APPENDIX 1

TREASURY MANAGEMENT STRATEGY 2019-20

INTRODUCTION

1.1 The Fire Authority (the Authority) is required to operate a balanced budget meaning that cash raised during the year from grants, council tax and other income sources will match the cash expenditure for the year. The first requirement of treasury management is to ensure that this cashflow is adequately planned with cash being available when it is needed. Surplus funds are invested in low risk counterparties or financial instruments commensurate with a low risk appetite, that offer adequate liquidity (i.e. ease of access) before considering any return on the investment. The investment strategy objectives are, in order of priority, security, liquidity and then yield.

1.2 The second main function of treasury management is the funding of the capital programme. The capital programme and plans provide a guide to the Authority's borrowing requirement which is essentially the longer-term cashflow planning to ensure that the capital programme commitments can be met. The management of longer-term cashflow may involve arranging long or short-term loans or by using cashflow surpluses. Any debt currently held may also be re-structured when favourable conditions arise and in line with risk and/or cost objectives.

1.3 The contribution the treasury management function makes to the organisation is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

1.4 CIPFA defines treasury management 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.'*

1.5 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately as part of the annual budget report pack.

1.6 This Authority has not engaged in any commercial investments and has no non-treasury investments.

2. TREASURY MANAGEMENT REPORTING REQUIREMENTS

2.1 The Authority is required to receive and approve, as a minimum, three main reports each year which incorporate policies, estimates and actual income and expenditure.

Prudential and Treasury Indicators and Treasury Strategy (this report) – the first and most important report covering:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy statement (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised and includes the treasury indicators); and
- an Investment Strategy (the parameters on how investments are to be managed).

A Mid-Year Treasury Management Report – this updates the Authority on the progress of the capital position, updates prudential indicators as necessary, and whether the actual execution of treasury management is in line with the Strategy or whether any policies need revision. Should there be a particularly volatile period affecting treasury management then more frequent reports will be submitted.

An Annual Treasury Management Report – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

3. TREASURY MANAGEMENT STRATEGY 2019/20

3.1 The Treasury Management Strategy covers two main areas:-

Capital:

- The capital plans and associated prudential indicators; and
- The minimum revenue provision (MRP) statement.

Treasury Management:

- The current position;
- Prudential indicators which limit the treasury risks and activities of the Authority;
- Prospects for interest rates;
- The borrowing strategy;
- The policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- The policy on creditworthiness; and
- The policy on using external service providers in relation to Treasury Management.

3.2 The above cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Communities and Local Government's Minimum Revenue Provision

(MRP) Guidance; the CIPFA Treasury Management Code and the Communities and Local Government's Investment Guidance.

3.3 The CIPFA Treasury Management Code requires the responsible officer (the Fire Authority Treasurer) to ensure that anyone with responsibility for treasury management receives adequate training. The external treasury management supplier will provide suitable training during the year as appropriate.

3.4 The joint Police and Fire Finance team will manage all day to day Treasury management services on behalf of the Authority, supported directly by Link Asset Services, Treasury Solutions as its external treasury management advisors. However, it is recognised that responsibility for treasury management decisions remains with the Authority at all times and overdue reliance will not be placed upon one source of advice alone. Nevertheless, it is also recognised that there is value in employing external advisors in order to gain access to specialist skills and resources.

4. CAPITAL EXPENDITURE PRUDENTIAL INDICATORS 2019-22

4.1 Capital expenditure

4.1.1 Capital expenditure plans are a key driver of treasury management activity. The funding of such plans impact on cash balances and borrowing requirements in the short and longer terms. The on-going consequences of these decisions have a direct impact on the annual revenue budget. As such, the following prudential indicators show the proposed capital expenditure plans, how they are to be funded, the impact on the organisation's finances and their affordability in terms of the impact on revenue budgets.

4.1.2 This prudential indicator is a summary of the Authority's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. These are based on actual and current forecast cash spend rather than the full budgeted capital programme, as affordability is based on actual cash movement.

Table 1: Capital Expenditure

2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
2,942	17,488	8,603	4,272

4.1.3 The next table shows how the above capital expenditure is to be financed. If there is a shortfall in available funds, the shortfall will be covered by additional borrowing. It is anticipated that c£11m of additional borrowing will be required over the period to finance the Training Centre project.

