, including the Prudential Indicators associated with the capital programme for 2017-18 to 2019-20 considered elsewhere on the agenda of this meeting. A Minimum Revenue Provision Statement for 2017-18 is also included for approval.
RESOURCE IMPLICATIONS	As indicated in this report
EQUALITY RISKS AND BENEFITS ANALYSIS (ERBA)	The contents of this report are considered compatible with existing human rights and equality legislation.
APPENDICES	A. Prudential and Treasury Management Indicators 2017-18 to 2019-20. B. Minimum Revenue Provision Statement 2017-18
LIST OF BACKGROUND PAPERS	Local Government Act 2003. Chartered Institute of Public Finance Accountancy's (CIPFA) Prudential Code.

1. INTRODUCTION

Background

1.1 The Authority is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Authority's low risk appetite, providing adequate liquidity initially before considering investment return.

1.2 The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer term cash flow planning, to ensure that the Authority can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Authority risk or cost objectives.

1.3 Treasury management is defined as:

> "the management of the local authority'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."

Statutory requirements

1.4 The Local Government Act 2003 (the Act) and supporting regulations requires the Authority to "have regard to" the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

1.5 The Act therefore requires the Authority to set outs its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as paragraph 8 of this report); this sets out the Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.6 The Department of Communities and Local Government issued revised investment guidance which came into force from 1 April 2010. This guidance was captured within the revised CIPFA Treasury Management Code 2011.

CIPFA requirements

1.7 The Authority has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management. The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities.
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Authority will seek to achieve those policies and objectives.
- Receipt by the Authority of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision

Policy for the year ahead, a mid-year review report and an annual report (stewardship report) covering activities during the previous year.

- Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for this this Authority the delegated body is Resources Committee, and for the execution and administration of treasury management decisions and for this Authority the responsible officer is the Treasurer.
- Delegation by the Authority of the role of scrutiny of treasury management strategy and polices to a named body. For this Authority the delegated body is Resources Committee.

1.8 In summary, this Authority will adopt the following reporting arrangements in accordance with the requirements of the Code:

Area of Responsibility	Authority/ Committee/ Officer	Frequency
Treasury Management Policy Statement (revised)	Full authority	Initial adoption in 2010
Treasury Management Strategy / Annual Investment Strategy / MRP policy	Full authority	Annually before the start of the year *(as per this report)*
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid-year report	Full authority	Mid-year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Full authority	
Annual Treasury Outturn Report	Full authority	Annually by 30 September after the end of the year
Treasury Management Monitoring Reports	Resources Committee	
Treasury Management Practices	Full authority	
Scrutiny of treasury management performance	Resources Committee	

Treasury Management Strategy for 2017-18

1.9 The suggested strategy for 2017-18 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Authority's treasury advisor, Capita Asset Services (Capita).

1.10 The strategy for 2017-18 cover two main areas:

Capital Issues

- capital plans and prudential indicators
- the Minimum Revenue Provision (MRP) strategy

Treasury Management Issues

- treasury limits in force which will limit the treasury risk and activities of the Authority
- treasury Indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers

2. CAPITAL PRUDENTIAL INDICATORS FOR 2017-18 TO 2017/18

2.1 It is a statutory duty for the Authority to determine and keep under review how much it can afford to borrow. The amount so determined is termed the “Affordable Borrowing Limit”. In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

2.2 The Authority must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future Authority tax levels is ‘acceptable’.

2.3 Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit can be found in paragraph 3.5 of this report.

2.4 The capital expenditure plans which inform the indicators, as proposed in the Capital Programme report considered elsewhere on the agenda, are shown in Table 1 below. Other long term liabilities such as PFI and leasing arrangements which already include borrowing instruments are excluded.

TABLE 1 Capital programme	2016-17 Predicted outturn £m	2017-18 Budget £m	2018-19 Budget £m	2019-20 Budget £m
Land and buildings	1.581	1.498	5.400	2.400
Vehicles, Plant and Equipment	2.440	5.085	5.600	4.300
TOTAL CAPITAL EXPENDITURE	**4.021**	**6.583**	**11.000**	**6.700**

2.5 Table 2 overleaf summarises the financing of the capital programmes shown in Table 1. Additional capital finance sources may become available during the year, for example, additional grants or external contributions. The Authority will be requested to approve increases to the capital programme to be financed from other capital resources as and when the need arises.

