LANCASHIRE COMBINED FIRE AUTHORITY
Meeting to be held on 19 February 2018

TREASURY MANAGEMENT POLICY AND STRATEGY 2018/19
(Appendix 1 refers)

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Executive Summary

The report sets out the Treasury Management Policy and Strategy for 2018/19, which is in line with CIPFA's revised Code of Practice.

The Strategy is based on the capital programme as presented to the Authority elsewhere on the agenda, and the financial implications of this are reflected in the revenue budget, also presented elsewhere on this agenda.

Recommendation

The Authority is asked to:-

- Approve the revised Treasury Management Strategy, including the Prudential Indicators, as set out in the report.
- Agree the Minimum Revenue Provision (MRP) calculation as set out in the report.
- Agree the Treasury Management Policy Statement at Appendix 1.

Information

Treasury Management is defined 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. "

In February 2012 the Combined Fire 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 Authority to approve a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised guidance on local authority investments in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year. . The strategy also has regard to other CIPFA treasury management publications such as risk management in 'Treasury Risk Toolkit for Local Authorities' (2012) and 'Using Financial Instruments to Manage Risk' (2013.)

The DCLG has issued a Consultation Paper on Investments which it proposes will be effective from 1 April 2018. This includes a new definition of investments namely investments "covers all the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment property portfolios. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework under this Code."

In practice, this means that any loans given or investment in assets wholly for income generation purposes are covered by the Code. Under the proposed Code loans for economic development purposes can be made even if they do not meet the strict criteria for security and liquidity. However, the Code will expect the loans to be proportionate to the overall portfolio and limits to be set on the maximum to be given.

Similarly, authorities can hold non-financial investment, which will normally have a physical asset that can be realised to recoup the capital invested. The Code requires details on the assessment of risk and the action to be taken if the value of the asset no longer covers the investment.

Currently, the LCFA does not make direct investment in property for income generation purposes nor provide loans to other bodies. Once the Consultation Paper is finalised then any appropriate action including the setting of limits will be undertaken.

Statutory Requirements

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.

This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.

Treasury Management Strategy for 2018/19

This Strategy Statement has been prepared in accordance with the CIPFA Treasury Management Code of Practice (2011). Accordingly, the Lancashire Combined Fire Authority's Treasury Management Strategy will be approved by the full Authority, and there will also be a mid-year and a year-end outturn report presented to the Resources Committee. In addition there will be monitoring and review reports to members in the event of any changes to Treasury Management policies or practices. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

This Authority has adopted the following reporting arrangements in accordance with the requirements of the revised Code: -

Area of Responsibility	Committee/ Officer	Frequency
Treasury Management Policy Statement	Resources Committee/Authority	Revised Policy Statement adopted in February 2013
Treasury Management Strategy / Annual Investment Strategy / MRP policy – scrutiny and approval	Resources Committee/ Authority	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report, scrutiny of performance	Resources Committee	Mid year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Resources Committee	As required
Annual Treasury Management Outturn Report	Resources Committee/ Authority	Annually by 30 September after the end of the year
Treasury Management Monitoring Reports	Director of Corporate Services	Quarterly
Treasury Management Practices	Director of Corporate Services	Annually

The Treasury Management Strategy, covers the following aspects of the Treasury Management function:-

- Prudential Indicators which will provide a controlling framework for the capital expenditure and treasury management activities of the Authority;
- Current Long-term debt and investments;
- Prospects for interest rates;
- The Borrowing Strategy;
- The Investment Strategy;
- Policy on borrowing in advance of need.

Setting the Treasury Management Strategy for 2018/19

In setting the treasury management strategy the following factors need to be considered as they may have a strong influence over the strategy adopted:

- economic forecasts;
- interest rate forecasts;
- the current structure of the investment and debt portfolio;
- future capital programme and underlying cash forecasts.