Table 2: Capital Financing

2018/19 Estimate £000		2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
2,942	Forecast Spend	17,488	8,603	4,272
	Financed by:			
0	General capital grants	0	0	0
0	Specific capital grants	0	0	0
500	Capital Receipts	0	0	100
2,042	Capital Reserves & Revenue Contributions	8,688	7,054	4,172
400	Borrowing requirement	8,800	1,549	0

4.2 Capital Financing Requirement (or borrowing needs)

4.2.1 The second prudential indicator is the Authority's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been financed either from revenue or capital funds. It is essentially a measure of borrowing need and any capital expenditure not financed in the above table will increase the CFR.

4.2.2 It should be noted that the Capital Financing Requirement increases during the period of the current MTFS, reflecting the new borrowing requirement due to planned capital expenditure, and a reduction in alternative capital funding sources.

Table 3: Capital Financing Requirement (CFR)

2018-19 Estimate £000	Capital Financing Requirement (CFR)	2019-20 Estimate £000	2020-21 Estimate £000	2021-22 Estimate £000
7,379	CFR brought forward	**7,301**	**15,655**	**16,788**
400	Net financing need for the year	8,800	1,549	0
(478)	Less MRP	(446)	(416)	(828)
7,301	**CFR carried forward**	**15,655**	**16,788**	**15,960**
(78)	**Movement in CFR**	**8,354**	**1,133**	**(828)**

4.2.3 In addition to the capital expenditure borrowing requirements, the Capital Financing Requirement also includes other long-term financial liabilities relating to an outstanding finance lease.

4.2.4 As previously mentioned, the Capital Financing Requirement is reduced every year by the minimum revenue provision (MRP). The Authority is required by statute to set aside MRP each year for the repayment of external debt. Under amendment regulation 4(1) of the 2008 Regulations, the Authority is charged with a simple duty to set aside MRP which it considers to be prudent. Guidance has been issued which sets out recommendations on the interpretation of 'prudent' and the Authority is required to prepare an annual statement on how it proposes to calculate MRP. The 2019/20 annual statement is set out in the Annex.

4.3 Core Funds and Expected Investment Balances

4.3.1 The application of funds, (capital receipts, reserves etc.), to finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on the cash available for investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are the estimated year-end balances for reserves. The Capital Receipts and Unapplied Capital Grants reserves are restricted in their usage to funding capital expenditure or repaying debt and cannot be used for revenue purposes.

Table 4: Reserves

Reserves	**31 March 2018 Actual £000**	**31 March 2019 Estimate £000**	**31 March 2020 Estimate £000**	**31 March 2021 Estimate £000**	**31 March 2022 Estimate £000**
Earmarked Revenue Reserves					
IRMP Reserve	9,488	8,042	7,248	3,822	0
Resource Centre Managers Reserves	6,362	3,909	3,613	3,130	3,062
Community Risk Reduction Reserve	474	314	314	314	314
Unitary Performance Group Reserve	367	367	117	117	117
	16,691	12,632	11,292	7,383	3,493
Capital Reserves					
Usable Capital Receipts	402	100	100	100	0
Revenue Reserve for Capital Expenditure	2,916	11,758	3,465	0	0
Unapplied Capital Grants	0	0	0	0	0
	3,318	11,858	3,565	100	0
General Reserve					
General Fund	8,210	2,210	2,210	2,210	2,210
Total Reserves	**28,219**	**26,700**	**17,067**	**9,693**	**5,703**

Affordability Prudential Indicators

4.3.2 So far the Strategy has covered the control of overall capital expenditure plans and borrowing prudential indicators. The following indicator provides an indication of the impact of the above capital expenditure plans and their financing proposals on the overall finances and precept (council tax). The Authority is requested to approve the following indicator:

Table 5: Ratio of financing costs to net revenue funding

2017/18 Actual	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
1.13%	1.11%	1.39%	1.61%	2.64%

4.3.3 This indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream. The estimates of financing costs include current commitments and the proposals included in the budget/medium-term financial plan. The ratios have moved mainly due to the requirement to increase borrowing in order to finance the capital programme from 2018/19 onwards, most notably new debt repayment provision (MRP) from 2021/22 in respect of the new Operational Training Centre which is due to be completed during 2020/21.

