Treasury Management Strategy and Investment Strategy 2018/19 to 2020/21

1. Summary

1.1. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis. The TMSS also includes the Annual Investment Strategy that is a requirement of the Department for Communities and Local Government's (DCLG) Investment Guidance.

1.2. As per the requirements of the Prudential Code, Hampshire Fire and Rescue Authority adopted the CIPFA Treasury Management Code at its meeting in February 2012. This report fulfils the Fire & Rescue Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the DCLG Guidance.

1.3. The purpose of this TMSS is, therefore, to approve:

- Treasury Management Strategy for 2018/19
- Annual Investment Strategy for 2018/19
- Prudential Indicators for 2018/19, 2019/20 and 2020/21 shown in Annex C
- Minimum Revenue Provision (MRP) Statement shown in Annex D

1.4. The Fire and Rescue Authority has potentially large exposures to financial risks including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Fire & Rescue Authority's treasury management strategy.

1.5. **This Report recommends the following be approved:**

- **Treasury Management Strategy and Annual Investment Strategy for 2018/19, (and the remainder of 2017/18) including:**
    - **Prudential Indicators for 2018/19, 2019/20 and 2020/21 – Annex C**
    - **Minimum Revenue Provision (MRP) Statement – Annex D**
- **That authority is delegated to the Chief Finance Officer to manage the Fire & Rescue Authority's investments according to the risk assessment process in the Investment Strategy as appropriate.**

2. Introduction

2.1. In February 2012 the Fire & Rescue Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Fire & Rescue Authority to approve a treasury management strategy before the start of each financial year. CIPFA consulted on changes to the Code in 2017, but has yet to publish a revised Code.

2.2. In addition, DCLG issued revised Guidance on Local Authority Investments in March 2010 that requires the Fire & Rescue Authority to approve an investment strategy before the start of each financial year.

2.3. This report fulfils the Fire & Rescue Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the DCLG Guidance.

2.4. The Fire & Rescue Authority has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Fire & Rescue Authority's treasury management strategy.

3. External Context

3.1. The following paragraphs explain the economic and financial background against which the Treasury Management Strategy is being set.

Economic background

3.2. The major external influence on the Fire & Rescue Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

3.3. Consumer price inflation (CPI) reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017. Since this point, CPI hit 3.1% in November 2017.

Credit outlook

3.4. High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

3.5. Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

3.6. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Fire & Rescue Authority; returns from cash deposits however remain very low.

Interest rate forecast

3.7. The Fire & Rescue Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

3.8. Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

3.9. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Annex A.

4. Balance Sheet Summary and Forecast

4.1. On 31st December 2017, the Fire & Rescue Authority held £8.4m of borrowing and £27.9m of investments. This is set out in further detail at Annex B. Forecast changes in these sums are shown in the balance sheet analysis in Table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31/03/17 Actual £m	**31/03/18 Estimate £m**	**31/03/19 Forecast £m**	**31/03/20 Forecast £m**	**31/03/21 Forecast £m**
Capital Funding Requirement	12.2	11.7	11.2	10.8	10.3
Less: External borrowing					
- Public Works Loan Board	(8.4)	(8.4)	(8.4)	(8.3)	(7.1)
Internal (over) borrowing	**3.8**	**3.3**	**2.8**	**2.5**	**3.2**
Less: Working capital	0.2	0.2	0.2	0.2	0.2
Less: Usable reserves	(28.6)	(23.3)	(14.5)	(12.7)	(11.5)
New borrowing or (investments)	**(24.6)**	**(19.9)**	**(11.5)**	**(10.1)**	**(8.1)**

4.2. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Fire & Rescue Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

4.3. The capital funding requirement is predominantly for major building works, including Strategic Headquarters. There is an on-going requirement for vehicles and other equipment that will need to be replaced over the coming years. Reserves will mainly be used to fund the Transformation programme, particularly Service Delivery Redesign.

4.4. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Fire & Rescue Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Fire & Rescue Authority expects to comply with this recommendation during 2018/19.

