NOTTINGHAMSHIRE
Fire & Rescue Service
Creating Safer Communities

Nottinghamshire and City of Nottingham
Fire and Rescue Authority

TREASURY MANAGEMENT STRATEGY 2018/19

Report of the Interim Treasurer to the Fire Authority

Date: 16 February 2018

Purpose of Report:

To seek approval of the Authority's Treasury Management Strategy for 2018/19.

To seek approval of the Authority's Minimum Revenue Provision Policy for 2018/19.

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1. BACKGROUND

1.1 The Local Government Act 2003 requires the Authority to set out its treasury strategy for borrowing and to prepare an annual investment strategy; this sets out the Authority's policies for borrowing, for managing its investments and for giving priority to the security and liquidity of those investments.

1.2 Treasury management is defined as "the management of investments and cash flows, 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."

1.3 The Authority adopted the CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes 2009 (the Code) on 9 April 2010. The Treasury Management Code of Practice was updated in December 2017 and it now reflects developments arising from the Localism Act 2011, namely the use of non-treasury related investments. It also includes some minor changes around risk management practices. It is a requirement of the Code that the Authority creates and maintains:

- A treasury management policy statement, which states the policies, objectives and approach to risk management of its treasury management activities. This statement is given in Appendix A.

- Suitable treasury management practices, setting out how the Authority will seek to achieve those policies and objectives and how activities will be controlled and managed. The Authority's practices were reviewed in 2013/14.

1.4 A report on the Prudential Code for Capital Accounting is also on this agenda. This report sets out the prudential indicators for 2018/19, which are designed to ensure that the Authority's capital investment plans are affordable, prudent and sustainable and are in accordance with CIPFA's Prudential Code. This Treasury Management Strategy report is complementary to that Prudential Code report and the proposed prudential and treasury limits for 2018/19 are included in both reports for completeness.

1.5 This report also sets out the Authority's Minimum Revenue Provision policy for 2018/19 for approval by Members in paragraphs 2.43 to 2.46.

1.6 The Authority has appointed Link Asset Services (formerly Capita) as its external treasury management adviser. Link Asset Services has provided the Authority with its view on the economic outlook and on anticipated interest rates for the forthcoming year.

2. REPORT

TREASURY MANAGEMENT STRATEGY FOR 2018/19

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

2.2 The Act therefore requires the Authority to set out its treasury strategy for borrowing and to prepare an annual investment strategy: this sets out the Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.

2.3 The suggested strategy for 2018/19 in respect of the following aspects of the treasury management function is based upon Officers' views on interest rates, supplemented with leading market forecasts provided by the Authority's treasury adviser, Link Asset Services.

2.4 The strategy covers:

- Prudential and treasury indicators;
- The borrowing requirement;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- Creditworthiness policy;
- Policy on use of external service providers;
- The Minimum Revenue Provision policy;
- Training of Officers and Members.

2.5 The Authority recognises that whilst there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources, responsibility for treasury management decisions remains with the organisation at all times. The Authority will therefore ensure that undue reliance is not placed upon external service providers.

BALANCED BUDGET REQUIREMENT

2.6 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Authority to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This includes a statutory requirement to make a prudent provision for an annual contribution from its revenue budget towards the reduction in its overall borrowing requirement. This charge is known as the Minimum Revenue Provision (MRP). This therefore means that increases in capital expenditure must be limited to a level whereby increases in the following charges to revenue are limited to a level which is affordable within the projected income of the Authority for the foreseeable future:

- Increases in interest charges caused by increased borrowing to finance additional capital expenditure;
- Any increases in running costs from new capital projects, and
- Any increases in the Minimum Revenue Provision.

ECONOMIC BACKGROUND

2.7 After the UK's relatively strong economic growth in 2016, growth in 2017 has been somewhat weaker with annual growth in the region of 1.5%. This can mainly be attributed to the sharp increase in inflation caused by the devaluation of sterling after the EU referendum.

2.8 In response to rising inflation, the Monetary Policy Committee (MPC) increased bank rate from 0.25% to 0.5% at its meeting in November 2017. It also gave forward guidance that it expects to increase bank rate only twice more in the next three years to reach 1.0% by 2020.

2.9 A more in depth analysis of the economic backdrop to this report can be found at Appendix B.

2.10 Link Asset Services has provided a forecast on the bank interest rate, which draws on current City forecasts:

Link Asset Services Bank Rate Forecasts	
As at 31 March 2018	0.50%
As at 31 March 2019	0.75%
As at 31 March 2020	1.00%
As at 31 March 2021	1.25%

2.11 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecast (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.

MANAGEMENT OF CASH RESOURCES

2.12 The Authority uses a main current account, an investment account and a number of local petty cash accounts. All of these accounts are held with

Barclays Bank PLC and are managed online. This system allows the Authority to make transfers to and from accounts in real time and thus allows the current account balance to be maintained at a minimum level. All surplus funds are held either in the investment account for short periods or are lent to institutional borrowers over longer periods.

2.13 The bank overdraft level is £200,000 and this is usually sufficient. There are occasions when the overdraft exceeds £200,000 and temporary arrangements are made with the bank to increase the limit to £500,000. The Prudential Code report included an overdraft limit of £500,000 within the authorised limit to allow for such instances. It is proposed that the day to day overdraft facility remains at a level of £200,000.

2.14 Part of the treasury management operation is to ensure that cash flows are adequately planned, with cash being available when it is needed. A 3 year cash flow projection is prepared together with a 3 month rolling cash flow forecast. The 3 month forecast is updated regularly and this process reveals when cash surpluses or shortages are likely to arise.

