Dorset Fire Authority

MEETING	Dorset Fire Authority
DATE OF MEETING	10 February 2015
OFFICER	Treasurer to the Fire Authority
SUBJECT OF THE REPORT	Treasury Management Strategy Statement and Prudential Indicators for 2015/16
EXECUTIVE SUMMARY	The CIPFA Prudential Code highlights particular aspects of the planning of capital expenditure and funding. The Code requires the publication and monitoring of certain Prudential Indicators which inform Members of the scope and impact of the capital spend. In addition, there are separate requirements under the CIPFA Treasury Management Code to publish a Treasury Management Strategy. This report sets out the issues for consideration and seeks agreement to the required indicators and strategies.
RISK ASSESSMENT	The Treasury Management policy carefully balances the acceptance and spread of borrower risk against the requirement to maximise returns. In addition, a potential budget risk exists if there is a shortfall against budget of interest earnings, or an increase against budget in the cost of borrowing, as a result of changes to interest rates or balances. The Authority is in an "under borrowed" position which it is meeting from internal resources, it will at some point have to address this issue and is therefore aware of the costs of long term borrowing over the next three years.
COMMUNITY IMPACT ASSESSMENT *Note: If the matrix indicates negative impacts on the community or staff, an equality impact assessment (EIA) will need to be completed.*	
BUDGET IMPLICATIONS	The budgetary implications of this report are included as part of the Revenue and Capital Budget reports on this agenda.
RECOMMENDATIONS	To approve: 1. The Prudential Indicators and Limits for 2015/16 to 2017/18. 2. The Minimum Revenue Provision (MRP) Statement. 3. The Treasury Management Strategy. 4. The Investment Strategy. That the Treasurer determines the most appropriate means of funding the Capital Programme.
BACKGROUND PAPERS	CIPFA Treasury Management Code of Practice Government Grant Settlement 2015/16 CIPFA Prudential Code for Capital Finance

APPENDICES	1. Treasury Management Investment Policy and Annexes 2. Schedule of Delegations
REPORT ORIGINATOR AND CONTACT	Richard Bates, Treasurer Tel: (01305) 228548

1. BACKGROUND

1.1 The Treasury Management function of the Authority, carried out by Dorset County Council, manages the cashflow, banking, money market transactions and long term debts, and in doing so manages the risks associated with these activities with a view to optimising interest earned and minimising the costs of borrowing. The cash turnover of the Authority from day to day activities is in excess of £80m a year; with roughly £40m a year cash inflows and £40m cash outflows. As a result the Treasury function within public sector organisations is highly regulated.

1.2 The Local Government Act 2003 introduced greater freedoms for Fire Authorities in relation to capital investment and the powers to borrow to finance capital works. To ensure that Authorities use their new powers responsibly, the Act requires the Authority to adopt the CIPFA Prudential Code and adhere to annually produced prudential indicators. The underlying objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with the best professional practice. There are 12 prudential indicators which summarise the expected capital activity and apply limits upon that activity and therefore the levels and types of borrowing. They reflect the outcome of the Authority's underlying capital appraisal systems.

1.3 Within this prudential framework there is an impact on the Authority's treasury management activity, as it directly impacts on its borrowing and/or investment activities. As a consequence the treasury management strategy is included as part of this report to complement these indicators. Some of the indicators are shown in the treasury management strategy part of this report to aid understanding.

1.4 This report revises the previously approved prudential indicators for 2015/16 and 2016/17, adds an extra year for 2017/18, and sets out the expected treasury operations for this period. It fulfils four key legislative requirements:

a) The reporting of the prudential indicators setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities);

b) The setting of the Authority's Minimum Revenue Provision (MRP) Policy, which states how the Authority will repay the borrowing made to fund capital purchases through the revenue account each year (as required by Regulation under the Local Government and Public Involvement in Health Act 2007, and in accordance with CLG Guidance);

c) The reporting of Treasury Management Strategy Statement which sets out how the Authority's treasury function will support the capital programme decisions, day to day treasury management and the restrictions on activity set through the treasury prudential indicators. The key indicators are required as part of the Local Government Act 2003 and is in accordance with

the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code.

d) The reporting of the investment strategy which sets out the Authority's criteria for choosing investment counterparties and how it minimises the risks faced. This strategy is in accordance with the CLG Investment Guidance.

1.5 The above policies and parameters provide an approved framework within which the officers undertake the day to day capital and treasury activities.