5. **BORROWING**

5.1 The capital expenditure plans set out in Section 4 provide details of the capital plans of the Authority. A key function of treasury management is to ensure that the cash resources are organised in accordance with the relevant regulations and professional codes so that sufficient cash is available to meet service activity and the capital strategy. This will involve both cashflow management and where capital expenditure plans require it, the arrangement of appropriate borrowing facilities. This Strategy covers the relevant treasury and prudential indicators, the current and projected debt positions and the Annual Investment Strategy.

Current Debt Position

5.1.1 The current debt position, as at 31 March 2018, with forward projections is summarised below. The table shows actual external debt against the underlying capital borrowing need highlighting any under or over borrowing.

Table 6: Debt Position

2017-18 Actual £000	2018-19 Estimate £000	Gross Borrowing Requirement	2019-20 Estimate £000	2020-21 Estimate £000	2021-22 Estimate £000
		External Debt			
1,914	1,903	Debt at 1 April	1,892	10,457	12,006
(11)	(11)	Expected change in Debt	8,565	1,549	0
1,903	1,892	External Debt at 31 March	10,457	12,006	12,006
37	25	Finance Lease	13	0	0
(12)	(12)	Expected change in Finance Lease	(13)	0	0
1,928	1,905	Actual Gross Debt at 31 March	10,457	12,006	12,006
7,379	7,301	Capital Financing Requirement	15,655	16,788	15,960
5,451	**5,396**	**Under / (over) borrowing**	**5,198**	**4,782**	**3,954**

5.1.2 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 that the Authority ensures that its gross debt does not, except in the short-term, exceed the total Capital Financing Requirement in the preceding year plus the estimates for any additional Capital Financing Requirement for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future plans but ensures that borrowing is not undertaken for revenue or speculative purposes.

5.1.3 The Treasurer confirms that the Authority complied with this prudential indicator in the current year and does not envisage any issues for the immediate future. This view takes into account current commitments, existing plans and the proposals included in the budget report and Medium Term Financial Plan for 2019-22 to be considered by the Fire Authority on 13th January 2019.

5.2 Treasury Indicators – limits to borrowing activities

5.2.1 There are two limits to borrowing, the operational boundary and the authorised limit for external debt. These are the current debt position as shown in 5.1.1 above plus the forecast requirement for external financing over the next three years.

5.2.2 **The operational boundary** is the limit which external debt and long-term liabilities is not normally expected to exceed. In most cases this would be a similar figure to the Capital Financing Requirement but may be higher or lower depending on the level of actual debt and repayment schedules. Temporary breach of the operational boundary is not in itself cause for concern but an indicator that such liabilities should be reviewed. If there was a sustained breach, (such as an increase in long-term borrowing), then this would need to be investigated and action taken.

5.2.3 The operational boundaries below are based on estimating the Authority's most likely level of borrowing and leasing each year. It includes long-term borrowing to fund capital expenditure plans, short-term temporary borrowing for cashflow purposes and the impact of any finance leases.

Table 7: Operational Boundary

Operational Boundary	**2019-20 Estimate £000**	**2020-21 Estimate £000**	**2021-22 Estimate £000**
Debt	10,557	12,106	12,106
Other long term liabilities	50	50	50
Total	**10,607**	**12,156**	**12,156**

5.2.4 As Table 7 shows, the Operational Boundary over the period 2019-22 is increasing because of the planned borrowing to support the capital programme. This is partially offset due to the amount set aside each year to reduce borrowing and financial liabilities known as MRP.

5.2.5 The **authorised limit for external debt** is a further key prudential indicator representing a control on the maximum level of borrowing. This represents a limit beyond which external debt and finance leases are prohibited and is set or revised by the Authority. It reflects the level of such debt which, while not desired, could be afforded in the short term but is not sustainable in the longer-term.

