REPORT REFERENCE NO.	**DSFRA/16/3**
MEETING	**DEVON & SOMERSET FIRE & RESCUE AUTHORITY (BUDGET MEETING)**
DATE OF MEETING	**19 FEBRUARY 2016**
SUBJECT OF REPORT	**TREASURY MANAGEMENT STRATEGY (INCLUDING PRUDENTIAL AND TREASURY INDICATORS REPORT 2016-17 TO 2018-19)**
LEAD OFFICER	**Treasurer**
RECOMMENDATIONS	***(a) that the following be approved:*** ***(i). the Treasury Management Strategy and the Annual Investment Strategy;*** ***(ii). the Minimum Revenue Provision (MRP) statement for 2016-17, as contained as Appendix B; and*** ***(iii). that the Treasurer be delegated authority to effect movements between the separately agreed prudential limits for borrowing;*** ***(b) that the statement at paragraph 3.3 of this report that borrowing limits and the debt management strategy have been set to ensure that net borrowing remains below the Capital Financing Requirement (CFR) for 2016-17 to 2018-19, in line with the requirements of the CIPFA Prudential Code, be noted.***
EXECUTIVE SUMMARY	This report sets out a treasury management strategy and investment strategy for 2016-17, including the Prudential Indicators associated with the capital programme for 2016-17 to 2018-19 considered elsewhere on the agenda of this meeting. A Minimum Revenue Provision Statement for 2016-17 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 2016-17 to 2018-19. B. Minimum Revenue Provision Statement 2016-17
LIST OF BACKGROUND PAPERS	Local Government Act 2003. Chartered Institute of Public Finance Accountancy's (CIPFA) Prudential Code.

1. INTRODUCTION

Background

1.1 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

1.2 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.

1.3 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 4 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.

1.4 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

1.5 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by the Authority on 19 February 2010. The Code was reissued in 2011 with cross sectorial guidance notes.

1.6 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.

1.7 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 2016-17

1.8 The suggested strategy for 2016-17 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).

1.9 The strategy for 2016-17 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

Balanced Budget Requirement

1.10 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.

1.11 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.

2. CAPITAL PRUDENTIAL INDICATORS FOR 2016-17 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 overleaf. Other long term liabilities such as PFI and leasing arrangements which already include borrowing instruments are excluded.

<u>TABLE 1</u> **Capital programme**	**2015-16 Predicted outturn £m**	**2016-17 Budget £m**	**2017-18 Budget £m**	**2018-19 Budget £m**
Land and buildings	1.436	1.768	2.412	1.505
Vehicles, Plant and Equipment	6.018	3.294	2.571	2.990
TOTAL CAPITAL EXPENDITURE	**7.454**	**5.062**	**4.983**	**4.495**

2.5 Table 2 below 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.

<u>TABLE 2</u> **Capital programme financing**	**2015-16 Predicted outturn £m**	**2016-17 Budget £m**	**2017-18 Budget £m**	**2018-19 Budget £m**
Programme per Table 1	7.454	5.062	4.983	4.495
Financed by:				
Borrowing	4.997	1.967	1.889	1.815
Revenue	2.457	3.095	3.094	2.680
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 2016-17 to 2018-19, based on the spending plans are shown in Table 3 overleaf.

TABLE 3 **Capital Financing Requirements (CFR)**	**2015-16 Estimate £m**	**2016-17 Estimate £m**	**2017-18 Estimate £m**	**2018-19 Estimate £m**
Capital Financing Requirement as at 31 March – borrowing	25.817	25.724	25.630	25.537
Capital Financing Requirement as at 31 March – other long term liabilities	1.444	1.374	1.299	1.209
Total Capital Financing Requirement as at 31 March	**27.261**	**27.098**	**26.929**	**26.746**

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**	**2015-16 Estimate £m**	**2016-17 Estimate £m**	**2017-18 Estimate £m**	**2018-19 Estimate £m**
Total CFR 1 April	24.091	27.261	27.098	26.929
Financing need for the year	4.997	1.967	1.889	1.815
Less MRP	(1.827)	(2.130)	(2.058)	(1.998)
Total Capital Financing Requirement as at 31 March	27.261	27.098	26.929	26.746
Movement in CFR	**3.170**	**(0.163)**	**(0.169)**	**(0.183)**

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 1 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 2016-17 is attached as Appendix B for Authority approval. The financing of the approved 2016-17 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 2016-17 to 2018-19 based on current commitments and the proposed Capital Programme are included in Table 5.