2. IMPACT OF PROPOSED COMBINATION

2.1 The Treasury Management Strategy has been written to cover a three year period from 2015/16 for Dorset Fire Authority. Clearly if the proposed combination with Wiltshire and Swindon Fire Authority goes ahead, a new Treasury Management Strategy will be required for the combined authority.

2.2 Also, once approved, any long term decisions such as new borrowing will need to be considered in the context of the existing profile of borrowing within both authorities. Consideration will also need to be given to the joint level of investments held with any institution prior to combination.

2.3 Work on a new Treasury Management Strategy for the combined authority will be progressed once combination is approved and will deal with any transitional implications.

3. CAPITAL PROGRAMME PRUDENTIAL INDICATORS

3.1 The Prudential Indicators (PIs) are driven by the Authority's Capital Programme plans. The Capital Programme influences all borrowing decisions made by the Authority and the subsequent Treasury Management activity associated with this. The PIs are also influenced by the wider Authority decisions and the effect of the revenue and capital proposals, included in the reports elsewhere on this agenda. All assumptions in this report are consistent with the Medium Term Financial Plan.

3.2 The Prudential Indicators are based on the report on the Capital Programme 2015/16 to 2017/18, elsewhere on this agenda. The figures quoted in this report are therefore subject to amendment depending on decisions made by the Dorset Fire Authority when considering the report.

Prudential Indicator 1 – Capital Expenditure

3.3 The first requirement of the Prudential Code is that the Authority must make reasonable estimates of the total capital expenditure it intends to incur over the following three financial years. Table 1 illustrates the actual and anticipated level of capital expenditure for the five years 2013/14 to 2017/18 and is the starting point for setting the rest of the PIs.

Table 1 – PI 1 Gross Capital Expenditure 2013/14 to 2017/18

	2013/14 £000 Actual	2014/15 £000 Estimate	2015/16 £000 Estimate	2016/17 £000 Estimate	2017/18 £000 Estimate
IT & Communications	101	196	324	72	113
Management Information Systems	0	0	75	0	0
Operational Equipment	104	116	227	164	123
Vehicles	1,014	503	2,741	1,536	1,576
Station Improvements	247	506	205	250	270
TOTAL	**1,466**	**1,321**	**3,572**	**2,022**	**2,082**

3.4 The capital programme is typically around £1-2m per annum, however there is a known spike in spending in 2015/16 due to planned vehicle replacements. Assumptions have been made about the likely level of government capital grant for 2015/16, but there are no figures for future years. The capital programme will therefore alter over time if new grants are received, which will be reported in subsequent reports.

3.5 The capital programme assumes that funding is from borrowing except where there are known capital grants, capital receipts in the year, or capital reserves can be utilised. Capital expenditure which cannot be immediately financed, or paid for, through revenue or capital resources (such as capital receipts), will require funding through either new borrowing or the utilisation of available cash resources pending borrowing. It is the new borrowing, together with existing borrowing, which has to be prudent, affordable and sustainable which forms the main element of the Prudential Code and drives PIs 2 to 7. Proposals on the level of borrowing for capital purposes are shown at paragraph 6.3 of this report and are set out for approval in the Revenue and Capital reports on this agenda.

Prudential Indicator 2 – The Capital Financing Requirement

3.6 The capital financing requirement (CFR) measures the Authority's underlying need to borrow for capital purposes. This figure includes all long term borrowing as well as financing that is implicit in Private Finance Initiative schemes and finance leases.

3.7 As part of a proactive and efficient Treasury Management Strategy, the Authority does not differentiate between cash held for revenue purposes and cash held to fund the capital programme. At any point in time the Authority has a number of cash flows, both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices.

3.8 External borrowing arises from long term funding of capital spend and short term cash management if required, and as such can fluctuate over a number of months and years. In contrast, the capital financing requirement reflects the Authority's underlying need to borrow for a capital purpose. The CIPFA Prudential Code includes the following as a key indicator of prudence:

"In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years."

3.9 This basically means that the Authority can only borrow for capital purposes and only for the capital expenditure it has set out and approved over the course of its three year capital programme. Estimates of the end of year capital financing requirement for the Authority for the current and future years and the actual capital financing requirement at 31 March 2014 are:

Table 2 Capital Financing Requirement Actual and Forecast 2013/14-2017/18

	2013/14 £000 Actual	2014/15 £000 Estimate	2015/16 £000 Estimate	2016/17 £000 Estimate	2017/18 £000 Estimate
Debt	15,900	15,264	15,578	16,476	17,399
Long Term Liabilities	16,000	15,295	14,592	13,904	13,240
CFR	**31,900**	**30,559**	**30,170**	**30,380**	**30,639**

3.10 The Authority has adopted a strategy of trying to maintain its CFR at around £16m for long term debt (excluding PFI and other long term liabilities), by applying grants and internal resources rather than take on new borrowing.