TABLE 2 Capital programme financing	2016-17 Predicted outturn £m	2017-18 Budget £m	2018-19 Budget £m	2019-20 Budget £m
Programme per Table 1	**4.021**	**6.583**	**11.000**	**6.700**
Financed by:				
Borrowing	1.992	1.922	1.867	1.897
Revenue	2.029	4.661	9.133	4.803
Grants	-	-	-	

The Authority's Borrowing Need (Capital Financing Requirement)

2.6 The Capital Financing Requirement (CFR) represents the authority's underlying need to borrow for capital purposes. The forecast CFR for 2017-18 to 2019-20, based on the spending plans are shown in Table 3.

TABLE 3 Capital Financing Requirements (CFR)	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m	2019-20 Estimate £m
Capital Financing Requirement as at 31 March – borrowing	25.724	25.631	25.537	25.444
Capital Financing Requirement as at 31 March – other long term liabilities	1.374	1.298	1.209	1.112
Total Capital Financing Requirement as at 31 March	**27.098**	**26.929**	**26.746**	**26.556**

2.7 The CFR does not increase indefinitely as the minimum revenue provision (MRP) is a statutory annual revenue charge which ensures that there are sufficient funds to repay borrowing. By approving Appendix A, the Authority is approving the CFR projections shown in table 4 below.

TABLE 4 CFR projections	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m	2019-20 Estimate £m
Total CFR 1 April	27.265	27.098	26.929	26.746
Financing need for the year	1.992	1.922	1.867	1.897
Less MRP	(2.159)	(2.091)	(2.050)	(2.088)
Total Capital Financing Requirement as at 31 March	27.098	26.929	26.746	26.556
Movement in CFR	**(0.167)**	**(0.169)**	**(0.183)**	**(0.190)**

Minimum Revenue Provision (MRP) Strategy

2.8 The Authority is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

2.9 CLG regulations have been issued which require the full Authority to approve an MRP Statement in advance of each year. A variety of options are provided under which MRP could be made, with an overriding recommendation that the Authority should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits.

2.10 Although four main options are recommended (as below), there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

For borrowing after 1 April 2008 which is supported by Revenue Support Grant (RSG) and for all borrowing before 1st April 2008:

Option 1 – Regulatory Method

MRP calculated on the basis of the old rules as this is the basis for calculating Revenue Support Grant implications.

Option 2 – CFR Method

MRP can be calculated on the basis of 4% of the CFR at the end of the preceding financial year. If the CFR at that date is nil or negative, no MRP is required.

For new borrowing after 1 April 2008, under the Prudential system and for which no Government support is given:

Option 3 – Asset Life Method

Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be made in equal annual instalments over the life of the asset. In this circumstance the asset life is to be determined when MRP commences and not changed after that.

MRP should normally commence in the financial year following the one in which the expenditure is incurred. However, when borrowing to construct an asset, the authority may treat the asset life as commencing in the year in which the asset first becomes operational. It may accordingly postpone beginning to make MRP until that year. Investment properties should be regarded as becoming operational when they begin to generate revenues.

Option 4 – Depreciation Method

MRP is to be equal to the provision required in accordance with depreciation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements.

2.11 It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the regulations. Whilst options 1 and 2 are available for unsupported borrowing before 1 April 2008, authorities are able to use options 3 and 4 if they choose to do so.

2.12 As some types of capital expenditure incurred by the Authority are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

2.13 A draft MRP statement for 2017-18 is attached as Appendix B for Authority approval. The financing of the approved 2017-18 capital programme, and the resultant prudential indicators have been set on the basis of the content of this statement.

Prudential Indicators for Affordability

2.14 The previous sections of the report cover the overall limits for capital expenditure and borrowing, but within the overall framework indicators are also included to demonstrate the affordability of capital investment plans.