2.15 Cash management processes have been examined by internal auditors and have been shown to be robust.

BORROWING STRATEGY

2.16 The prudential indicators for borrowing are set out in Appendix C. Background information relating to these indicators is contained within the Prudential Code for Capital Finance 2018/19 report which is elsewhere on this agenda.

2.17 The capital financing requirement is the sum of money required from external sources to fund capital expenditure i.e. the Authority's underlying need to borrow or lease. For 2018/19 this figure is estimated at £27,306,000. This figure is comprised of capital expenditure incurred historically by the Authority that has yet to be financed by capital receipts, grants, or contributions from revenue including MRP charges, plus estimated capital expenditure and capital financing for 2017/18 and 2018/19.

2.18 The Authority's strategy in the past has been to borrow funds from the Public Works Loan Board (PWLB). The PWLB is an agent of HM Treasury and its function is to lend money from the National Loans Fund to local authorities and other prescribed bodies. Its interest rates are generally favourable compared to those applicable to borrowings from other sources within the marketplace. Following a period of consultation, the government has announced that it intends to abolish the PWLB and transfer its functions for lending to local authorities to the Treasury, with operational responsibility delegated to the Debt Management Office. However, this is not expected to have a tangible impact on the Authority's ability to borrow from the government at preferential rates and, as this change has yet to be implemented, this report will continue to refer to "the PWLB". In 2007/08, a £4m loan was borrowed from a bank, with a fixed interest rate which was lower than the equivalent PWLB rate. It is therefore proposed that the

Authority continues to borrow primarily from the PWLB, but considers fixed rate market borrowing when market rates are lower than PWLB rates. In addition to this, the Authority may also consider loans from the UK's Municipal Bond Agency, which is likely to be offering loans to local authorities in the near future.

2.19 The loan of £4m referred to in paragraph 2.18 is structured as a "Lender Option Borrower Option (LOBO)" loan. This means that on 7 March 2013 and on that anniversary every five years, the lender may revise the interest rate, which is currently 4.13%. The Authority may choose to repay the loan without penalty if the amended interest rate is not advantageous. If the lender does exercise the option to revise the interest rate, the strategy will be to either agree to continue the loan with the revised interest rate or to repay the loan and replace it with new, long term debt at a lower rate depending on which is the most advantageous option for the Authority. As the interest rate was not changed on 7 March 2013, the next opportunity for a revision is 7 March 2018. Given the current interest rate environment, it is unlikely that the LOBO rate will be revised at this time.

2.20 Over the next three years, it is anticipated that the Authority will need to borrow up to £8m to finance the capital programme and to replace up to £4m of maturing loans.

2.21 Link Asset Services' view on future PWLB interest rates is:

	Mar 18	Jun 18	Sep 18	Dec 18	Mar 19	Mar 20	Mar 21
5 yr PWLB	1.60%	1.60%	1.70%	1.80%	1.80%	2.10%	2.30%
10 yr PWLB	2.20%	2.30%	2.40%	2.40%	2.50%	2.70%	3.00%
25 yr PWLB	2.90%	3.00%	3.00%	3.10%	3.10%	3.40%	3.60%
50 yr PWLB	2.60%	2.70%	2.80%	2.90%	2.90%	3.20%	3.40%

The table above has been adjusted for the PWLB certainty rate, which is a 20 basis points reduction in the interest rate for Authorities such as this one which have applied for it.

2.22 As stated in paragraph 2.11, economic forecasting is particularly difficult at this time. Gilt yields, and therefore PWLB rates, are influenced by geopolitical developments as well as developments in financial markets. These include:

- Timings of Bank of England base rate changes which could impact on the economy if incorrect;
- Inflation levels;
- Brexit negotiations;
- Geopolitical risks such as North Korea, Europe and the Middle East;
- European politics, in Germany for example;
- A resurgence of the Eurozone debt crisis;
- Rising US protectionism under President Trump.

2.23 In view of the above forecast the Authority's borrowing strategy will be based upon the following information.

- A combination of capital receipts, internal funds and borrowing will be used to finance capital expenditure in 2018/19 and beyond.

- Three PWLB loans will mature in the medium term (£1m and £1.5m in 2018/19 and £1.5m in 2020/21). These will need to be replaced with new borrowing and it is estimated that new borrowing in the period 2018/19 to 2020/21 will be in the region of £8m.

- Link Asset Services' view is that PWLB rates are likely to rise over the next three years. It may therefore be advantageous to take out new loans earlier in the period, as this will have a lesser impact on the revenue budget for the periods of the loans. However, if this is in advance of the need to spend, there will be a cost of capital impact as referred to in paragraph 2.27 below.

- PWLB rates on loans of less than ten years duration are expected to be lower than longer term PWLB rates. However, the existing debt maturity profile of the Authority will also be taken into account when decisions are made regarding the duration of new borrowing. The Authority will strive to seek a balance between securing the most advantageous rate whilst ensuring that it is not unduly exposed to re-financing risk.

- Consideration will also be given to borrowing fixed rate market loans at 0.25% – 0.50% below the PWLB target rate and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.

- PWLB Maturity loans will continue to be taken if the overall cost of such loans is less than the equivalent Annuity loans. If this strategy results in a short term breach of the Gross Borrowing and Capital Financing Requirement indicator, then the reasons for this will be explained to members of the Authority.