5. Borrowing Strategy

5.1. The Fire & Rescue Authority currently holds £8.4 million of loans, which represents no change since the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 1 shows that the Fire & Rescue Authority does not expect to need to borrow in 2018/19. The Fire & Rescue Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £16.5 million.

Objectives

5.2. The Fire & Rescue Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Fire & Rescue Authority's long-term plans change is a secondary objective.

Strategy

5.3. Given the significant cuts to public expenditure and in particular to local government funding, the Fire & Rescue Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, if the Fire & Rescue Authority does need to borrow, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

5.4. By internally borrowing, the Fire & Rescue Authority would be able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. If borrowing is required, the benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Fire & Rescue Authority with this 'cost of carry' and breakeven analysis.

5.5. In addition, the Fire & Rescue Authority may borrow short-term loans (normally for up to one month) to cover unplanned cash flow shortages.

Sources of borrowing

5.6. The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body

- UK local authorities
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Hampshire Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other sources of debt finance

5.7. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

5.8. The Fire & Rescue Authority has previously raised all of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans, which may be available at more favourable rates.

Short-term and Variable Rate loans

5.9. These loans leave the Fire & Rescue Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Debt Rescheduling

5.10. The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Fire & Rescue Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

6. Investment Strategy

6.1. The Fire & Rescue Authority holds invested funds representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Fire & Rescue Authority's investment balance has ranged between £21.1 and £37.1 million, however it is planned that balances will fall significantly between now and 31 March 2019 as shown in Table 1.

Objectives

6.2. Both the CIPFA Code and the DCLG Guidance require the Fire & Rescue Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

The Fire & Rescue Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Negative Interest Rates

6.3. If the UK enters into a recession in 2018/19, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy

6.4. Given the increasing risk and very low returns from short-term unsecured bank investments, the Fire & Rescue Authority aims to continue to diversify into more secure and/or higher yielding asset classes during 2018/19. This is especially the case for the estimated £10m that is available for longer-term investment. Approximately 81% (increased from 77% last year) of the Fire & Rescue Authority's surplus cash is invested so that it is not subject to bail-in risk, as it is invested in local authorities, pooled property and equity funds, and secured bank bonds. Whilst the remaining cash is subject to bail-in risk, 28% of this balance is held in short-term notice accounts which produce a significant return commensurate with the bail-in risk, 21% is held in overnight money market funds which are subject to a reduced risk of bail-in, 37% is held in certificates of deposit which can be sold on the secondary market and 5% is held in overnight bank call accounts for liquidity purposes. Further detail is provided at Annex B. This diversification will represent a continuation of the new strategy adopted in 2015/16.

6.5. The Fire & Rescue Authority's investments in pooled property and equity funds allow the Fire & Rescue Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. The funds which are operated on a variable net asset value (VNAV) basis offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short-term. All of the Fire & Rescue Authority's pooled fund investments are in the funds' distributing share classes which pay out the income generated.

6.6. Although money can be redeemed from the pooled funds at short notice, the Fire & Rescue Authority's intention is to hold them for at least the medium term. Their performance and suitability in meeting the Fire & Rescue Authority's investment objectives are monitored regularly and discussed with Arlingclose.

6.7. As shown in Annex B, without this allocation the weighted average return of the Fire & Rescue Authority's cash investments would have been 0.57%; the allocation to high yielding investments has added 0.54% (£0.151m based on the cash balance at 31 December 2017) to the average interest rate earned by the remainder of the portfolio.

Table 2: High yield investments capital value

	Principal invested £m	Market value 31/12/2017 £m	Capital yield (per annum) %
Pooled Property Funds	2.0	2.1	4.65
Pooled Equity Funds	1.5	1.7	5.91
Total	**3.5**	**3.8**	**5.10**

Investment Limits

6.8. The maximum that will be lent to any one organisation (other than the UK Government) will be £4m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, and investments in pooled funds, as they would not count against a limit for any single foreign country, since the risk is diversified over many countries.