2.15 A key indicator of the affordability of capital investment plans is the ratio of financing costs to the net revenue stream; this indicator identifies the trend in the cost of capital financing (borrowing costs net of investment income) against the Authority's net budget requirement. Annual capital financing costs are a product of total debt outstanding, the annual repayment regime and interest rates. The forecast ratios for 2017-18 to 2019-20 based on current commitments and the proposed Capital Programme are included in Table 5.

TABLE 5 Financing v Net revenue	2016-17 Estimate %	2017-18 Estimate %	2018-19 Estimate %	2019-20 Estimate %
Ratio of Financing Costs to Net Revenue Stream	4.17	4.26	4.20	4.19

2.16 The estimate of the incremental impact of capital investment decisions proposed in the recommended Capital Programme over and above capital investment decisions that have previously been taken by the Authority are given in Table 6. These figures do not represent the total impact on the Authority tax over and above 2016-17 as a consequence of the total capital programme, only the incremental impact over and above previous decisions made on capital investment. The figures given represent the incremental impact for a Band D property.

TABLE 6	2017-18 Estimate £ p	2018-19 Estimate £ p	2019-20 Estimate £ p
Element of Authority tax for New Capital Spending	£0.06	£0.09	£0.09

3. BORROWING

3.1 The capital expenditure plans set out in Section 2 provide details of the service activity of the Authority. The treasury management function ensures that the Authority's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current borrowing position

3.2 The Authority's treasury portfolio position at 31st March 2016, with forward projections are summarised below in Tables 7 & 8. Table 7 shows the actual external debt (the treasury management operations). Table 8 shows the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

TABLE 7 Gross debt	2016-17 £m	2017-18 £m	2018-19 £m	2019-20 £m
	Estimate	Estimate	Estimate	Estimate
External Debt (1 April)	25.818	25.724	25.630	25.537
New Borrowing	-	-	-	
Replacement debt	-	-	-	-
Repaid debt	(0.094)	(0.094)	(0.093)	(0.093)
External debt (31 March)	25.724	25.630	25.537	25.444
Other long-term liabilities (OLTL) (1 April)	1.444	1.374	1.299	1.209
Expected in year changes to OLTL	(0.070)	(0.075)	(0.090)	(0.097)
OLTL (31 March)	1.374	1.299	1.209	1.112
Total Gross debt at 31 March	**27.098**	**26.929**	**26.746**	**26.556**

TABLE 8 Capital Financing Requirement	2016-17 £m	2017-18 £m	2018-19 £m	2019-20 £m
	Estimate	Estimate	Estimate	Estimate
Total Gross Debt from Table 7	27.098	26.929	26.746	26.556
Capital Financing Requirement 31 March from Table 4	27.098	26.929	26.746	26.556
Under / (over) borrowed 31 March	**-**	**-**	**-**	**-**

3.3 Within the prudential indicators there are a number of key indicators to ensure that the Authority operates its activities within well-defined limits. One of these is to ensure that over the medium term, net borrowing will only be for capital purposes i.e. net external borrowing does not exceed the total Capital Financing Requirement in the preceding year plus the estimates for the current year and the next two years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. The Treasurer is able to report that the Authority complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Limits to Borrowing Activity

3.4 Two Treasury Management Indicators control the level of borrowing. They are:

- **The *authorised limit*** - this represents the maximum limit beyond which any additional borrowing is prohibited until the limit is revised by the Authority. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the 2018-19 budget process.

- **The *operational boundary*** – this indicator is based on the probable external debt during the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year.

3.5 Tables 9 and 10 detail, respectively:

- the recommended Authorised Limits for 2017-18 and the medium term; and
- the recommended Operational Boundaries for 2017-18 and the medium term.