2.24 The Authority is currently maintaining an under-borrowed position. This means that the capital financing requirement has not been fully funded with loan debt; instead the cash supporting the Authority's reserves and balances is being used as a temporary measure. The use of cash balances in this way is known as "internal borrowing", and this strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered. However, the Authority recognises that internal borrowing itself poses a different kind of risk, as there is a chance that balances may need to be replenished at a time when interest rates are higher. In this respect, internal borrowing is effectively variable rate debt. The Authority will therefore aim to build cash levels up again in the future in order to ensure that reserves and balances are "cash-backed" to an appropriate level, however the timing of this will very much depend on the prevailing economic conditions and the Authority's ability to ensure the security of funds.

2.25 Officers, in conjunction with treasury advisors, will continually monitor both the prevailing interest rates and market forecasts, adopting the following responses to a change in position:

- if it were felt that there was a significant risk of a sharp **fall** in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it were 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 start date and 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 re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

2.26 The Authority's gross debt position is projected to be £23.2m by the end of 2017/18, but investments of approximately £7m are expected to be in place at 31 March 2018, giving a net debt position of around £16.2m. Currently, investment interest rates are substantially lower than debt interest rates so the use of reserves rather than borrowing to finance capital expenditure over the past three years has resulted in better value for money in the short term (see paragraph 2.24 for more details). However, the Authority recognises that there will be requirement to borrow in the medium term when the cash from surplus reserves has been exhausted. Interest rates are forecast to rise slowly over the next three years, and the Authority will monitor rate changes closely when determining when the time is right to borrow.

2.27 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, although this scenario is unlikely anyway given that current borrowing rates are higher than current investment interest rates, creating a cost of capital impact. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of funds invested. In determining whether borrowing will be undertaken in advance of need the Authority will:

- Ensure that borrowing is only undertaken to finance the capital programme approved within the current Medium Term Financial Strategy;

- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;

- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;

- Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

2.28 Where the Authority has made a decision to defer long term borrowing either in order to benefit from a forecasted reduction in interest rates or to avoid unnecessary carrying costs, it may undertake short term borrowing to alleviate temporary cash shortages caused by internally borrowing cash balances to support capital expenditure.

2.29 The rescheduling of debt involves the early repayment of existing borrowings and their replacement with new loans. As short term borrowing rates will be cheaper than longer term fixed interest rates, this would indicate a potential to generate savings by switching from long to short term debt. However, a premium would be payable which may negate the savings, and the loan maturity profile of the Authority indicates that this would increase exposure to interest rate risk. It is therefore unlikely that rescheduling of debt will take place in 2018/19 although this will be kept under review should circumstances change. Rescheduling will be considered for the following reasons:

- The generation of cash savings and / or discounted cash flow savings;

- Enhancing the balance of the portfolio by amending the maturity profile.

Any rescheduling of debt will be reported to Members at the earliest meeting following its action.

INVESTMENT STRATEGY

2.30 The Authority will have regard to the CLG's Guidance on Local Government Investments, the Audit Commission's report on Icelandic investments and the 2017 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Authority's investment priorities are:

(a) the security of capital and
(b) the liquidity of its investments.

The Authority will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Authority is low in order to give priority to security of its investments. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Authority will not engage in such activity.

2.31 Investment opportunities will arise when there are temporary cash surpluses. In accordance with guidance from CIPFA, and in order to minimise the risk to investments, the Authority sets a minimum acceptable credit quality of counterparties for investment. To determine the institutions with which investments may be placed, the Authority uses the creditworthiness service provided by Link Asset Services. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors forming the core element. It is recognised that ratings should not be the sole determinant of the quality of an institution, and Capita's creditworthiness service does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

- Credit watches and credit outlooks from credit rating agencies;

- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings;

- Sovereign ratings to select counterparties from only the most creditworthy countries;

- Information from the financial press and share price information.

2.32 The modelling approach combines credit ratings, credit watches, credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product is a series of colour code bands which indicate the relative creditworthiness of counterparties and enable diversification in investments. These colour codes are used by the Authority to determine both the credit-worthiness of institutions and the duration for investments. It is regarded as an essential tool, which the Authority would not be able to replicate using in house resources.

2.33 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Capita's weekly credit list of potential counterparties. The Authority will therefore use counterparties within the following durational bands:

- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days

Institutions within the "purple band" (24 months), the "yellow band" (5 years) or with no colour band will not be used.

2.34 The Authority has previously determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix D. This list will be added to or deducted from by Officers should ratings change in accordance with this policy. The UK currently has a sovereign rating of AA and has been placed on "negative outlook" which raises the potential for it to be downgraded further within the next eighteen months if the economic outlook for the UK deteriorates. If the UK were to be downgraded to AA- this would remove the option of investing with the Authority's existing bankers and all other UK institutions. It is therefore proposed that the strategy be changed for 2018/19 to continue to use counterparties from the UK should its sovereign credit rating be downgraded to AA-. Investments with UK counterparties will remain subject to creditworthiness criteria outlined in 2.33.

2.35 The credit list provided by Link as at 26 January is attached at Appendix E. This will be updated for changes on a daily basis.

2.36 The Markets in Financial Instruments Directive ("MIFID I") came into force in 2007. "MIFID II" is a revision of the Directive which is effective from 3 January 2018. Under the revised regulations, Local Authorities are categorised as "retail clients". This categorisation limits both the financial instruments and providers available to authorities for treasury management purposes. However, authorities can opt up to become "elective professional clients" if certain criteria are satisfied. This Authority was able to satisfy the criteria, and so has opted up to elective professional status, and has therefore retained its access to a wider range of financial products.