Economic Context

The forecast economic conditions include an expectation that growth in the next few years will be low. Negotiations on the UK exit from the European Union and future trade relations is causing uncertainty. The progress and final outcome of these negotiations may impact on economic growth not only in 2018/19 but also in future years. In his budget in November 2017, the Chancellor of the Exchequer announced forecasts of growth which were significantly less than those given in the budget of spring 2017. The forecast was as follows:

	November 2017 Budget	Spring Budget
2017/18	1.5%	1.8%
2018/19	1.4%	1.6%
2019/20	1.3%	1.8%
2020/21	1.5%	1.9%
2021/22	1.5%	2.0%

Inflation increased during 2017 with the Consumer Price Index (CPI) rising to 3.0% in September. This was largely as a result of the impact of the fall in the value of sterling following the Brexit decision and it is anticipated that inflation will fall from this position. The forecast CPI in the Chancellor's budget was as follows:

2017/18	3.0%
2018/19	2.2%
2019/20	1.8%
2020/21	2.0%
2021/22	2.0%

With inflation increasing and unemployment remaining low during 2017/18 the Bank of England believed that the extent of spare capacity in the economy seemed limited and the pace at which the economy could grow without generating inflationary pressure had fallen over recent years. Therefore the Monetary Policy Committee of the Bank of England concluded that a rise in interest rates was appropriate. In November 2017 they raised the base rate for the first time in a decade with the base rate increasing from 0.25% to 0.50%

Looking forward, the forecast from the Council's treasury advisers, Arlingclose, is for UK Bank Rate to remain at 0.50% during 2018/19. The Monetary Policy Committee emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

Interest Rate Forecast and Prospects for Market Liquidity

The prevailing and forecast interest rate situation will be monitored to inform borrowing decisions and to ensure that opportunities for debt restructuring are maximised. Regular forecasts of interest rates are provided by Arlingclose Ltd, treasury management advisers to Lancashire County Council.

Treasury consultants Arlingclose Ltd 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.

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.

The latest forecast provided by Arlingclose Ltd is shown in the table below:

	Bank Rate %	3 month LIBID %	12 month LIBID %	5 year gilt yield %	10 year gilt yield %	20 year gilt yield %	50 year gilt yield %
March 18	0.50	0.50	0.70	0.75	1.25	1.85	1.70
June 18	0.50	0.50	0.70	0.80	1.25	1.85	1.70
September 18	0.50	0.50	0.70	0.80	1.25	1.85	1.70
December 18	0.50	0.50	0.80	0.80	1.25	1.85	1.70
March 19	0.50	0.50	0.80	0.85	1.30	1.90	1.75
June 19	0.50	0.50	0.80	0.90	1.30	1.90	1.80
September 19	0.50	0.50	0.80	0.90	1.35	1.95	1.85
December 19	0.50	0.50	0.80	0.95	1.40	1.95	1.90
March 20	0.50	0.50	0.80	0.95	1.45	2.00	1.95
June 20	0.50	0.50	0.80	1.00	1.50	2.05	1.95
September 20	0.50	0.50	0.80	1.05	1.55	2.05	1.95
December 20	0.50	0.50	0.80	1.10	1.55	2.05	1.95
March 21	0.50	0.50	0.80	1.15	1.60	2.10	2.00

In the above table 'bank rate' refers to the policy rate of the Bank of England. 'LIBID' is the London Interbank bid rate and can be used as a proxy for short term market interest rates. PWLB borrowing rates are based on 'Gilt Yield' and so this is a forecast of long term interest rates. The Authority can borrow at 80 basis points above the gilt yield, so for example a fixed interest rate to borrow PWLB money for 10 years would be 2.05%, 1.25% plus 0.80%.

Current Treasury Portfolio Position

At the 31 December 2017 the debt outstanding was £m with investments of £39.725m -

Debt	Principal £m	%
Fixed rate loans from the Public Works Loan Board	2.000	100%
Variable rate loans		-
	2.000	100%
Investments		

Variable rate investments with Lancashire County Council	34.725	87.4%
Fixed rate investments	5.000	12.6%
	39.725	100%

The level of investments represents the Authority's cumulative surplus on the General Fund, the balances on other cash-backed earmarked reserves and a cash-flow balance generated by a surplus of creditors over debtors and by grant receipts in advance of payments. There is a net investment figure of £39.7m.