TABLE 9 Authorised limits	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m	2019-20 Estimate £m
Authorised limit for External Debt				
- External Debt	26.824	26.912	26.814	26.716
- Other long term liabilities	1.278	1.364	1.270	1.167
TOTAL AUTHORISED LIMIT FOR EXTERNAL DEBT	**28.101**	**28.276**	**28.084**	**27.883**

TABLE 10 Operational boundary	2016-17 Estimate £m	2017-18 Estimate £m	2018-19 Estimate £m	2019-20 Estimate £m
Operational Boundary for External Debt				
- External Debt	25.537	25.631	25.537	25.444
- Other long term liabilities	1.209	1.299	1.209	1.112
TOTAL OPERATIONAL BOUNDARY FOR EXTERNAL DEBT	**26.746**	**26.930**	**26.746**	**26.556**

3.6 It is estimated that the actual external debt at 31 March 2017 will be £25.724 million.

Prospects for interest rates

3.7 The Authority has appointed 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 11 gives their central view.

TABLE 11 – Forecast Interest Rates

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

3.8 The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th 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 Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 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, 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.

3.9 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 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 Bank Rate could be brought forward.

3.10 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

3.11 The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy.

3.12 Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Fed. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

3.13 PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

3.14 The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

3.15 Apart from the above uncertainties, downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
  - Italian constitutional referendum 4.12.16 resulted in a 'No' vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
  - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
  - Dutch general election 15.3.17;
  - French presidential election April/May 2017;
  - French National Assembly election June 2017;
  - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

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

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing 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.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

3.17 Investment returns are likely to remain low during 2017/18 and beyond;

3.18 Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th 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 authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;

3.19 There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

Borrowing strategy

3.20 As reported in the separate report on this agenda "Capital Programme 2017-18 to 2019-20", it is the strategic intent of the Authority not to increase its exposure to external borrowing during the next six years. To achieve this a recommendation the Authority has supported the inclusion in the base revenue budget a revenue contribution to capital investment (£3,7m in 2017-18).

3.21 This being the case there is no intention to take out any new borrowing during 2017-18. Should this position change then the Treasury Management Strategy will need to be reviewed to reflect any change to the borrowing strategy and would be subject to a further report to the full Authority.

Treasury management limits on activity

3.22 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 / 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 12 overleaf provides the following treasury indicators and limits for Authority approval:

TABLE 12 – Treasury management Indicators 2017-18

Interest Rate Exposures			
	2017-18	**2018-19**	**2019-20**
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	30%	30%	30%
Maturity structure of fixed interest rate borrowing 2017-18			
		Lower	**Upper**
Under 12 months		30%	0%
12 months to 2 years		30%	0%
2 years to 5 years		50%	0%
5 years to 10 years		75%	0%
10 years to 20 years		100%	50%

.***Policy on borrowing in advance of need***

3.23 The Authority will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds.

Debt rescheduling

3.24 As short term borrowing rates will be considerably cheaper than longer term rates, there may be potential for some residual 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 size of premiums incurred, their short term nature and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any such rescheduling and repayment of debt is likely to cause a flattening of the authority's maturity profile as in recent years there has been a skew towards longer dated PWLB.

3.25 Consideration will also be given to identify if there is any 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.

3.26 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 adopted borrowing strategy, and
- enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

3.27 All rescheduling will be reported to the Resources Committee, at the earliest meeting following its action.

4. ANNUAL INVESTMENT STRATEGY

Investment Policy

4.1 The Authority will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Authority's investment priorities are:

(a) the security of capital and

(b) the liquidity of its investments.

4.2 The Authority will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Authority is low in order to give priority to security of its investments.

4.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Authority will not engage in such activity.

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

Creditworthiness Policy

4.5 This Authority uses the creditworthiness service provided by Capita Treasury Services. This service employs a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as 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

4.6 This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads 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 code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Authority to determine the duration for investments and are therefore referred to as durational bands. The Authority is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Authority would not be able to replicate using in house resources.

4.7 The Capita Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

4.8 Typically the minimum credit ratings criteria the Authority use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. 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.

4.9 All credit ratings will be monitored weekly. The Authority is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service. If a downgrade results in the counterparty/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.

4.10 Sole reliance will not be placed on the use of this external service. In addition this Authority will also use market data and market information, information on government support for banks and the credit ratings of that government support.

Approved Instruments for Investments

4.11 Investments will only be made with those bodies identified by the authority for its use through the Annual Investment Strategy.