Table 3: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£4m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£4m per group
Any group of pooled funds under the same management	£4m per manager
Registered Providers	£6m in total
Money Market Funds	50% in total

Approved Counterparties

6.9. The Fire & Rescue Authority may invest its surplus funds with any of the counterparty types in Table 4 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 4: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers Unsecured	Registered Providers Secured
UK Govt	n/a	n/a	£ Unlimited 30 years	n/a	n/a	n/a
AAA	£2m 5 years	£4m 20 years	£4m 30 years	£2m 20 years	£2m 20 years	£2m 20 years
AA+	£2m 5 years	£4m 10 years	£4m 25 years	£2m 10 years	£2m 10 years	£2m 10 years
AA	£2m 4 years	£4m 5 years	£4m 15 years	£2m 5 years	£2m 10 years	£2m 10 years
AA-	£2m 3 years	£4m 4 years	£4m 10 years	£2m 4 years	£2m 10 years	£2m 10 years
A+	£2m 2 years	£4m 3 years	£2m 5 years	£2m 3 years	£2m 5 years	£2m 5 years
A	£2m 13 months	£4m 2 years	£2m 5 years	£2m 2 years	£2m 5 years	£2m 5 years
A-	£2m 6 months	£4m 13 months	£2m 5 years	£2m 13 months	£2m 5 years	£2m 25 years
None	£1m 6 months	n/a	£4m 25 years	n/a	£2m 5 years	£2m 5 years
Pooled funds	£4m per fund					

This table must be read in conjunction with the notes below

Credit Rating

6.10. Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Banks Unsecured

6.11. Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Banks Secured

6.12. Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government

6.13. Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 30 years.

Corporates

6.14. Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent.

Registered Providers

6.15. Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

Pooled Funds

6.16. Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

6.17. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Fire & Rescue Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Depending on the type of pooled fund invested in, it may have to be classed as capital expenditure. Because pooled funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Fire & Rescue Authority's investment objectives will be monitored regularly.

Operational bank accounts

6.18. The Fire & Rescue Authority may incur operational exposures, for example though current accounts, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept low. The Fire & Rescue Authority's operational bank account is with National Westminster; therefore the Fund does not hold unsecured investments in this bank, and aims to keep the overnight balances held in current accounts as positive, and as close to £0 as possible. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Fire & Rescue Authority maintaining operational continuity.

Risk Assessment and Credit Ratings

6.19. Credit ratings are obtained and monitored by the Fire & Rescue Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

6.20. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments

6.21. The Fire & Rescue Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

6.22. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Fire & Rescue Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Fire & Rescue Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office, or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified Investments

6.23. The DCLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

6.24. The Fire & Rescue Authority defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Non-specified Investments

6.25. Any investment not meeting the definition of a specified investment is classed as non-specified. The Fire & Rescue Authority does not intend to make any investments denominated in foreign currencies. Non-specified investments will therefore be limited to long-term investments, (i.e. those that are due to mature 12 months or longer from the date of arrangement), pooled funds that the Fire & Rescue Authority intends to hold as long-term investments (for more than one year) and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in Table 5 below.

Table 5: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£10m
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	£10m
Total non-Sterling investments	£0m
Total investments in foreign countries rated below AA+	£0m
Total non-specified investments	£18m*

* Total non-specified investments is a limit in its own right, and is not meant to equal the aggregate of the limits for total long-term investments, and investments without credit ratings or rated below A-.

Liquidity Management

6.26. The Fire & Rescue Authority has due regard for its future cash flows when determining the maximum period for which funds may prudently be committed. Historic cash flows are analysed in addition to significant future cash movements, such as payroll, grant income and council tax precept.

Limits on long-term investments are set by reference to the Fire & Rescue Authority's medium term financial position (summarised in Table 1) and forecast short-term balances.

7. Non-Treasury Investments

7.1. Although not classed as treasury management activities the Fire & Rescue Authority may also make loans and investments for service purposes, for example the direct purchase of land or property. Such loans and investments will be subject to the Fire & Rescue Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy. The Fire & Rescue Authority does not have any existing non-treasury investments.