2.37 In accordance with its low risk appetite, the Authority may undertake the following types of "specified" investments:

- Deposits with the Debt Management Office (Government);
- Term deposits with Banks and Building Societies;
- Call deposits with Banks and Building Societies;
- Term Deposits with uncapped English and Welsh local authority bodies;
- Triple-A rated Money Market Funds (CNAV, LVNAV and VNAV);
- UK Treasury Bills;
- Certificates of Deposit.

2.38 The risks associated with investing will be reduced if investments are spread e.g. over counterparties or over countries. The Authority will therefore aim to limit its investment with any single counterparty to £2m. It is, however, difficult to impose any further spreading requirement due to the relatively small size of the Authority's investments and the fact that investment institutions will often only accept a minimum investment sum, which may render any such policy unworkable. Despite this Officers will, wherever possible, avoid the concentration of investments with one counterparty or group.

2.39 The majority of past investments have been for periods of 3 months or less. In the current financial climate no term deposit investments with other counterparties, such as UK semi-nationalised banks and local authorities, will be made for more than 1 year without the prior approval of the Treasurer and the Chair of Finance and Resources Committee. The Authority will avoid locking into longer term deals while investment rates are down at historically low levels unless exceptionally attractive rates are available which make longer term deals worthwhile.

2.40 All credit ratings will be monitored via a weekly update from Link Asset Services. The Authority is alerted to changes to ratings of all three agencies as and when they occur through its use of the Link creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of Credit Ratings the

Authority will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

2.41 Investments will normally be made for durations which accord with Link's credit quality list so, for example, an investment would be made for no more than 100 days (3 months) with a "Green" rated counterparty. This policy works well with fixed term deposits but where the Authority invests in a "call" account in a bank there is no fixed duration for the deposit. In such instances, officers will monitor intelligence about the bank and give notice to withdraw funds immediately if there is any indication of a substantially increased risk to the security of the deposit. Where call accounts are used, deposits will only be made where the minimum notice period is no longer than the Link suggested duration for that institution, and it is therefore recognised that the total period of the investment may be longer than the Link suggested duration in some cases.

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

MINIMUM REVENUE PROVISION POLICY 2018/19

2.43 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 came into force on 31 March 2008. These regulations were an amendment to the 2003 regulations and introduced several changes to the capital finance regime for local authorities (including fire authorities) in England. The most significant of these were provisions dealing with the calculation of Minimum Revenue Provision (MRP), which is the amount an authority charges to its revenue account in respect of the financing of capital expenditure.

2.44 Under the regulations, Authorities must make a "prudent provision" for MRP and guidance is given on the interpretation of this: "provision for the borrowing which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service". This guidance translates into the asset life method. Authorities are permitted to continue charging MRP calculated using the old method for borrowing and credit arrangements which funded capital expenditure incurred before 1 April 2007. This method calculates a charge of 4% of the capital financing requirement each year to revenue.

2.45 The following policy on MRP is therefore recommended to members and budgetary provision for MRP has been made on this basis:

- For all borrowing and credit arrangements to fund capital expenditure incurred before or during 2006/07, the minimum revenue provision applied in 2018/19 will continue to be calculated on the basis of the 4% CFR (capital financing requirement) method. This method will continue to be used in future years for capital expenditure incurred during or before 2006/07.

- For all borrowing and credit arrangements to fund capital expenditure incurred from 2007/08 onwards, the minimum revenue provision applied in 2018/19 will be calculated on the basis of the Asset Life method.

2.46 The regulations also allow for Voluntary Revenue Provision (VRP) charges to be made. A VRP charge would be in addition to the MRP charge, and would have the effect of reducing MRP charges in future years, resulting in revenue budget savings. If the situation arises in the year whereby Officers feel that a VRP charge would be advantageous (e.g. if there are revenue budget underspends), then a recommendation will be made to Finance and Resources Committee to approve a VRP charge during the year.

TRAINING OF OFFICERS AND MEMBERS

2.47 Under the Code, good practice is defined as ensuring that all staff involved in treasury management are appropriately trained and experienced to undertake their duties. Employees within the Finance Department who carry out treasury management activities are suitably trained and experienced and routinely attend at least one treasury management update event each year to ensure that their knowledge keeps pace with changes

2.48 It is also suggested that those tasked with treasury management scrutiny responsibilities also have access to suitable training. A treasury management training seminar was last held for Members of the Fire Authority in January 2017, and further training is planned for April 2018.

3. FINANCIAL IMPLICATIONS

The financial implications of this report are set out in full within the body of the report.

4. HUMAN RESOURCES AND LEARNING AND DEVELOPMENT IMPLICATIONS

There are no human resources or learning and development implications arising directly from this report.

5. EQUALITIES IMPLICATIONS

There are no equalities issues arising directly from this report.

6. CRIME AND DISORDER IMPLICATIONS

There are no crime and disorder implications arising directly from this report.

7. LEGAL IMPLICATIONS

There are no legal implications arising directly from this report, other than the requirement to act within the Authority’s powers when undertaking treasury management borrowings and investments.

8. RISK MANAGEMENT IMPLICATIONS

The investment of local authority funds cannot be achieved without some element of risk. Careful choice of borrowers using creditworthiness indices will minimise this risk. This prudent approach will undoubtedly result in some interest rate loss but the principles of security and liquidity are paramount.

9. COLLABORATION

There are no collaboration implications arising from this report.