Borrowing and Investment Requirement

In the medium term LCFA borrows for capital purposes only. 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 table below compares the estimated CFR to the debt which currently exists, this gives an indication of the borrowing required. It also shows the estimated resources available for investment. An option is to use these balances to finance the expenditure rather than investing, often referred to as internal borrowing. The table gives an indication of the minimum borrowing or investment requirement through the period.

The CFR forecast includes the impact of the latest forecast of the funding of the Capital Programme which currently assumes that there will be no borrowing.

	31/3/17	31/3/18	31/3/19	31/3/20	31/3/21
	£m	£m	£m	£m	£m
Capital Financing Requirement	14.906	14.576	14.262	13.920	13.547
Less long term liabilities (PFI)	-14.651	-14.316	-14.012	-13.665	-13.287
Less external borrowing	-5.514	-2.000	-2.000	-2.000	-2.000
Borrowing requirement	-5.259	-1.740	-1.750	-1.745	-1.740
Reserves and working capital	-38.097	-35.200	-22.900	-17.500	-13.400
Borrowing/(investment) need	-43.356	-36.940	-24.650	-19.245	-15.140

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. However, the table above shows that the level of loans was above the CFR at 31 March 2017. This was the result of the Authority adopting a policy of setting aside additional Minimum Revenue Provision (MRP) in order to generate the cash to repay loans either on maturity or as an early repayment. The effect of this policy was that the cash was available to enable an early repayment of £3.184m of debt during 2017/18 in addition to £0.330m which matured in the year.

The table above indicates that rather than having a need for borrowing it is estimated that the Authority has an underling need to invest although the available balances are forecast to reduce.

Although the Authority does not have plans for new borrowing it does currently hold £2.000m of loans as part of its strategy for funding previous years' capital programmes.

Borrowing Strategy

Although it is unlikely that borrowing will required in 2017/18 it is still best practice to approve a borrowing strategy and a policy on borrowing in advance of need. In considering a borrowing strategy the Authority needs to make provision to borrow short term to cover unexpected cash flow shortages or to cover any change in the financing of its Capital Programme.

Therefore the approved sources of long-term and short-term borrowing are:

- Public Works Loan Board;
- UK local authorities;
- any institution approved for investments;
- any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK;
- UK public and private sector pension funds.

In the past the Authority has raised all of its long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans, the Municipal Bond Agency set up recently by the Local Government Association and bank loans, that may be available at more favourable rates.

Policy on Borrowing in Advance of Need

In line with the existing policy the Authority will not borrow more than or in advance of need purely in order to profit from the investment of the extra sums borrowed. However advance borrowing may be taken if it is considered that current rates are more favourable than future rates and that this advantage outweighs the cost of carrying advance borrowing. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds and relationships.

In determining whether borrowing will be undertaken in advance of need the authority will:-

- Ensure that there is a clear link between the capital programme and the maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- Ensure the on-going 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 merits and demerits of alternative forms of funding.
- Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

Debt Restructuring

The Authority's debt has arisen as a result of prior years' capital investment decisions. It has not taken any new borrowing out since 2007 as it has been utilising cash balances to pay off debt as it matures, or when deemed appropriate. Following the repayment of £3.3m of debt in 2017/18 we anticipate holding £2.0m of debt at 31 March 2018. All the debt is from the Public Works Loans Board (PWLB) and is all at fixed rates of interest and is only repayable on maturity. The table below shows the maturity profile and interest rate applicable on these:-

Loan Amount	Maturity Date	Interest rate
£650k	December 2035	4.49%
£650k	June 2036	4.49%
£700k	June 2037	4.48%

This debt was taken out in 2007 when base rates was 5.75% and when the Authority was earning 5.84% return on its investments.