8. Treasury Management Indicators

8.1. The Fire & Rescue Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures

8.2. This indicator is set to control the Fire & Rescue Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of principal borrowed or invested will be:

Table 6: Interest Rate Exposures

	2018/19	2019/20	2020/21
Upper limit on fixed interest rate borrowing exposure	£16.5m	£16.0m	£15.6m
Upper limit on variable interest rate borrowing exposure	£16.5m	£16.0m	£15.6m
Upper limit on fixed interest rate investment exposure	£10m	£10m	£10m
Upper limit on variable interest rate investment exposure	£45m	£45m	£45m

8.3. Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Maturity Structure of Borrowing

8.4. This indicator is set to control the Fire & Rescue Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 7: Maturity Structure of Borrowing

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	75%	0%
20 years and above	100%	0%

Principal Sums Invested for Periods Longer than 364 days

8.5. The purpose of this indicator is to control the Fire & Rescue Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Table 8: Principle Sums Invested for Periods Longer than 364 days

	2018/19	2019/20	2020/21
Limit on principal invested beyond year end	£10m	£10m	£10m

8.6. Although the limits on principal invested beyond year end is greater than the expected investment balances at 31 March 2020 and 31 March 2021, as shown in Table 1, these limits has been set to allow for current long-term investments to mature, as well as to allow flexibility if capital expenditure is experienced to be slower than forecast.

9. Other Items

9.1. There are a number of additional items that the Fire & Rescue Authority is obliged by CIPFA or DCLG to include in its Treasury Management Strategy.

Policy on Use of Financial Derivatives

9.2. In the absence of any explicit legal power to do so, the Fire & Rescue Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

Investment Training

9.3. The needs of H3's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

9.4. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA and other appropriate organisations.

9.5. CIPFA's Code of Practice requires that the Fire & Rescue Authority ensures that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Members of the Finance and General Purposes Committee were invited to a workshop presented by Arlingclose on 29 November 2017, which gave an update on treasury matters. A further Arlingclose workshop has been planned for November 2018.

Investment Advisers

9.6. The Fire & Rescue Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings the Treasurer, his staff, and Arlingclose.

Investment of Money Borrowed in Advance of Need

9.7. The Fire & Rescue Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Fire & Rescue Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Fire & Rescue Authority's overall management of its treasury risks. The total amount borrowed will not exceed the authorised borrowing limit of £16.5 million.

Arlingclose Economic & Interest Rate Forecast November 2017

Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.
- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.
- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.
- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.
- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.
- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.
- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Forecast:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.
- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.
- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.19**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.15**
3-month LIBID rate														
Upside risk	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.22**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	-0.10	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.20**
1-yr LIBID rate														
Upside risk	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.27**
Arlingclose Central Case	**0.70**	**0.70**	**0.70**	**0.70**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.77**
Downside risk	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.15	**-0.26**
5-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.80**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**0.89**
Downside risk	-0.20	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.55**	**1.36**
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.85**	**1.85**	**1.85**	**1.85**	**1.85**	**1.90**	**1.90**	**1.95**	**1.95**	**2.00**	**2.05**	**2.05**	**2.05**	**1.93**
Downside risk	-0.20	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.38**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.75**	**1.80**	**1.85**	**1.90**	**1.95**	**1.95**	**1.95**	**1.95**	**1.82**
Downside risk	-0.30	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.39**

Existing Investment & Debt Portfolio Position at 31 December 2017

Investments	Asset value on 31/07/2017 £m	Asset value on 31/12/2017 £m	Average rate/yield on 31/12/2017 %	Average life on 31/12/2017 years
Short term investments				
- Banks and Building Societies				
- Unsecured	7.12	4.24	0.48	0.15
- Secured	3.42	4.00	0.77	0.52
- Money Market Funds	15.16	1.15	0.39	0.01
- Local Authorities	1.00	9.00	0.38	0.46
	26.70	**18.39**	**0.49**	**0.37**
Long term investments				
- Banks and Building Societies				
- Secured	6.00	6.00	0.82	1.55
	6.00	**6.00**	**0.82**	**1.55**
High yield investments				
- Pooled Property Funds*	2.00	2.00	4.58	n/a
- Pooled Equity Funds*	1.50	1.50	5.22	n/a
	3.50	**3.50**	**4.85**	**n/a**
TOTAL INVESTMENTS	**36.20**	**27.89**	**1.11**	**0.66**
Increase/ (Decrease) in Investments £m		(8.31)		

	£m	**%**
External Borrowing		
PWLB	(8.35)	(4.71)
Investments		
Total Investments	27.89	1.11
Net Investments	**19.54**	**(0.43)**

* Yield represents the average of each investment class' most recent dividend payments as a percentage of the asset value.