5.2.6 This is a statutory limit determined under section 3(1) of the Local Government Act 2003. The Government retains an option to control either the total of all local authorities' plans or those of any specific public body; although this power has yet to be exercised.

5.2.7 The Authority is requested to approve the following authorised limits.

Table 8: Authorised Limit

Authorised limit for external debt	**2019-20 Estimate £000**	**2020-21 Estimate £000**	**2021-22 Estimate £000**
Borrowing	12,557	14,106	14,106
Other Long Term Liabilities	100	100	100
Total Authorised Limit	**12,657**	**14,206**	**14,206**

5.3 Prospects for Interest Rates

5.3.1 Link Asset Services have been appointed as external treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. The following table gives our central view.

Link Asset Services Interest Rate View	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

Source: Link Asset Services

5.3.2 The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth has been healthy since that meeting, but is expected to weaken somewhat during the last quarter of 2018. At their November meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The next increase in Bank Rate is therefore forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

5.3.3 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.00 – 2.25% in September 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We have, therefore, seen US 10 year bond Treasury yields rise above 3.2% during October 2018 and also seen investors causing a sharp fall in equity prices as they sold out of holding riskier assets.

5.3.4 Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

5.3.5 From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

5.3.6 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.

Investment and borrowing rates

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018-19 and have increased modestly since the summer. 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 the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

- 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

5.4 Borrowing Strategy

5.4.1 As shown in Table 6, the Authority is currently under-borrowed and forecast to remain so for the period covered by this Strategy. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting reserves, balances and cash flow has been used as a temporary measure. This Strategy is appropriate for the current economic scenario and prudent given that limited investment return on surplus cash flow and counter-party risk are still issues that need to be considered. The risks associated with this Strategy are twofold, firstly the Authority could run out of cash should all reserves be utilised quickly at which point borrowing would be required and secondly, when the need to re-finance the internal borrowing arises, without careful planning, the Authority will be exposed to the prevailing interest rates at that time which may not be the most favourable.

5.4.2 At this point maintaining under-borrowing of £4m to £5m going forward is considered to be manageable and a sensible position in view of available cash reserves and poor returns that can be achieved on cash balances invested.

5.4.3 The Treasurer will however keep interest rates and the cashflow impact under continual review in order to adopt a pragmatic approach to changing circumstances, supported by advice from the external Treasury Management advisers. It may at some point be necessary to reduce under-borrowing as cash reserves reduce due to ongoing budget pressures by securing additional new external borrowing above that forecast to fund the ongoing capital programme in table 2 although this is not anticipated in the short or medium term.

5.4.4 A key aim of the borrowing strategy is to minimise the cost of the loan portfolio whilst ensuring that the obligation to repay the loans is spread out over a period of time. This reduces the impact of such loans on the revenue budget. The profile of the repayment of the debt portfolio is shown below at 5.6.3.

5.4.5 Where short term borrowing arrangements are required to support a temporary low general fund bank balance, the Authority will engage with Treasury Advisors to understand if there are any Local Authority counterparties available to lend from. The offer will then be considered and terms of loans agreed between the Principal Accountant and nominated officer from the lending organisation.

5.5 Policy on borrowing in advance of need

5.5.1 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 within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Authority can ensure the security of such funds.