Non-specified Investments

4.12 Non specified investments are those which do not meet the Specified Investment Criteria and covers those counterparties where there is either no recognised credit rating and/or an anticipation that an investment will be for greater than one year in duration.

4.13 The Authority had not previously placed non-specified investments as a result of its prudent approach to place security and liquidity over yield. However from April 2015 it was agreed that the strategy be amended to include investments with maturity of longer than 364 days. The maximum duration limit on any non-specified deposit will be determined by the colour assigned to the Counterparty on the Capita Asset Services credit list on the date the investment is placed, but typically will be for no longer than 24 months. Where such investments are placed via the Secondary Market i.e. buying the remaining term of an existing instrument, then the term will be for 24 months.

4.14 A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the categories outlined in Table 13 overleaf.

4.15 The maturity limits recommended will not be exceeded. Under the delegated powers the Section 151 Officer can set limits that are based on the latest economic conditions and credit ratings.

4.16 Table 13 overleaf shows those bodies with which the Authority will invest.

TABLE 13	
Specified Investments	Non Specified Investments
Deposits with the Debt Management Agency Deposit Facility	
Term Deposits with UK government, UK local authorities, highly credit rated banks and building societies (including callable deposits and forward deals)	Term Deposits with UK government, UK local authorities, highly credit rated banks and building societies (including callable deposits and forward deals) Non-credit rated building societies. ***The total amount of non-specified investments will not be greater than £5m in value.***
Banks nationalised/part nationalised or supported by the UK government	Banks nationalised/part nationalised or supported by the UK government
Money Market Funds	
Non UK highly credited rated banks	
UK Government Treasury Bills	
Certificates of Deposit	
Corporate Bonds	
Gilts	

4.17 The Authority has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide).

Investment Strategy

4.18 In-house funds: The Authority's in-house managed funds are mainly cash-flow derived and investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates.

4.19 Interest rate outlook: The Authority has appointed Capita Asset Services (Capita) as treasury advisor to the Authority and part of their service is to assist the Authority to formulate a view on interest rates. 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:

Capita Bank Rate forecast for financial year ends (March)

2016-17 0.25%

2017-18 0.25%

2018-19 0.25%

2019-20 0.50%

4.20 The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

2016/17 0.25%
2017/18 0.25%
2018/19 0.25%
2019/20 0.50%
2020/21 0.75%
2021/22 1.00%
2022/23 1.50%
2023/24 1.75%
Later years 2.75%

4.21 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.

Investment treasury indicator and limit (total principal funds invested for greater than 364 days)

4.22 These limits are set with regard to the Authority's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

Maximum principal sums invested > 364 days			
£m	**2017-18**	**2018-19**	**2019-20**
Principal sums invested > 364 days	£5m	£5m	£5m

End of year investment report

4.23 At the end of the financial year, the Authority will report on its investment activity as part of its Annual Treasury Report.

Policy on the use of external service providers

4.24 The Authority uses Capita as its external treasury management advisers. The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

4.25 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.

Treasury Management Scheme of Delegation

Full Authority

- Receiving and reviewing reports on treasury management policies, practices and activities

- Approval of annual strategy
- Approval of/amendments to the Authority's adopted clauses, treasury management policy statement and treasury management practices
- Budget consideration and approval
- Approval of the division of responsibilities
- Approving the selection of external service providers and agreeing terms of appointment.
- Reviewing the treasury management policy and procedures and making recommendations to the Authority.

Resources Committee;

- Receiving and reviewing regular monitoring reports and acting on recommendations

Role of the Section 151 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
- Recommending the appointment of external service providers.

5. SUMMARY AND RECOMMENDATIONS

5.1 The Authority is required to consider and approve the treasury management strategy to be adopted prior to the start of the financial year. This strategy must also include proposed prudential indicators and a minimum provision statement (MRP). Approval of the strategy for 2017-18 as contained in this report will also incorporate the adoption of the revised CIPFA Treasury Management Code of Practice.

