CHESHIRE FIRE AUTHORITY

MEETING OF: CHESHIRE FIRE AUTHORITY
DATE: 14TH FEBRUARY 2018
REPORT OF: HEAD OF FINANCE
AUTHOR: WENDY BEBBINGTON

SUBJECT: TREASURY MANAGEMENT STRATEGY AND PRACTICES 2018-19

Purpose of Report

1. This report seeks approval for the Treasury Management Strategy and Practices for the year 2018-19. This is a requirement of guidance issued by the Department of Communities and Local Government (DCLG), the CIPFA Treasury Management Code and the CIPFA Prudential Code. It also assists the Authority in showing its compliance with requirements contained in the Local Government Act 2003.

Recommended: That

[1] approval be given to the Authority's Treasury Management Strategy for the year 2018-19;

[2] the Authority's approach to treasury risk management and its Treasury Management Practices be approved; and

[3] the Authority's prudential indicators including the Authorised Limit and Operational Boundary be approved.

Treasury Management Strategy for 2018-19

2. The Treasury Management Strategy ('the Strategy') for 2018-19 (attached as Appendix 1 to this report) is comprised of three main elements, namely:

   - Borrowing Strategy (paragraphs 43 to 49 of the Strategy)
   - Annual Investment Strategy (paragraphs 56 to 71 of the Strategy)
   - Minimum Revenue Provision (MRP) Strategy (paragraphs 17 to 22 of the Strategy)

3. The Strategy is required in order to comply with the Local Government Act 2003, the CIPFA Treasury Management Code of Practice, the CIPFA Prudential Code and the latest guidance from the Government covering investments and Minimum Revenue Provision.

4. CIPFA has recently reviewed and revised its Treasury Management Code of Practice and the Prudential Code. Changes are not wide ranging, most significant is the introduction of a capital strategy requirement which CIPFA acknowledges will be implemented by many organisations for the 2019/20 budget cycle. This is due to the requirement being introduced late in the current budget planning cycle.

5. Another notable change is the inclusion of requirements for non-treasury investments for example the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash balances. This type of income generation is not within usual fire service business and the change is therefore unlikely to impact on the Fire Authority.

6. CIPFA has also made some changes to prudential indicators, which are now incorporated into this report along with other revisions and amendments to the codes.

7. Under The Markets in Financial Instruments Directive (MiFID II) Regulations, the Financial Conduct Authority is now obliged to treat all Local Authorities (which includes the Fire Authority) as “retail clients” under European Union legislation. However, the regulator does offer the option to “opt up” to an Elective Professional Client if the authority meets certain criteria. There are no new “protections” for retail counterparties under MiFID II compared to the current MiFID regime. As such, opting up to Elective Professional Client status does not result in losing any current protections. By opting up, we will continue to maintain the status quo in terms of the investments that we currently use. If we chose not to opt up, we may lose access to Money Market Funds (MMF) and other pooled vehicles that we currently use, as they may not have been set up to deal with retail counterparties.

8. MiFID II was introduced on 3rd January 2018. This only applies to regulated products which include MMF and other investment funds, Certificate of Deposits, Gilts and Corporate Bonds. It does not apply to simple term deposits. After taking advice from the Authority’s treasury advisors, the Authority has “opted up” to Professional Client status with the only MMF on its current counterparty list, Standard Life Investments liquidity Fund. To opt up, the Authority demonstrated that cash balances are in excess of £10m and there is a professional resource within the organisation, equipped to be able to make daily treasury investment decisions.

9. The Strategy also provides context to inform the three individual elements.

<u>Borrowing Strategy</u>

10. The Borrowing Strategy for the Authority reflects the current approach that while interest rates for investments remain low, the Authority will finance its capital programme from cash balances as far as possible. The Authority has however approved the use of borrowing to fund its

training centre project (and associated works) at Sadler Road in order to preserve reserves for other matters requiring capital expenditure.

11. The Authority's current borrowing is almost exclusively with the Public Work Loans Board (PWLB) and this will continue to be the preferred source of future borrowing.

Annual Investment Strategy

12. The Annual Investment Strategy explains that the overarching principle is to ensure that the Authority is prudent in its investment decisions, whilst trying to maximise returns.

13. The Annual Investment Strategy also sets out the investment instruments used by the Authority, and how the Authority uses credit ratings to help determine which institutions to invest in.

14. The Authority will avoid locking into long term investements whilst interest rates remain at their current low levels, and will limit investments over one year to a maximum of £5 million.