Prudential Indicators 2018/19

The Local Government Act 2003 requires the Fire & Rescue Authority to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Fire & Rescue Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The Fire & Rescue Authority's planned capital expenditure and financing may be summarised as follows. Further detail is provided in the capital programme.

Capital Expenditure and Financing	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Total Expenditure	**6.0**	**12.0**	**5.4**	**5.2**
Capital Receipts	-	1.5	-	-
Government Grants	0.2	0.1	-	-
Capital Payments Reserves	5.6	9.9	5.4	5.2
Revenue Contributions	0.1	0.5	-	-
Total Financing	**6.0**	**12.0**	**5.4**	**5.2**

Estimates of Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Fire & Rescue Authority's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31/03/18 Revised £m	31/03/19 Estimate £m	31/03/20 Estimate £m	31/03/21 Estimate £m
Total CFR	**11.7**	**11.2**	**10.8**	**10.3**

The CFR is forecast to fall by £1.4m over the next three years as capital expenditure financed by debt is outweighed by resources put aside for debt repayment.

Gross Debt and the Capital Financing Requirement

In order to ensure that over the medium term debt will only be for a capital purpose, the Fire & Rescue Authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	31/03/18 Revised £m	31/03/19 Estimate £m	31/03/20 Estimate £m	31/03/21 Estimate £m
Borrowing	8.4	8.4	8.3	7.1
Total Debt	**8.4**	**8.4**	**8.3**	**7.1**

Total debt is expected to remain below the CFR during the forecast period.

Operational Boundary for External Debt

The operational boundary is based on the Fire & Rescue Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Fire & Rescue Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Fire & Rescue Authority's debt.

Operational Boundary	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Borrowing	14.3	13.9	13.4	13.0
Total Debt	**14.3**	**13.9**	**13.4**	**13.0**

Authorised Limit for External Debt

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Fire & Rescue Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2017/18 Limit £m	2018/19 Limit £m	2019/20 Limit £m	2020/21 Limit £m
Borrowing	16.9	16.5	16.0	15.6
Total Debt	**16.9**	**16.5**	**16.0**	**15.6**

Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2017/18 Revised %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
General Fund	1.03	1.02	0.97	0.91

Incremental Impact of Capital Investment Decisions

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £
General Fund - increase in annual band D Council Tax	5.01	6.23	6.23

Adoption of the CIPFA Treasury Management Code

The Fire & Rescue Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition in February 2012. It fully complies with the Code's recommendations.

Annex D

Annual Minimum Revenue Provision Statement 2018/19

Where the Fire & Rescue Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Fire & Rescue Authority to have regard to the Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the DCLG Guidance) most recently issued in 2012.

The broad aim of the DCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The DCLG Guidance requires the Fire & Rescue Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The four MRP options available are:

- Option 1: Regulatory Method
- Option 2: CFR Method
- Option 3: Asset Life Method
- Option 4: Depreciation Method

MRP in 2018/19

Options 1 and 2 may be used only for supported (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government) capital expenditure funded from borrowing. Methods of making prudent provision for unsupported capital expenditure include Options 3 and 4 (which may also be used for unsupported capital expenditure if the Fire & Rescue Authority chooses).

The Fire & Rescue Authority will apply Option 1/Option 2 in respect of unsupported capital expenditure funded from borrowing and Option 3/Option 4 in respect of unsupported capital expenditure funded from borrowing.

MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

Capital expenditure incurred during 2018/19 will not be subject to a MRP charge until 2019/20.

Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2017, the budget for MRP has been set as follows:

	31.03.2018 Estimated CFR £m	2018/19 Estimated MRP £
Capital expenditure before 01.04.2008	**11.542**	462,000
Unsupported capital expenditure after 31.03.2008	**0.134**	3,000
Total General Fund	**11.676**	**465,000**
Total	**11.676**	**465,000**