TABLE 5 **Financing v Net revenue**	**2015-16 Estimate %**	**2016-17 Estimate %**	**2017-18 Estimate %**	**2018-19 Estimate %**
Ratio of Financing Costs to Net Revenue Stream	3.76	4.19	4.19	4.10

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 overleaf. These figures do not represent the total impact on the Authority tax over and above 2015-16 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	**2016-17 Estimate £ p**	**2017-18 Estimate £ p**	**2018-19 Estimate £ p**
Element of Authority tax for New Capital Spending	(£0.04)	(£0.26)	(£1.07)

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 31 March 2015, with forward projections are summarised below in Tables 7 & 8. Table 7 overleaf 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**	**2015/16 £m**	**2016-17 £m**	**2017-18 £m**	**2018-19 £m**
	Estimate	**Estimate**	**Estimate**	**Estimate**
External Debt (1 April)	25.944	25.818	25.724	25.630
New Borrowing	-	-	-	
Replacement debt	-	-	-	-
Repaid debt	(0.127)	(0.094)	(0.094)	(0.093)
External debt (31 March)	25.818	25.724	25.630	25.537
Other long-term liabilities (OLTL) (1 April)	1.509	1.443	1.374	1.299
Expected in year changes to OLTL	(0.066)	(0.069)	(0.075)	(0.090)
OLTL (31 March)	1.443	1.374	1.299	1.209
Total Gross debt at 31 March	**27.261**	**27.098**	**26.929**	**26.746**

TABLE 8 **Capital Financing Requirement**	**2015-16 £m**	**2016-17 £m**	**2017-18 £m**	**2018-19 £m**
	Estimate	**Estimate**	**Estimate**	**Estimate**
Total Gross Debt from Table 7	27.261	27.098	26.929	26.746
Capital Financing Requirement 31 March from Table 4	27.261	27.098	26.929	26.746
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. This is demonstrated by the fact that the operational boundary for external debt borrowing in 2016-17 of £26.746 million (Table 10) does not exceed the CFR for 2018-19 of £26.746 million (Table 3).

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 estimate for 2016-17 is revised as part of the 2016-17 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 2016-17 and the medium term; and
- the recommended Operational Boundaries for 2016-17 and the medium term.

TABLE 9 **Authorised limits**	**2015-16 Estimate £m**	**2016-17 Estimate £m**	**2017-18 Estimate £m**	**2018-19 Estimate £m**
Authorised limit for External Debt				
- External Debt	29.477	26.824	26.726	26.128
- Other long term liabilities	1.516	1.443	1.364	1.270
TOTAL AUTHORISED LIMIT FOR EXTERNAL DEBT	**30.993**	**28.267**	**28.090**	**27.398**

TABLE 10 **Operational boundary**	**2015-16 Estimate £m**	**2016-17 Estimate £m**	**2017-18 Estimate £m**	**2018-19 Estimate £m**
Operational Boundary for External Debt				
- External Debt	28.186	25.537	25.444	24.851
- Other long term liabilities	1.444	1.209	1.112	1.010
TOTAL OPERATIONAL BOUNDARY FOR EXTERNAL DEBT	**29.630**	**26.746**	**26.556**	**25.861**

3.6 It is estimated that the actual external debt at 31 March 2016 will be £25.818 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 our central view.