Minimum Revenue Provision (MRP)

15. All authorities have a legal requirement to set money aside to cover the repayment of debt, and this is known as the Minimum Revenue Provision (MRP). The amount of MRP charged needs to be a prudent amount. The broad aim of this is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which capital expenditure provides benefits, or, in the case of borrowing supported by formula grant, reasonably commensurate with the period implicit in the determination of the grant.

16. It is proposed that the Authority continues to set the MRP at 6.7% of the opening Capital Financing Requirement (CFR) in respect of its existing CFR. This is considered to be a prudent and sustainable approach, however the 6.7% level remains subject to review.

17. Any future new borrowing will, under delegated powers (known as prudential borrowing), be subject to MRP under option 3 of the Government Guidance. It will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, borrowing in respect of capital expenditure on the new Training Centre Project will be related to the estimated life of that asset.

18. The policy will be reviewed on an annual basis. If it is ever proposed to vary the terms of the original statement during any year, approval from the Authority will be required.

Risk Management

19. The identification, understanding and management of risk are a significant part of the Authority's treasury management activities. Risk

management is, and has been for a number of years, well embedded in the area of treasury management.

20. To avoid the Authority suffering loss as a result of its treasury management activities, a number of risk management procedures are in place. These procedures are based on the principles that security of deposit is paramount, and there is a need to maintain liquidity. Returns should be commensurate with these principles.

21. Key risks are:

a. Counter-Party Risk

Counter-parties is the term used for another party to an agreement or contract. In the context of this risk, this means a body with whom we have invested surplus funds. The risk is that an amount deposited by the Authority will not be repaid in full when it becomes due.

When selecting counter-parties the avoidance of loss of principal is regarded as paramount. This is achieved by having in place formal policies and procedures that ensure that the risk of a potential loss of principal through the default of a counter-party is reduced to an appropriate level. Those policies include setting minimum requirements on the financial standing of counter-parties and an upper limit on the amount that can be deposited with an individual counter-party or group of related counter-parties.

b. Liquidity Risk

This risk is that cash will not be available when it is required to meet the Authority's obligations.

To mitigate that risk, the Authority prepares and monitors a cashflow forecast which identifies expected inflows and outflows. The purpose of preparing the forecast is to identify the timing, duration and magnitude of any cash surpluses and shortfalls.

c. Refinancing Risk

This risk is that the Authority will be unable to renew its maturing loans or reinvest deposits on reasonable terms.

This risk is managed to an acceptable level by ensuring that the maturity profile of the Authority's long term loans portfolio remains relatively even. The Authority also tries to avoid having a number of large deposits maturing on the same day.

d. Legal and Regulatory Risk

This is the risk that one of the parties to an agreement will be unable to honour its legal obligations to the other party.

When investing its cash balances, the Authority adheres to the guidance issued by DCLG which defines and encourages a prudent investment policy, particularly in relation to security (protecting invested capital sums from loss) and liquidity (keeping funds readily available to meet immediate expenditure needs).

e. Prevention of Fraud, Error and Collusion

All loans and deposits are made on the Authority's behalf by the Head of Finance or another nominated officer. Every deal is also recorded and reconciled within the Authority's general ledger and bank account by one officer and approved by another officer (segregation of duties)

Treasury Management Practices for 2018-19

22. It is a requirement of the CIPFA Treasury Management Code that the Authority maintains and reviews Treasury Management Practices (TMPs). The TMPs are a substantial set of documents and have not been included with these papers but have been made available on the Authority's website for Member consideration. They demonstrate in some detail the way in which the Authority meets its requirement to properly manage its treasury management activities.

Prudential Indicators for 2018-19

23. The Prudential Indicators ('the Indicators') are included in Appendix 1 at paragraphs 9 to 16 and 24 to 32.

24. Performance against the Indicators demonstrates that the Authority's strategy in relation to capital expenditure and investment is prudent and robust. The Indicators deal with the Authority's position in relation to capital expenditure and capital financing requirement, net borrowing, limits on borrowing, and the impact on revenue.

25. In addition the Indicators confirm the prudence and sustainability of the Authority's Treasury Management Strategy and help set a framework of prudence within which the Authority will continue to operate.

Treasury Management Performance Reporting

26. In accordance with both the requirements of the Prudential Code and the CIPFA Code for Treasury Management in the Public Services, the Authority will receive:

    i) A mid-year treasury management report – this will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

    ii) An annual treasury report – this provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Legal Implications

27. The approval of the Treasury Management Strategy and Treasury Management Practices is a legal requirement. They provide officers with a clear framework within which to operate.

Financial Implications

28. The report is financial in nature.

Equality and Diversity Implications

29. There are no differential impacts identified on any section of our community in relation to this report.

Environmental Implications

30. There are no specific environmental implications identified in relation to this report.