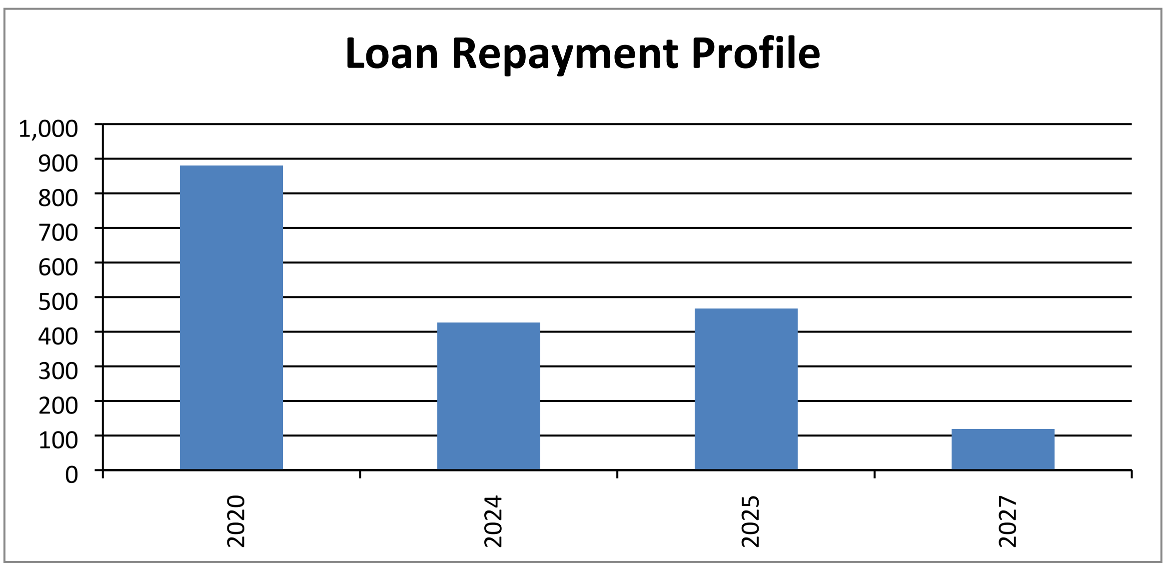
5.6 Debt Rescheduling

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

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

- The generation of cash savings and/or discounted cash flow savings
- Helping to fulfil the treasury strategy
- Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

5.6.3 Any potential rescheduling will be very carefully considered. A table showing the current profile of the debt portfolio is shown below:



5.6.4 All current borrowing is on a fixed rate basis with a current overall weighted average 4.51%. Any new loans taken out for future capital expenditure plans or the repayment of maturing debt will be subject to the rates applicable at that time. Any early repayment of debt would also be subject to the expense of early pay-back premiums.

5.6.5 Key sensitivities of the interest rate forecast are likely to be:

- if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be reviewed with the potential action of increasing borrowing to cover the under borrowed position or future known commitments or repayments while rates were still relatively low; and

- If it were felt that there was a significant risk of a sharp fall in short and long-term interest rates due to a weakening of economic factors; then longer-term borrowing will be postponed until rates were deemed at their lowest and a review of current debt would be undertaken to ascertain the benefit of rescheduling to more competitive short term loans.

5.7 Treasury Management limits on activity

5.7.1 There are three debt-related treasury activity limits. Their purpose is to restrain borrowing activity within certain limits to manage risk and reduce the impact of adverse movement in interest rates. However, if these are set too restrictively they will impair the opportunity to reduce costs or maximise value for money. The Authority is requested to approve the following indicators and limits.

Table 9: Interest Rate Limits

	2019/20	2020/21	2021/22
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%

Table 10: Maturity structure of fixed interest rate borrowing 2019/20

Maturity Structure of Authority Borrowing	Lower Limit %	Upper Limit %
Under 12 months	0%	50%
12 months to 2 years	0%	50%
2 years to 5 years	0%	50%
5 years to 10 years	0%	75%
10 years and above	5%	100%

6. ANNUAL INVESTMENT STRATEGY

6.1 Investment Policy

6.1.1 The Authority’s investment policy has regard to the Communities and Local Government’s Guidance on Local Government Investments and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectorial Guidance Notes (the CIPFA TM Code). The Authority’s principal objectives for investments are security first, liquidity next and finally yield.

6.1.2 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

a) Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

b) Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Authority will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

c) Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

d) The Authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in table 11 below under the categories of 'specified' and 'non-specified' investments.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.

- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

Table 11: Approved Investment Instruments

Specified Investments (maturities up to one year)
▫ Bank & Building Societies Term Deposits
▫ Other Local Authority Term Deposits
▫ Debt Management Agency Deposit Facility
▫ AAA Money Market Funds (CNAV/LVNAV/VNAV)
Non-Specified Investments (maturities over one year)
▫ Bank & Building Societies Term Deposits
▫ Other Local Authority Term Deposits
Other Non-Specified Investments
▫ Fixed term deposits with variable rates & maturities

e) Non-specified investments limit. The Authority has determined that it will limit the maximum total exposure to non-specified investments as being 20% of the total investment portfolio.

f) Lending limits, the maximum amount for each counterparty will be set at £10m per organisation/group. The maximum investment duration for each counterparty will be set in line with the creditworthiness service provided by Link Asset Services as set out in paragraph 6.2.

g) Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 6.3).

h) The Authority has engaged external consultants, (see paragraph 3.4), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

i) All investments will be denominated in sterling.

j) As a result of the change in accounting standards for 2018/19 under IFRS 9, the Authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.)