Prudential Indicator 3 – Ratio of Financing Costs to Net Revenue Stream

3.11 PI 3 expresses the net costs of financing the capital programme as a percentage of the funding receivable from the Government and council tax payers, expressed as a ratio. The net cost of financing includes interest and principal repayments, netted off by interest receivable in respect of any cash investments held.

3.12 Previously, borrowing was largely supported by central government through the Revenue Support Grant. Only borrowing that was not supported by the Government would be taken into account in this measure. However, the introduction of the new formula grant system and in particular formula damping, means it is no longer possible to demonstrate that Government supported borrowing costs were exactly covered by Government grant. This PI therefore considers the cost of all borrowing in relation to the net revenue budget.

Table 3 – Interest and Repayment costs as a Proportion of the Net Revenue Budget

	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Ratio	3.4%	3.3%	3.2%	3.4%	2.9%

3.13 In simple terms, this PI is similar to expressing a household's mortgage interest and repayment costs as a proportion of its income.

Prudential Indicator 4 – Estimate of Incremental Impact of Capital Investment Decisions on the Council Tax

3.14 This indicator estimates the extra cost of capital investment decisions proposed in this budget report, over and above capital investment decisions that have previously been taken by the Authority. Where new capital expenditure is to be financed by borrowing there will be an additional financing cost and this PI represents it in terms of its impact on the level of council tax. It does not mean that council tax will increase by this amount as corresponding efficiencies are made elsewhere in the budget. It acts to illustrate the impact of the capital investment decisions on council tax if taken in isolation.

3.15 Capital expenditure decisions financed by borrowing could in fact feed through to a reduction in the level of council tax if the investment made allows savings to be realised, for example, the capital investment on building a new fire station might release sufficient revenue savings to enable a reduction to the level of council tax.

3.16 The figures below represent the extra estimated cost in each year of the additional borrowing if it were all funded from council tax.

Table 4 Impact of Capital Expenditure decisions on the level of council tax

	2015/16 £	**2016/17 £**	**2017/18 £**
Cost of capital programme on Band D council tax	0.26	0.43	0.46

4. MINIMUM REVENUE PROVISION POLICY STATEMENT

4.1 The Authority is required to make a provision (charge to the revenue account) for the repayment of any borrowings it has each financial year, regardless of whether any actual debt is repaid. The Department for Communities and Local Government, (CLG) requires that before the start of each financial year the Authority should prepare a statement of its policy on making such provisions, known as the Minimum Revenue Provision (MRP) for that year.

4.2 The Authority is required to calculate for the current financial year an amount of MRP which it considers to be prudent. The broad aim of prudent provision is to ensure that its underlying borrowing need, as expressed by the CFR, is repaid over a period reasonably commensurate with the life of the capital assets that the borrowing has financed. The statement should indicate which of the options for MRP are to be followed.

4.3 Whilst the CLG Regulations revoke previous MRP requirements, Authorities are allowed to continue historical accounting practice.

4.4 The Authority is recommended to approve the following MRP Statement:

a) For capital expenditure incurred before 1 April 2008 or which is Supported Capital Expenditure, the MRP policy will be based, as now, on the CFR.

b) From 1 April 2008 for all unsupported borrowing, the MRP policy will be based on the Asset Life Method. MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must also be applied for any expenditure capitalised under a Capitalisation Directive).

5. TREASURY MANAGEMENT STRATEGY 2015/16 TO 2017/18

5.1 The capital expenditure plans summarised in Section 2 provide details of the service activity of the Authority. The treasury management function ensures that the Authority's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet the service activity. This involves the organisation of the cash flow and, where capital investment plans require, the organisation of appropriate borrowing facilities.

5.2 The treasury management service is therefore an important part of the overall financial management of the Authority's affairs. The prudential indicators consider the affordability and impact of capital expenditure decisions, and set out the Authority's overall capital framework. The Treasury Management service considers the effective funding of these decisions. Together they form part of the process which ensures the Authority meets its balanced budget requirement under the Local Government Finance Act 1992.

5.3 The Authority's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised 2011). The Authority adopts the Code of Practice on Treasury Management and its revisions, which in itself is a key Prudential Indicator that it has complied with. As a result of adopting the Code, the Authority also agreed to create and maintain a Treasury Management Policy statement (TMPs) which states the policies and objectives of the Authority's Treasury Management activities.