10. RECOMMENDATIONS

It is recommended that Members:

10.1 Approve the Treasury Management Strategy 2018/19 as set out in this report.

10.2 Approve the continued use of UK counterparties should the UK sovereign rating fall to AA-.

10.3 Approve the Minimum Revenue Provision policy 2018/19 as set out in paragraphs 2.43 to 2.46.

11. BACKGROUND PAPERS FOR INSPECTION (OTHER THAN PUBLISHED DOCUMENTS)

None.

Theresa Channell
INTERIM TREASURER TO THE FIRE AUTHORITY

APPENDIX A

TREASURY MANAGEMENT POLICY STATEMENT

1. The Authority defines its treasury management activities as: “The management of the 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”.

2. The Authority regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

3. The Authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.”

ECONOMIC BACKGROUND **APPENDIX B**

After the UK's relatively strong economic growth in 2016, growth in 2017 has been somewhat weaker: quarter 1 was just +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). This can mainly be attributed to the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, which increased the cost of imports and in turn led to a reduction in consumer disposable income. This has impacted on the services sector of the economy, which accounts for around 80% of GDP, as consumers have cut back on their expenditure.

In response to rising inflation, the Monetary Policy Committee (MPC) increased bank rate from 0.25% to 0.5% at its meeting in November 2017. It also gave forward guidance that it expects to increase bank rate only twice more in the next three years to reach 1.0% by 2020. However, some forecasters expect growth to accelerate significantly in 2018. This view is based primarily on the coming fall in inflation (as the effect of the devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring an end to the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak sector services growth. If this scenario were to materialise then the MPC would be likely to accelerate its pace of increases in bank rate during 2018 and onwards.

One key area of risk is that consumers may have become used to the cheap borrowing rates that have prevailed since 2008, especially for mortgages. There is concern that some consumers may have over-extended their borrowing and become complacent about interest rates going up as the bank rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in bank rate in the coming years. Consumer borrowing is a particularly vulnerable area in terms of the MPC getting the pace and strength of bank rate increases right, without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

Nearly ten years on from the financial crash of 2008, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures were a combination of lowering central interest rates, and flooding financial markets with liquidity through means such as quantitative easing (QE). The key issue now is that the period of stimulating economic recovery is coming to a close, and a new period has begun during which monetary policy is refocusing on countering the threat of rising inflationary pressures as stronger growth becomes more firmly established. The time has therefore come to begin reversing the previous monetary policy measures of low interest rates and QE, and this must be carefully managed in order to avoid shocks to the world economy. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for higher yields and therefore into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This makes both asset categories vulnerable to a sharp correction.

It is important therefore that central banks gradually unwind their holdings of bonds in order to prevent destabilising financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. The timing of this must be balanced, as taking action that is too rapid or too strong could squash economic recovery, whilst taking action that is too weak or too slow could cause inflation to get out of control.

World growth seems to be on an encouraging trend of stronger performance, rising earnings and falling levels of employment. In October the International Monetary Fund upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

Economic growth in the Eurozone picked up in 2016 and has now gathered strength and momentum thanks to the monetary stimulus provided by the European Central Bank (ECB). However, the ECB is still struggling to get inflation up to its 2% target and in November inflation is 1.5%. It is therefore unlikely to start raising bank rates until possibly 2019.

Growth in the US economy has been fairly erratic, ranging from 1.2% in quarter 1 of 2017 to 3.2% in quarter 3. Unemployment has fallen to the lowest level in many years, while wage inflation pressures (and inflationary pressures generally) have been building. The Federal Reserve has started to gradually increase rates, with four increases since December 2016. At its September meeting, the Federal Reserve said it would start to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities.

Source – Link Asset Management.

APPENDIX C

PRUDENTIAL AND TREASURY INDICATORS FOR 2018/19

Estimate of Ratio of Financing Costs to Net Revenue Stream	5.7%
Estimate of Total Capital Expenditure to be Incurred	£3,191,000
Estimate of Capital Financing Requirement	£27,306,000
Operational Boundary	£29,723,000
Authorised Limit	£32,695,000
Upper limit for fixed rate interest exposures	100%
Upper limit for variable rate interest exposures	30%
Loan Maturity:	Limits:
Under 12 months	Upper 20% Lower 0%
12 months to 5 years	Upper 30% Lower 0%
5 years to 10 years	Upper 75% Lower 0%
Over 10 years	Upper 100% Lower 0%
Over 20 years	Upper 100% Lower 30%
Upper Limit for Principal Sums Invested for Periods Longer than 365 Days	£2,000,000

APPENDIX D

APPROVED COUNTRIES FOR INVESTMENTS – FITCH RATINGS

AAA	AA+	AA
Australia	Finland	Abu Dhabi (U.A.E)
Canada	Hong Kong	France
Denmark		U.K.
Germany		
Luxembourg		
Netherlands		
Norway		
Singapore		
Sweden		
Switzerland		
U.S.A.		