6.2 Creditworthiness Policy and Exposure to Risk

6.2.1 The Authority utilises the creditworthiness service provided by Link Asset Services as its Treasury Management advisers. This service employs a sophisticated modelling approach incorporating credit ratings from the three main credit rating agencies – Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swaps to give early warning of likely changes in credit ratings; and
- Sovereign ratings to select counterparties from only the most creditworthy countries.

6.2.2 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Authority to determine the suggested duration of investments. The Authority will use counterparties within the following durational bands:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No Colour Not to be used

6.2.3 As this methodology uses a wide range of information beyond basic credit ratings, it ensures that no one source of information is given undue credence. All ratings and colour codes are monitored weekly via Link's credit listings and in-between via business press. The Authority is alerted to changes to any ratings via email from Link.

- 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 and any current investments reviewed for potential movement.

6.2.4 Sole reliance will not be placed on the use of this external service. In addition to Link, the Joint Finance Team officers will also use market data and information, information on any external support for banks to help support its decision making process.

UK banks – ring fencing

6.2.5 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

6.2.6 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

6.2.7 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Authority will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

6.3 Country Limits

6.3.1 The Authority has determined that it will only use approved counterparties from the UK and from countries outside of the UK with a minimum sovereign credit rating of AAA from Fitch (or equivalent). The list will be added to, or deducted from, should ratings change.

6.4 Investment Strategy

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

6.4.2 The Authority would seek to maintain at all times a core liquid balance of £4m, and maintain a liquid balances vs longer term balances ratio of 50% - 50%.

6.4.3 For its cash flow generated balances, the Authority will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest.

6.4.4 Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1, 2022. Bank Rate forecasts for financial year ends (March) are:

2018/19 0.75%
2019/20 1.25%
2020/21 1.50%
2021/22 2.00%

The overall balance of risks to economic growth in the UK is probably neutral. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

6.4.5 Investment treasury indicator and limit - total principal funds invested for greater than 365 days. This limit is set with regard to the Authority's liquidity requirements and to reduce the need for early sale of an investment. It is based on the forecast availability of funds after each year-end.

The Authority is asked to approve the following treasury indicator and limit:

Table 12: Investment Treasury Limit:

	2019/20	**2020/21**	**2021/22**
	Upper	**Upper**	**Upper**
Principal sums invested for longer than 365 days	£5m	£5m	£5m

6.5 End of Year Investment Report

6.5.1 At the end of the financial year, the Treasurer will report on the Authority's investment activity as part of the Annual Treasury Report.

ANNEX 1

Minimum Revenue Provision (MRP) Statement

1. The Authority is required to make an annual provision from revenue to contribute towards the repayment of borrowing. This requirement arises under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008, which simplifies earlier MRP requirements by placing a duty on the Authority to determine each year an amount of minimum revenue provision, which it considers to be prudent. In order to assist the Authority with this determination, guidance for assessing what would represent a prudent provision has been issued under Section 21 (1A) of the Local Government Act 2003 (The Guidance). The Authority is required to have regard to the Guidance when considering the amount of their annual "prudent" MRP.

2. 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.

3. 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.

4. The use of this option for certain schemes will also result in a nil MRP charge until the year after that in which all expenditure on the scheme, project or other item of capital expenditure has been fully accrued under proper accounting practices, regardless of the extent of such expenditure that has not been accrued at the end of the previous financial year. Estimated life periods will be determined using appropriately qualified Officers professional judgement.

5. Based on the current projected capital outturn position for 2018-19, it is expected that this will equate to a charge of approximately £446k for 2019-20.

6. The policy will be reviewed on an annual basis. If it is proposed to vary the strategy during the year, a revised statement will be submitted to the Authority.