5.4 It is a requirement for an annual strategy to be reported to the Authority outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid year monitoring report.

5.5 The strategy document covers:

a) An update on deposits held with the Icelandic Banks

b) A consideration of the economic outlook and the prospects for interest rates

c) An outline of the forecast cash position of the Authority

d) The borrowing strategy

e) The prudential indicators that affect the borrowing strategy

f) The investment strategy for the year

g) An analysis of sensitivities to interest rates

h) The Performance Indicators

i) Treasury Management Advice

j) Member and Officer Training

Icelandic Banks Update

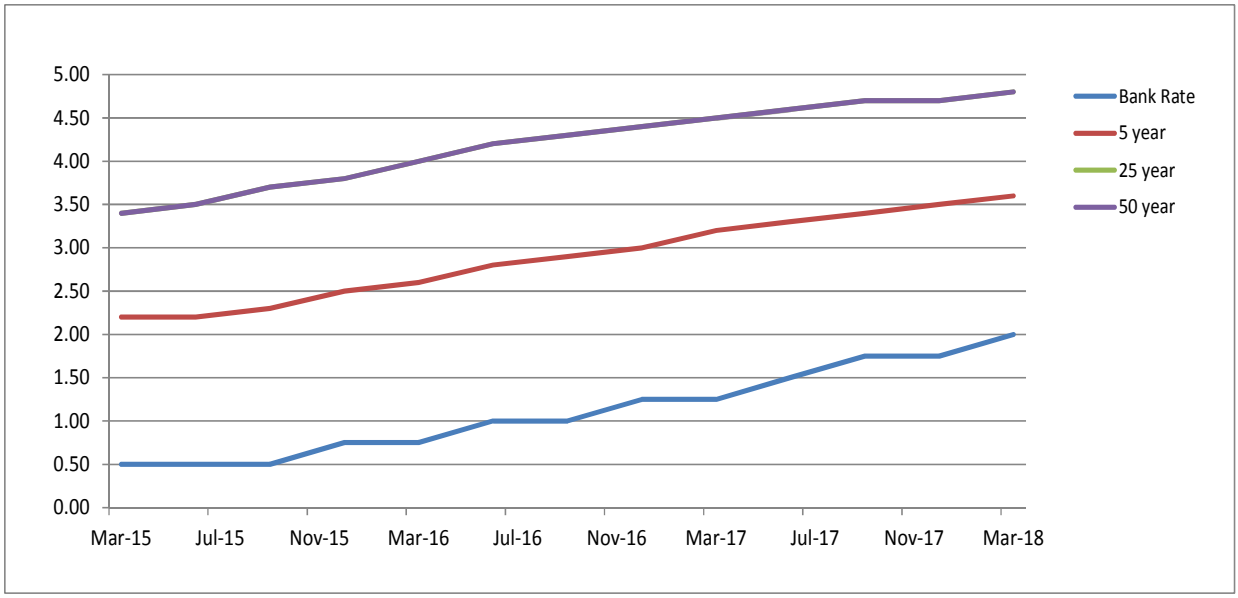
5.6 Members will be aware that in September 2008 Dorset Fire Authority made a temporary loan to Heritable Bank, totalling £1 Million. This was a fixed term loan at an interest rate of 5.88% repayable on 30 January 2009. At the time that this loan was made, Heritable Bank met the criteria set by the Treasury Management Policy.

5.7 To date we have received fourteen separate repayments totalling £944k, or 94% of our claim. We anticipate that some further small repayments may be received but the debt has been fully written off in the Authority's accounts.

Economic Outlook and Prospects for Interest Rates

5.8 The Authority has appointed Capita Asset Services as its treasury management adviser, and part of this service is to assist the Authority to form a view on interest rates. Chart 1 shows Capita's interest rate projections for key borrowing rates to March 2017, based on the medium term economic outlook.

Chart 1



5.9 UK GDP growth surged during 2013 and the first half of 2014. Since then it appears to have subsided somewhat but still remains strong by UK standards and

is expected to continue likewise into 2015 and 2016. Capita believes that there needs to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this recovery to become more firmly established. One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling disposable income and living standards to start improving. The plunge in the price of oil brought CPI inflation down to a low of 1.0% in November, the lowest rate since September 2002. Inflation is expected to stay around or below 1.0% for the best part of a year; this will help improve consumer disposable income and so underpin economic growth during 2015. However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer disposable income and economic growth. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen early in 2015.