Given the high interest rates payable on these loans, relative to current interest rates, we have again reviewed opportunities for debt repayment/restructuring.

The level of penalty applicable on early repayment of loans now stands at £877k. (As previously reported the level of penalty is dependent upon two factors, the difference between the interest chargeable on the loan and current interest rates, the greater this difference the greater the penalty, and the length to maturity, the greater the remaining time of the loan the greater the penalty. Hence as interest rates increase or as loans get closer to maturity the level of penalty will reduce.)

Outstanding interest payable between now and maturity is £1.684k. Giving a gross saving of £807k.

Penalty incurred	£877k
Savings on interest payable	(£1,684k)
Gross Saving	(£807k)

However as highlighted as part of the Treasury Management Strategy and the previous reports, any early repayment means that cash balances available for investment will be reduced and hence interest receivable will also be reduced. The extent of which is dependent upon future interest rates.

<u>Comparison Utilising Updated Base Rate 0.5%</u>

As a starting point we have assumed interest rates remain at their current level, 0.5%. Based on this the anticipated reduction in interest receivable, as a result of the early repayment of loans, is £270k. Hence the net saving by repaying loans early is £537k

Penalty incurred	£877k
Savings on interest payable	(£1,684k)
Reduction in interest receivable	£270k
Net Saving	(£537k)

This shows at current interest rates it would be financially advantages to pay off all loans. However, using 0.5% as an interest rate forecast seems unrealistic, as all forecasts suggest that interest rates will increase in the medium to long term.

Comparison Utilising Current Gilt Rates

As such we have recalculated the net impact based on current investment returns available on Gilts at the end of November, 1.8% for a 20 year gilt. The overall position is summarised below, showing that the anticipated reduction in interest receivable is far more significant, £972k, resulting in a net cost of £165k if all the loans were repaid:-

Penalty incurred	£877k
Savings on interest payable	(£1,684k)
Reduction in interest receivable	£972k
Net Cost	£165k

Comparison Demonstrating Breakeven Position

As a final comparator we have calculated a breakeven position in terms of the average interest rate that would be required over the remaining life of each loan in order for early repayment costs to be fully offset. This shows that an average rate of return on investments of 1.49% represents the break-even position, whereby the penalty incurred and the loss of return on investments matches the saving in interest payable on the loan.

Penalty incurred	£877k
Savings on interest payable	(£1,684k)
Reduction in interest receivable	£807k
Net Cost	-

In essence this means that if returns on investments over the next 20 years exceed 1.49% then it is financially disadvantageous to pay off the loans, if interest rate averages less than 1.49% then it is financially advantageous. It is worth noting that other than during the current financial crisis interest rates have never been at such a low rate. If, as seems likely, interest rates prove to be higher than this then the early repayment of debt results in a worse overall financial position.

Comparison Demonstrating Costs of Restructuring Loans

As an alternative it is possible to repay the loans as they stand and take out new loans at current interest rates. The interest chargeable on any new loans will depend upon the maturity profile and hence to demonstrate the impact of this we have looked at two maturity profiles, 10 years and 20 years, and assume that the loans are from the PWLB.

Current interest rates on a 10 year loan are 2.25% which results in

Penalty incurred	£877k
Savings on interest payable on original loan	(£1,684k)
Interest payable on new loan	£845k
Reduction in interest receivable (arising from the penalty and the shorter maturity date)	£82k
Net Cost	£120k

As can be seen this option would cost the Authority an additional £120k.

Current interest rates on a 20 year loan are 2.75% which results in

Penalty incurred	£877k
Savings on interest payable on original loan	(£1,684k)
Interest payable on new loan	£1,032k
Reduction in interest receivable (arising from the penalty and the shorter maturity date)	£82k
Net Cost	£307k

As can be seen this option would cost the Authority an additional £307k.

As such the current penalty charge is too high to justify paying off the loan or restructuring it at the present time. This position will be reviewed again a part of the Treasury Management mid-year update.