KEVIN WOODWARD
Treasurer

APPENDIX A DSFRA/17/3

PRUDENTIAL INDICATORS

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
				INDICATIVE INDICATORS 2020/21 to 2022/23		
	£m Estimate	£m Estimate	£m Estimate	£m Estimate	£m Estimate	£m Estimate
Capital Expenditure						
Non - HRA	6.583	11.000	6.700	6.200	4.700	4.700
HRA (applies only to housing authorities)						
Total	6.583	11.000	6.700	6.200	4.700	4.700
Ratio of financing costs to net revenue stream						
Non - HRA	4.25%	4.18%	4.17%	4.08%	3.97%	3.62%
HRA (applies only to housing authorities)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Capital Financing Requirement as at 31 March	£000	£000	£000	£000	£000	£000
Non - HRA	25,631	25,537	25,444	24,851	24,758	24,264
HRA (applies only to housing authorities)	0	0	0	0	0	0
Other long term liabilities	1,299	1,209	1,112	1,010	907	791
Total	26,929	26,746	26,555	25,861	25,665	25,055
Annual change in Capital Financing Requirement	£000	£000	£000	£000	£000	£000
Non - HRA	(169)	(183)	(191)	(695)	(196)	(611)
HRA (applies only to housing authorities)	0	0	0	0	0	0
Total	(169)	(183)	(191)	(695)	(196)	(611)
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p	£ p
Increase/(decrease) in council tax (band D) per annum	£0.06	£0.09	£0.09	N/A	N/A	N/A
PRUDENTIAL INDICATORS - TREASURY MANAGEMENT						
Authorised Limit for external debt	£000	£000	£000	£000	£000	£000
Borrowing	26,912	26,814	26,716	26,093	25,996	25,477
Other long term liabilities	1,364	1,270	1,167	1,061	953	830
Total	28,276	28,084	27,883	27,154	26,948	26,307
Operational Boundary for external debt	£000	£000	£000	£000	£000	£000
Borrowing	25,631	25,537	25,444	24,851	24,758	24,264
Other long term liabilities	1,299	1,209	1,112	1,010	907	791
Total	26,929	26,746	26,555	25,861	25,665	25,055
Maximum Principal Sums Invested over 364 Days						
Principal Sums invested > 364 Days	5,000	5,000	5,000	5,000	5,000	5,000

TREASURY MANAGEMENT INDICATOR	Lower Limit %
Limits on borrowing at fixed interest rates	70%
Limits on borrowing at variable interest rates	0%
Maturity structure of fixed rate borrowing during 2016/17	
Under 12 months	0%
12 months and within 24 months	0%
24 months and within 5 years	0%
5 years and within 10 years	0%
10 years and above	50%

MINIMUM REVENUE STATEMENT (MRP) 2017-18

Supported Borrowing

The MRP will be calculated using the regulatory method (option 1). MRP will therefore be calculated using the formulae in the old regulations, since future entitlement to RSG in support of this borrowing will continue to be calculated on this basis.

Un-Supported Borrowing (including un-supported borrowing prior to 1 April 2008)

The MRP in respect of unsupported borrowing under the prudential system will be calculated using the asset life method (option 3). The MRP will therefore be calculated to repay the borrowing in equal annual instalments over the life of the class of assets which it is funding. The repayment period of all such borrowing will be calculated when it takes place and will be based on the finite life of the class of asset at that time and will not be changed.

Finance Lease and PFI

In the case of Finance Leases and on balance sheet PFI schemes, the MRP requirement is regarded as met by a charge equal to the element of the annual charge that goes to write down the balance sheet liability. Where a lease of PFI scheme is brought, having previously been accounted for off-balance sheet, the MRP requirement is regarded as having been met by the inclusion of the charge, for the year in which the restatement occurs, of an amount equal to the write-down for the year plus retrospective writing down of the balance sheet liability that arises from the restatement. This approach produces an MRP charge that is comparable to that of the Option 3 approach in that it will run over the life of the lease or PFI scheme and will have a profile similar to that of the annuity method.

MRP will normally commence in the financial year following the one in which the expenditure was incurred. However, when borrowing to construct an asset, the authority may treat the asset life as commencing in the year in which the asset first becomes operational. It may accordingly postpone the beginning to make MRP until that year. Investment properties will be regarded as becoming operational when they begin to generate revenues.