APPENDIX E

NFRS Approved Counterparty Lending List as at 26 January 2018

			Fitch Ratings			Moodys Ratings			S&P Ratings								
Counterparty			Long Term	Short Term		Long Term	Short Term		Long Term	Short Term	Suggested Duration	(Watch/ Outlook Adjusted)	CDS Price	CDS Status	(CDS Adjusted with manual override)	Monetary Limit	Duration
Australia		SB	AAA		SB	Aaa		NO	AAA				13.16				
Banks	Australia and New Zealand Banking Group Ltd.	SB	AA-	F1+	SB	Aa3	P-1	NO	AA-	A-1+	O - 12 mths	O - 12 mths	38.09	●	O - 12 mths		
	Commonwealth Bank of Australia	SB	AA-	F1+	SB	Aa3	P-1	NO	AA-	A-1+	O - 12 mths	O - 12 mths	40.25	●	O - 12 mths		
	Macquarie Bank Ltd.	SB	A	F1	SB	A2	P-1	NO	A	A-1	R - 6 mths	R - 6 mths			R - 6 mths		
	National Australia Bank Ltd.	SB	AA-	F1+	SB	Aa3	P-1	NO	AA-	A-1+	O - 12 mths	O - 12 mths	40.25	●	O - 12 mths		
	Westpac Banking Corp.	SB	AA-	F1+	SB	Aa3	P-1	NO	AA-	A-1+	O - 12 mths	O - 12 mths	40.25	●	O - 12 mths		
Belgium		SB	AA-		SB	Aa3		SB	AA				12.23				
Banks	BNP Paribas Fortis	SB	A+	F1	SB	A1	P-1	SB	A	A-1	R - 6 mths	R - 6 mths			R - 6 mths		
	KBC Bank N.V.	PO	A	F1	SB	A1	P-1	PO	A	A-1	R - 6 mths	R - 6 mths			R - 6 mths		
Canada		SB	AAA		SB	Aaa		SB	AAA				33.83				
Banks	Bank of Montreal	SB	AA-	F1+	NO	A1	P-1	SB	A+	A-1	O - 12 mths	O - 12 mths			O - 12 mths		
	Bank of Nova Scotia	SB	AA-	F1+	NO	A1	P-1	SB	A+	A-1	O - 12 mths	O - 12 mths			O - 12 mths		
	Canadian Imperial Bank of Commerce	NO	AA-	F1+	NO	A1	P-1	SB	A+	A-1	O - 12 mths	O - 12 mths			O - 12 mths		
	National Bank of Canada	SB	A+	F1	NO	A1	P-1	SB	A	A-1	R - 6 mths	R - 6 mths			R - 6 mths		

Counterparty			Fitch Ratings Long Term	Fitch Ratings Short Term		Moodys Ratings Long Term	Moodys Ratings Short Term		S&P Ratings Long Term	S&P Ratings Short Term	Suggested Duration	(Watch/ Outlook Adjusted)	CDS Price	CDS Status	(CDS Adjusted with manual override)	Monetary Limit	Duration
	Royal Bank of Canada	SB	AA	F1+	NO	A1	P-1	NO	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
	Toronto-Dominion Bank	SB	AA-	F1+	NO	Aa2	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
Denmark		SB	AAA		SB	Aaa		SB	AAA				9.62				
Banks	Danske A/S	SB	A	F1	SB	Aa3	P-1	SB	A	A-1	R - 6 mths	R - 6 mths	25.51	●	R - 6 mths		
Finland		SB	AA+		SB	Aa1		SB	AA+				10.61				
Banks	OP Corporate Bank plc		WD	WD	SB	Aa3	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
France		SB	AA		SB	Aa2		SB	AA				12.10				
Banks	BNP Paribas	SB	A+	F1	SB	Aa3	P-1	SB	A	A-1	R - 6 mths	R - 6 mths	22.47	●	R - 6 mths		
	Credit Agricole Corporate and Investment Bank	SB	A+	F1	SB	A1	P-1	PO	A	A-1	R - 6 mths	R - 6 mths	17.91	●	R - 6 mths		
	Credit Agricole S.A.	SB	A+	F1	SB	A1	P-1	PO	A	A-1	R - 6 mths	R - 6 mths	19.97	●	R - 6 mths		
	Credit Industrial et Commercial	SB	A+	F1	SB	Aa3	P-1	SB	A	A-1	R - 6 mths	R - 6 mths			R - 6 mths		
	Societe Generale	SB	A	F1	SB	A2	P-1	SB	A	A-1	R - 6 mths	R - 6 mths	23.45	●	R - 6 mths		
Germany		SB	AAA		SB	Aaa		SB	AAA				6.63				
Banks	BayernLB	SB	A-	F1	SB	Aa3	P-1		NR	NR	R - 6 mths	R - 6 mths			R - 6 mths		
	Commerzbank AG	SB	BBB+	F2	PO	A2	P-1	NO	A-	A-2	G - 100 days	G - 100 days	51.45	●	G - 100 days		