TABLE 11

	NOW	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
BANK RATE	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75
3 month LIBID	0.52	0.50	0.50	0.60	0.80	0.90	1.00	1.10	1.30	1.40	1.50	1.60	1.80	1.90
6 month LIBID	0.66	0.70	0.70	0.80	0.90	1.00	1.20	1.30	1.50	1.60	1.70	1.80	2.00	2.20
12 month LIBID	0.98	1.00	1.00	1.10	1.20	1.30	1.50	1.60	1.80	1.90	2.00	2.10	2.30	2.40
5 yr PWLB	1.92	2.00	2.10	2.20	2.30	2.40	2.50	2.60	2.70	2.80	2.90	3.00	3.10	3.20
10 yr PWLB	2.58	2.60	2.70	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.60	3.70
25 yr PWLB	3.36	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10	4.10
50 yr PWLB	3.18	3.20	3.20	3.30	3.40	3.50	3.60	3.70	3.80	3.90	3.90	4.00	4.00	4.00

3.8 **UK.** UK Gross Domestic Product (GDP) growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%. Quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a slight increase in quarter 2 to +0.5% (+2.3% y/y) before weakening again to +0.4% (2.1% y/y) in quarter 3.

3.9 The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that Consumer Prices Index (CPI) inflation has fallen to, or near to, zero since February 2015. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK.

3.10 The Inflation Report was also notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but a second, more recent round of falls in fuel and commodity prices will delay a significant tick up in inflation from around zero: this is now expected to get back to around 1% by the end of 2016 and not get to near 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase. However, more falls in the price of oil and imports from emerging countries in early 2016 will further delay the pick up in inflation. There is therefore considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the Monetary Policy Committee (MPC) will decide to make a start on increasing Bank Rate.

3.11 The weakening of UK GDP growth during 2015 and the deterioration of prospects in the international scene, especially for emerging market countries, have consequently led to forecasts for when the first increase in Bank Rate would occur being pushed back to quarter 4 of 2016. There is downside risk to this forecast i.e. it could be pushed further back.

3.12 **USA.** The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then pulled back to 2.0% in quarter 3. The run of strong monthly increases in nonfarm payrolls figures for growth in employment in 2015 prepared the way for the Federal Reserve to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

3.13 **EZ.** In the Eurozone, the European Central Bank (ECB) fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected Eurozone (EZ) countries. This programme of €60bn of monthly purchases started in March 2015 and it was intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its Quantitative Easing (QE) programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

3.14 **Greece.** During July, Greece finally capitulated to European Union (EU) demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

3.15 **Portugal and Spain.** The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. An anti-austerity coalition has won a majority of seats in Portugal while the general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

Borrowing strategy

3.16 As reported in the separate report on this agenda "Capital Programme 2016-17 to 2018-19", 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 has been made in that report to make provision in the 2016-17 revenue budget for a revenue contribution to capital (minimum of £2.8m). It is also planned for future revenue budgets to include a revenue contribution of £2m.

3.17 This being the case there is no intention to take out any new borrowing during 2016-17. 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

3.18 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 2016-17

£m	2016/17	2017/18	2018/19
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	30%	30%	30%
Maturity structure of fixed interest rate borrowing 2016/17			
		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

3.19 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

3.20 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.

3.21 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.

3.22 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).

3.23 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 Investment Strategy incorporates an amendment recommended by the Resources Committee at its meeting on 20 November 2014 and approved by the Authority at its meeting on 20 February 2015 (Minute RC/9) to reflect changes to credit agencies ratings to cease monitoring the Viability and Strength standalone ratings as a consequence of the eventual removal of implied Government support to banks. As a result of these rating agency changes, it was agreed that the credit element of the Authority's future methodology will focus solely on the Short and Long Term ratings of an institution.

4.7 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.

4.8 The selection of counterparties with a high level of creditworthiness will be achieved by selecting institutions down to and including the durational band of no more than three months within Capita's weekly credit list of worldwide potential counterparties. These will be referred to as highly credit rated institutions.

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4.9 CIPFAs TM Code removed the requirement to have regard to the “lowest” credit rating from the credit rating agencies of Fitch, Moodys and Standard and Poors. Historically, this Authority chose to follow the Capita colour matrix credit assessment as it gave a more balanced approach. With the removal of this lowest common denominator requirement from CIPFA the Authority’s will continue to use a combination of the Capita colour matrix and any additional information available locally on which to base investment decisions.