It is also worth noting that whilst the capital budget does not show any additional borrowing being required in the next 5 years, it does not include any allowance for relocating Service Headquarters. This project is currently on hold and should the Authority decide to proceed with the relocation it will need to take out additional borrowing to meet the costs.

Investment Strategy

At 31st December 2017 the Authority held £39.7m invested funds, representing income received in advance of expenditure plus existing balances and reserves. In the past 12 months, the Authority's investment balance has ranged between £51.8m and £29.0m. The variation arises principally due to the timing of the receipt of government grants. It is anticipated that similar levels will be maintained in the forthcoming year.

Both the CIPFA Code and the CLG Guidance require the 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 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 receiving unsuitably low investment income.

Therefore in line with the guidance the Treasury Management Strategy is developed to ensure the Fire Authority will only use very high quality counterparties for investments.

The Authority may invest its surplus funds with any of the counterparties in the table below, subject to the cash and time limits shown.

Counterparty		Cash limit	Time limit †
Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody’s and Standard & Poor’s is:	AAA	£5m each	5 years*
	AA+		3 years*
	AA		2 years*
	AA-		2 years*
Call Accounts with banks and other organisations with minimum AA- credit rating		£10m	next day
UK Central Government (irrespective of credit rating)		unlimited	50 years**
UK Local Authorities (irrespective of credit rating)		£5m each	10 years**
Secured Bond Funds AA rating and WAL not more than 3 yrs		£5m each	n/a
Secured Bond Funds AAA rated and WAL not more than 5 yrs		£5m each	n/a

* but no longer than 2 years in fixed-term deposits and other illiquid instruments
** but no longer than 5 years in fixed-term deposits and other illiquid instruments

Allowable bond funds are defined by credit rating and weighted average life (WAL). Investing in senior secured bonds backed by collateral provides a protection against bail-in. Although the average life of the securities within the fund will be either 3 or 5 years, funds can be redeemed within 2 days of request but in general these should be seen as longer term investments. The fund targets returns of 3 month Libor + 40 basis points which is currently around % in total.

Regarding the risk of investing with another local authority, only a very few authorities have their own credit rating, but those that do are the same or one notch below the UK Government reflecting the fact that they are quasi-Government institutions. On the whole credit ratings are seen as unnecessary by the sector because the statutory and prudential framework within which the authorities operate is amongst the strongest in the world. In addition any lender to a local authority has protection, under statute, by way of a first charge on the revenues of that authority. No local authority has ever defaulted to date and this also may be an indication of security. However, following the downgrade of the UK credit rating by the rating agencies those local authorities with a rating saw a reduction in their ratings. Therefore, consideration has been given to reducing the risk associated with the investment with other local authorities. Arlingclose, the County Council's Treasury Management advisor, state they are "comfortable with clients making loans to UK local authorities for periods up to four years, subject to this meeting their approved strategy. For periods longer than four years we recommend that additional due diligence is undertaken prior to a loan being made." On this basis it is proposed that the investments to local authorities are limited as follows:

	Maximum individual investment (£m)	Maximum total investment (£m)	Maximum period
Up to 4 years	5	25	4 years
Over 4 years	5	25	10 years

The investment in LCC as part of the call account arrangement is excluded from the above limits. The balance on this account is dependent upon short term cash flows and therefore does not have a limit.

Whilst the investment strategy has been amended to allow greater flexibility with investments any decision as to whether to utilise this facility will be made based on an assessment of risk and reward undertaken jointly between the Director of Corporate Services and LCC Treasury Management Team, and consideration of this forms part of the on-going meetings that take place throughout the year.

The legislative context referred to earlier in the report effectively means that, because taxpayers will no longer bail-out failed banks, the required funds will be paid by equity investors and depositors. Local authorities' deposits will be at risk and consequently although currently available within the policy it is unlikely that long term unsecured term deposits will be used at the present time. However lending to banks on a collateralised basis is something that is being considered for the future.

Currently all of the Authority's investments are with other local authorities.