		Fitch Ratings			Moodys Ratings			S&P Ratings									
Counterparty		Long Term		Short Term	Long Term		Short Term	Long Term		Short Term	Suggested Duration	(Watch/ Outlook Adjusted)	CDS Price	CDS Status	(CDS Adjusted with manual override)	Monetary Limit	Duration
	Deutsche Bank AG	SB	BBB+	F2	SB	A3	P-2	NO	A-	A-2	G - 100 days	G - 100 days	65.35	●	G - 100 days		
	DZ BANK AG Deutsche Zentral-Genossenschaftsbank	SB	AA-	F1+	SB	Aa1	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
	Landesbank Baden-Wuerttemberg	SB	A-	F1	SB	Aa3	P-1		NR	NR	R - 6 mths	R - 6 mths			R - 6 mths		
	Landesbank Berlin AG				SB	Aa2	P-1				O - 12 mths	O - 12 mths			O - 12 mths		
	Landesbank Hessen-Thueringen Girozentrale	SB	A+	F1+	SB	Aa3	P-1	SB	A	A-1	O - 12 mths	O - 12 mths	38.32	●	O - 12 mths		
	Landwirtschaftliche Rentenbank	SB	AAA	F1+	SB	Aaa	P-1	SB	AAA	A-1+	P - 24 mths	P - 24 mths			P - 24 mths		
	Norddeutsche Landesbank Girozentrale	NO	A-	F1	NO	Baa2	P-2		NR	NR	N/C - 0 mths	N/C - 0 mths			N/C - 0 mths		
	NRW.BANK	SB	AAA	F1+	SB	Aa1	P-1	SB	AA-	A-1+	P - 24 mths	P - 24 mths			P - 24 mths		
Netherlands		SB	AAA		SB	Aaa		SB	AAA				9.61				
Banks	ABN AMRO Bank N.V.	SB	A+	F1	SB	A1	P-1	PO	A	A-1	R - 6 mths	R - 6 mths			R - 6 mths		
	Bank Nederlandse Gemeenten N.V.	SB	AA+	F1+	SB	Aaa	P-1	SB	AAA	A-1+	P - 24 mths	P - 24 mths			P - 24 mths		
	Cooperatieve Rabobank U.A.	SB	AA-	F1+	NO	Aa2	P-1	PO	A+	A-1	O - 12 mths	O - 12 mths	18.95	●	O - 12 mths		
	ING Bank N.V.	SB	A+	F1	SB	Aa3	P-1	SB	A+	A-1	O - 12 mths	O - 12 mths	17.45	●	O - 12 mths		
	Nederlandse Waterschapsbank N.V.				SB	Aaa	P-1	SB	AAA	A-1+	P - 24 mths	P - 24 mths			P - 24 mths		
Qatar		NO	AA-		NO	Aa3		NO	AA-				91.70				
Banks	Qatar National Bank	NO	A+	F1	NO	Aa3	P-1	NO	A	A-1	R - 6 mths	R - 6 mths	119.08	●	G - 100 days		
Singapore																	

Counterparty			Fitch Ratings Long Term	Fitch Ratings Short Term		Moodys Ratings Long Term	Moodys Ratings Short Term		S&P Ratings Long Term	S&P Ratings Short Term	Suggested Duration	(Watch/ Outlook Adjusted)	CDS Price	CDS Status	(CDS Adjusted with manual override)	Monetary Limit	Duration
		SB	AAA		SB	Aaa		SB	AAA								
Banks	DBS Bank Ltd.	SB	AA-	F1+	SB	Aa1	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
	Oversea-Chinese Banking Corp. Ltd.	SB	AA-	F1+	SB	Aa1	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
	United Overseas Bank Ltd.	SB	AA-	F1+	SB	Aa1	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
Sweden		SB	AAA		SB	Aaa		SB	AAA				9.62				
Banks	Nordea Bank AB	SB	AA-	F1+	SB	Aa3	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
	Skandinaviska Enskilda Banken AB	SB	AA-	F1+	SB	Aa3	P-1	SB	A+	A-1	O - 12 mths	O - 12 mths			O - 12 mths		
	Svenska Handelsbanken AB	SB	AA	F1+	SB	Aa2	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
	Swedbank AB	SB	AA-	F1+	SB	Aa3	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
Switzerland		SB	AAA		SB	Aaa		SB	AAA				19.00				
Banks	Credit Suisse AG	SB	A	F1	SB	A1	P-1	SB	A	A-1	R - 6 mths	R - 6 mths	44.00	●	R - 6 mths		
	UBS AG	SB	AA-	F1+	SB	Aa3	P-1	SB	A+	A-1	O - 12 mths	O - 12 mths	18.45	●	O - 12 mths		
United Arab Emirates		SB	AA		SB	Aa2		SB	AA				53.16				
Banks	First Abu Dhabi Bank PJSC	SB	AA-	F1+	SB	Aa3	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths			O - 12 mths		
United Kingdom		NO	AA		SB	Aa2		NO	AA				14.24				

		Fitch Ratings			Moodys Ratings			S&P Ratings									
Counterparty			Long Term	Short Term		Long Term	Short Term		Long Term	Short Term	Suggested Duration	(Watch/ Outlook Adjusted)	CDS Price	CDS Status	(CDS Adjusted with manual override)	Monetary Limit	Duration
AAA rated and Government backed securities	Collateralised LA Deposit*										Y - 60 mths	Y - 60 mths			Not Applicable		
	Debt Management Office										Y - 60 mths	Y - 60 mths			Not Applicable		
	Multilateral Development Banks										Y - 60 mths	Y - 60 mths			Not Applicable		
	Supranationals										Y - 60 mths	Y - 60 mths			Not Applicable		
	UK Gilts										Y - 60 mths	Y - 60 mths			Not Applicable		
Banks	Abbey National Treasury Services PLC	PW	A	F1	SB	Aa3	P-1				R - 6 mths	O - 12 mths			O - 12 mths		
	Bank of Scotland PLC	SB	A+	F1	SB	Aa3	P-1	PO	A	A-1	R - 6 mths	O - 12 mths	40.60	●	O - 12 mths		
	Barclays Bank PLC	PW	A	F1	NO	A1	P-1	SB	A	A-1	R - 6 mths	R - 6 mths	41.98	●	R - 6 mths		
	Close Brothers Ltd	SB	A	F1	SB	Aa3	P-1				R - 6 mths	R - 6 mths			R - 6 mths		
	Clydesdale Bank PLC	SB	BBB+	F2	PO	Baa1	P-2	SB	BBB+	A-2	N/C - 0 mths	N/C - 0 mths			N/C - 0 mths		
	Co-operative Bank PLC (The)	SB	B-	B	PO	Caa2	NP				N/C - 0 mths	N/C - 0 mths			N/C - 0 mths		
	Goldman Sachs International Bank	SB	A	F1	SB	A1	P-1	SB	A+	A-1	R - 6 mths	R - 6 mths	50.41	●	R - 6 mths		
	HSBC Bank PLC	SB	AA-	F1+	NO	Aa3	P-1	SB	AA-	A-1+	O - 12 mths	O - 12 mths	18.45	●	O - 12 mths		
	Lloyds Bank Plc	SB	A+	F1	SB	Aa3	P-1	PO	A	A-1	R - 6 mths	O - 12 mths	34.50	●	O - 12 mths		
	Santander UK PLC	PW	A	F1	SB	Aa3	P-1	SB	A	A-1	R - 6 mths	R - 6 mths			R - 6 mths		
	Standard Chartered Bank	SB	A+	F1	SB	A1	P-1	SB	A	A-1	R - 6 mths	R - 6 mths	38.49	●	R - 6 mths		
	Sumitomo Mitsui Banking Corporation Europe Ltd	SB	A	F1	SB	A1	P-1	SB	A	A-1	R - 6 mths	R - 6 mths	48.21	●	R - 6 mths		