4.10 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.

4.11 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

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

Non-specified Investments

4.13 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.

4.14 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.

4.15 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 12 below.

4.16 The maturity limits recommended will not be exceeded. Under the delegated powers the Section 112 Officer (equivalent to the Section 151 Officer) can set limits that are based on the latest economic conditions and credit ratings.

4.17 At the meeting of Resources Committee held on the 10 February 2016 consideration was given to the diversification of the investment portfolio to include higher return investments such as Property Funds and Peer-to-Peer lending. It was agreed that further information would be required, including potential risks, associated with this type of investment before inclusion within the Annual Investment Strategy, and that a further report be considered at the next meeting of Resources Committee to be held on the 17 May 2016. Any recommendation to include such type of investment would require a variation to the Annual Investment Strategy to be approved by the full Authority before any transactions can be made.

4.18 Table 13 below 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	

4.19 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

4.20 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.

4.21 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. Capita's central view of changes in Bank Rate is shown below;

Capita Bank Rate forecast for financial year ends (March)

2016 0.50%

2017 0.75%

2018 1.25%

2019 1.75%

4.22 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 0.60%
2017/18 1.25%
2018/19 1.75%
2019/20 2.25%
2020/21 2.50%
2021/22 2.75%
2022/23 2.75%
2023/24 3.00%
Later years 3.00%

4.23 The overall balance of risks to these forecasts is currently to the downside (i.e. start of increases in Bank Rate occurs later). However, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk.

4.24 **Investment treasury indicator and limit** - total principal funds invested for greater than 364 days. 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			
	2016/17	**2017/18**	**2018/19**
Principal sums invested > 364 days	£5m	£5m	£5m

End of year investment report

4.25 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

4.26 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.

4.27 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 112 (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 2016-17 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/16/3

PRUDENTIAL INDICATORS

				INDICATIVE INDICATORS 2017/18 to 2020/21		
	2016/17 £m Estimate	2017/18 £m Estimate	2018/19 £m Estimate	2019/20 £m Estimate	2020/21 £m Estimate	2021/22 £m Estimate
Capital Expenditure						
Non - HRA	5.062	4.983	4.495	4.055	3.725	4.690
HRA (applies only to housing authorities	-	-	-	-	-	-
Total	5.062	4.983	4.495	4.055	3.725	4.690
Ratio of financing costs to net revenue stream						
Non - HRA	4.19%	4.19%	4.10%	4.10%	4.09%	4.06%
HRA (applies only to housing authorities	-	-	-	-	-	-
Capital Financing Requirement as at 31 March	£000	£000	£000	£000	£000	£000
Non - HRA	25,724	25,630	25,537	25,444	24,851	24,757
HRA (applies only to housing authorities	-	-	-	-	-	-
Other long term liabilities	1,374	1,299	1,209	1,112	1,010	907
Total	27,098	26,929	26,747	26,556	25,861	25,665
Annual change in Capital Financing Requirement	£000	£000	£000	£000	£000	£000
Non - HRA	(162)	(169)	(183)	(191)	(695)	(197)
HRA (applies only to housing authorities	-	-	-	-	-	-
Total	(162)	(169)	(183)	(191)	(695)	(197)
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p	£ p	£ p
Increase/(decrease) in council tax (band D) per annum	(£0.04)	(£0.26)	(£1.07)	N/A	N/A	N/A

PRUDENTIAL INDICATORS - TREASURY MANAGEMENT

Authorised Limit for external debt	£000	£000	£000	£000	£000	£000
Borrowing	26,824	26,726	26,128	26,030	29,044	31,243
Other long term liabilities	1,278	1,177	1,071	963	841	701
Total	28,101	27,902	27,199	26,993	29,885	31,944
Operational Boundary for external debt	£000	£000	£000	£000	£000	£000
Borrowing	25,537	25,444	24,851	24,757	27,802	30,005
Other long term liabilities	1,209	1,112	1,010	907	791	656
Total	26,747	26,556	25,861	25,665	28,592	30,661

MINIMUM REVENUE STATEMENT (MRP) 2016-17

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.