The Authority currently has access to a call (instant access) account with a local authority, which pays bank rate, this is currently 0.50%. Each working day the balance on the Authority's current account is invested to ensure that the interest received on surplus balances is maximised.

In addition a long term loans have been placed with an UK local authorities as outlined below. A further £5m loan matured in the year.

Start Date	End Date	Principal	Rate	Annual Interest	Interest 2017/18
30/6/14	28/6/19	£5,000,000	2.4%	£120,000	£120,000

Consideration is given fixing further investments if the maturity fits with estimated cash flows and the rate is considered to be attractive. This will continue to be reviewed. Current rates payable by other local authorities are:

3 month investment	0.50%
6 month investment	0.55%
12 month investment	0.70%

The overall combined amount of interest earned on Fixed/Call balances as at 31st December 2017 is £0.198m on an average balance of £42.133mm at an annualised rate of 0.62%. This compares favourably with the benchmark 7 day LIBID which averages 0.17% over the same period, and is 0.12% above the current bank rate.

Specified and Non-specified investments

The legislative and regulatory background to treasury management activities requires the Authority to set out its use of "specified" and "non-specified" investments.

Specified Investments: The CLG 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”.

The Authority defines “high credit quality” organisations 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.

Non-Specified Investments: are any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. 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, and investments with bodies and schemes not meeting the definition on high credit quality.

The Authority may lend or invest money using any of the following instruments:-

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits where the Authority may demand repayment at any time (with or without notice),
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments, and

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

The Authority prepares daily cash flow forecasts to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority’s medium term financial plan and cash flow forecast.

Minimum Revenue Provision (MRP)

Under Local Authority Accounting arrangements the Authority is required to set aside a sum of money each year to reduce the overall level of debt. This sum is known as the Minimum Revenue Provision (MRP).

The Authority will assess their MRP for 2018/19 in accordance with guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

It is proposed to continue to utilise the Capital Financing Requirement (CFR) Method. This provides for a charge of 4% of the value of fixed assets, as measured on the balance sheet, for which financing provision has not already been made. .

	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m
Statutory charge to revenue 4% MRP	0.010	0.010	0.010	0.010
Additional voluntary lump sum MRP	-	-	-	-
Total MRP	0.010	0.010	0.010	0.010

Whilst the Authority has no unsupported borrowing, nor has any plans to take out any unsupported borrowing it needs to approve a policy relating to the MRP that would apply if this were not the case. As such in accordance with the Local Government Act 2003, the MRP on any future unsupported borrowing will be calculated using the Asset Life Method. This will be based on a straightforward straight – line calculation to set an equal charge to revenue over the estimated life of the asset. Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Authority. However, the Authority reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Authority are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

Assets held under a PFI contracts and finance leases form part of the Balance Sheet. This has increased the overall capital financing requirement and on a 4% basis the potential charge to revenue. To prevent the increase the guidance permits a prudent MRP to equate to the amount charged to revenue under the contract to repay the liability. In terms of the PFI schemes this charge forms part of the payment due to the PFI contractor.

Prudential Indicators for 2017/18(revised) to 2020/21 in respect of the Combined Fire Authority's Treasury Management Activities.

In accordance with its statutory duty and with the requirements of the Prudential Code for Capital Finance and the CIPFA Code for Treasury Management, the Combined Fire Authority produces each year a set of prudential indicators which regulate and control its treasury management activities.

The following table sets out the debt and investment-related indicators which provide the framework for the Authority’s proposed borrowing and lending activities over the coming three years. These indicators will also be approved by members as part of the Capital Programme approval process along with other capital expenditure-related indicators, but need to be reaffirmed and approved as part of this Treasury Management Strategy.

It should be noted that contained within the external debt limits, there are allowances for outstanding liabilities in respect of the PFI schemes and finance leases for operational vehicles and photocopiers.