Counterparty		Fitch Ratings Long Term		Fitch Ratings Short Term	Moodys Ratings Long Term		Moodys Ratings Short Term	S&P Ratings Long Term		S&P Ratings Short Term	Suggested Duration	(Watch/ Outlook Adjusted)	CDS Price	CDS Status	(CDS Adjusted with manual override)	Monetary Limit	Duration
	UBS Ltd.	SB	AA-	F1+	SB	A1	P-1	SB	A+	A-1	O - 12 mths	O - 12 mths	18.45	●	O - 12 mths		
Building Society	Coventry Building Society	SB	A	F1	SB	A2	P-1				R - 6 mths	R - 6 mths			R - 6 mths		
	Leeds Building Society	SB	A-	F1	SB	A3	P-2				G - 100 days	G - 100 days			G - 100 days		
	Nationwide Building Society	NO	A+	F1	SB	Aa3	P-1	SB	A	A-1	R - 6 mths	R - 6 mths			R - 6 mths		
	Nottingham Building Society				SB	Baa1	P-2				N/C - 0 mths	N/C - 0 mths			N/C - 0 mths		
	Principality Building Society	SB	BBB+	F2	SB	Baa2	P-2				N/C - 0 mths	N/C - 0 mths			N/C - 0 mths		
	Skipton Building Society	SB	A-	F1	SB	Baa1	P-2				G - 100 days	G - 100 days			G - 100 days		
	West Bromwich Building Society				SB	B1	NP				N/C - 0 mths	N/C - 0 mths			N/C - 0 mths		
	Yorkshire Building Society	SB	A-	F1	SB	A3	P-2				G - 100 days	G - 100 days			G - 100 days		
Nationalised and Part Nationalised Banks	National Westminster Bank PLC	PW	BBB+	F2	PO	A2	P-1	PO	BBB+	A-2	B - 12 mths	B - 12 mths			Not Applicable		
	Royal Bank of Scotland Group Plc	SB	BBB+	F2	SB	Baa3	P-3	SB	BBB-	A-3	B - 12 mths	B - 12 mths			Not Applicable		
	The Royal Bank of Scotland Plc	SB	BBB+	F2	NO	A2	P-1	SB	BBB+	A-2	B - 12 mths	B - 12 mths	47.44	●	Not Applicable		
United States		SB	AAA		SB	Aaa		SB	AA+				14.27				
Banks	Bank of America N.A.	SB	A+	F1	SB	Aa3	P-1	SB	A+	A-1	O - 12 mths	O - 12 mths			O - 12 mths		
	Bank of New York Mellon, The	SB	AA	F1+	SB	Aa1	P-1	SB	AA-	A-1+	P - 24 mths	P - 24 mths	33.13	●	P - 24 mths		
	Citibank N.A.	SB	A+	F1	PO	A1	P-1	SB	A+	A-1	R - 6 mths	O - 12 mths	40.10	●	O - 12 mths		
	JPMorgan Chase Bank N.A.	SB	AA-	F1+	SB	Aa2	P-1	SB	A+	A-1	O - 12 mths	O - 12 mths			O - 12 mths		

Counterparty	Fitch Ratings Long Term	Fitch Ratings Short Term	Moodys Ratings Long Term	Moodys Ratings Short Term	S&P Ratings Long Term	S&P Ratings Short Term	Suggested Duration	(Watch/ Outlook Adjusted)	CDS Price	CDS Status	(CDS Adjusted with manual override)	Monetary Limit	Duration
Wells Fargo Bank, NA	SB AA-	F1+	SB Aa1	P-1	NO AA-	A-1+	O - 12 mths	O - 12 mths	40.94	●	O - 12 mths		

Advisory notes: (M) = Manually added counterparty. If a rating changes for this institution it will not alter its status on the counterparty list, or limits assigned to it.

Please note that the Link Asset Services suggested methodology applies a minimum sovereign criteria of "AA-". In instances where individual client criteria allows for the potential use of entities from lower rated sovereigns, suggested duration columns in these lists may show a "colour", but this will purely be based on the ratings / CDS of the individual entity. It will not take account of the sovereign rating, which alone may provide a reason for it not being included within the Link Asset Services suggested list of counterparties.
Please note that CDS values are as at the close of business from the previous day.