Treasury Management Prudential Indicators

Treasury Management Prudential Indicators	2017/18 (Revised)	2018/19	2019/20	2020/21
	£m	£m	£m	£m
1. Adoption of the Revised CIPFA Code of Practice on Treasury Management (2011)	Adopted for all years			
2. Authorised limit for external debt - A prudent estimate of external debt, which includes sufficient headroom for unusual cash movements.				
Borrowing	7.800	5.000	7.000	12.000
Other long-term liabilities	15.400	15.000	15.000	14.000
TOTAL	23.200	20.000	22.000	26.000
3. Operational boundary for external debt - A prudent estimate of debt, but no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the Authority's current plans.				
Borrowing	6.800	3.000	5.000	10.000
Other long-term liabilities	14.500	14.200	13.800	13.400
TOTAL	21.300	17.200	18.800	23.400
4. Upper limit for fixed interest rate exposure				
Upper limit of borrowing at fixed rates	100%	100%	100%	100%
Upper limit of investments at fixed rates	100%	100%	100%	100%
5. Upper limit for variable rate exposure Upper limit of borrowing at variable rates	25%	50%	50%	50%
Upper limit of investments at variable rates	100%	100%	100%	100%
6. Upper limit for total principal sums invested for over 364 days (per maturity date)	25.000	25.000	25.000	25.000
7. Maturity structure of Debt	Upper Limit %		Lower Limit %	
Under 12 months	100		-	
12 months and within 24 months	30		-	
24 months and within 5 years	50		-	
5 years and within 10 years	50		-	
10 years and above	100		-	

Financial Implications

It is worth noting that the Authority currently utilises Lancashire County Council to undertake its Treasury Management Activities, at an annual cost of £7,300, which is built into the current and future budgets.

The following table summarises the Financing costs for the Authority:-

	2018/19	2019/20	2020/21
	£m	£m	£m
Interest Payable on PWLB loans	0.090	0.090	0.090
Interest Receivable on call account and fixed term investments	(0.272)	(0.232)	(0.252)
Minimum Revenue Provision re PWLB loans	0.010	0.010	0.010
Net financing income from Treasury Management activities*	(0.172)	(0.132)	(0.152)

*There are financing costs associated with vehicle finance leases and the PFI agreements, which are not included in the balances above as they are not the result of Treasury Management activities.

Human Resource Implications

None

Equality and Diversity Implications

None

Environmental Impact

None

Business Risk Implications

The Treasury Management strategy is designed to minimise the Authority's financial risk associated with investment decisions, whilst maximising the return on any investments made. As such the adoption of the CIPFA's Code of Practice on Treasury Management and the monitoring arrangements in place ensure that any risks faced by the Authority are managed.

However, it must be acknowledged that there will always be a balance between risk and return and hence the strategy does not completely eliminate the risk of any further default on investments in the future.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact
CIPFA Treasury Management Code of Practice and Guidance	November 2011	Keith Mattinson
The Department of Communities and Local Government (CLG) guidance on local authority investments	March 2010	Keith Mattinson
Treasury Management in the Public Services: Code of Practice 2011 Edition.	November 2011	Keith Mattinson
Revenue and Capital Budget Reports	February 2018	Keith Mattinson
Reason for inclusion in Part II, if appropriate:		

APPENDIX 1

Treasury Management Policy Statement

The Authority's financial regulations require it to create and maintain a Treasury Management Policy Statement, stating the policies, objectives and approach to risk management of its treasury activities, as a cornerstone for effective treasury management.

Definition

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.

Risk management

The Fire 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, and any financial instruments entered into to manage these risks.

Value for money

The Fire 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.

Borrowing policy

The Fire Authority greatly values revenue budget stability and will therefore borrow the majority of its long-term funding needs at long-term fixed rates of interest. However, short term and variable rate loans may be borrowed to either offset short-term and variable rate investments or to produce revenue savings. The Authority will also constantly evaluate debt restructuring opportunities of the existing portfolio.

The Fire Authority will set an affordable borrowing limit each year in compliance with the Local Government Act 2003, and will have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy

The Fire Authority's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local authority services is an important, but secondary, objective.

The Fire Authority will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an Investment Strategy each year as part of the Treasury Management Strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.