5.10 A rebalancing of the economy towards exports has started but as 40% of UK exports go to the Eurozone, the difficulties in this area are likely to continue to dampen UK growth. The US, the main world economy, faces similar debt problems to the UK, but the US has seen reasonable growth, cuts in government expenditure and tax rises, meaning the annual government deficit has been halved from its peak without appearing to do too much damage to growth. The US, the biggest world economy, has generated impressive growth rates of 4.6% (annualised) in Quarter 2 2014 and 5.0% in Quarter 3. This is very promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path of full recovery from the financial crisis of 2008. Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by mid 2015.

5.11 The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

a) The general election in Greece on 25 January 2015 has brought a political party to power which is anti EU and anti austerity. If this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strenthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify;

b) As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that

could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

c) Investment returns are likely to remain relatively low during 2015/16 and beyond;

d) Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the likelihood that the ECB will commence quantitative easing (purchase of EZ government debt) in early 2015. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;

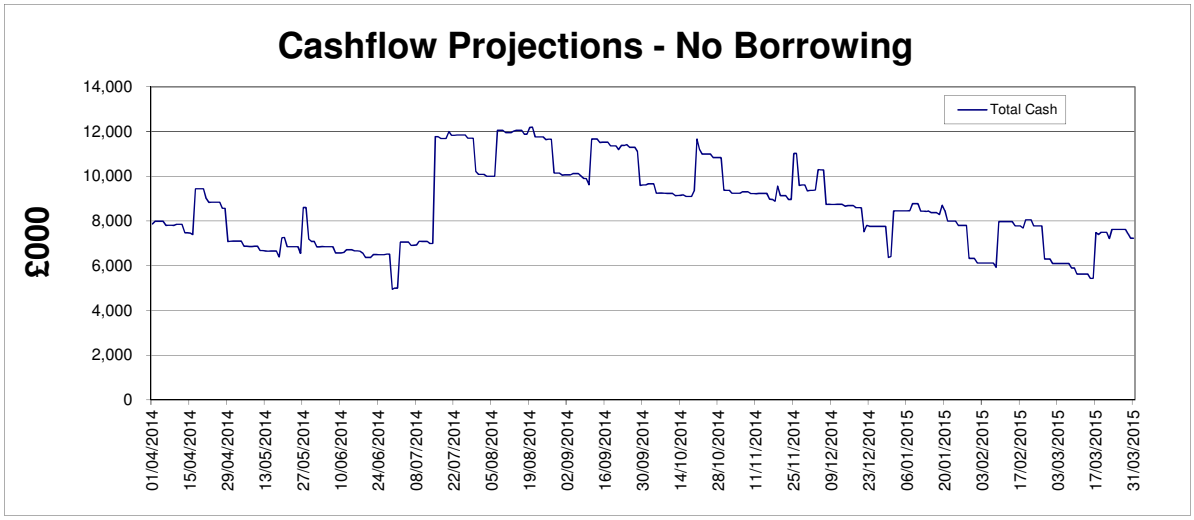
e) There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss caused by high borrowing costs and low investment returns.

Day to Day Cash Management Activity

5.12 The Authority's cash balances will fluctuate throughout the year as income is received and expenditure is made. Chart 2 shows the projected cashflow position assuming that no additional borrowing is taken. It shows cash balances fluctuate between major receipt days, when government grant or the council tax precepts are received and major payment days such as the employee payroll. The maximum level of cash balances is expected to be around £13m and the minimum around £7m.

5.13 The Authority is required by law to set a balanced budget, meaning that its cash in-flows should broadly match its cash outflows over the medium term. The chart provides a useful guide to officers when formulating the borrowing and investment strategy.

Chart 2 – Dorset Fire Authority Cashflow Forecast 2015/16



5.14 This cash flow forecast is based on the high level budget figures and historic trends. The budget for interest earnings is based on the cash flow as set out above (average balance £10m) with an average interest rate of 0.5%, average balances will be affected if any long term borrowing is taken during the year.

Borrowing Strategy

5.15 The Authority can borrow long term funds from three main sources:

a) The Public Works Loans Board (PWLB) is the government agency that provides long term funding to local authorities, with loans priced according to the gilt markets. Loans can be taken for periods of 1 to 50 years at fixed or variable rates.

b) The Banking Sector also offer long term 'market' loans. Although these tend to take the form of Lender Option Borrower Options (LOBO) loans, which can be taken over periods of 40-70 years, all types of loans will be considered if they are consistent with the borrowing strategy. The LOBOs usually have a fixed rate of interest for a period of time (normally 1 – 10 years) at the start of the loan, after which the lender has the option to change the interest rate. If the option is called the borrower then has an option whether to accept or repay the loan. The risks are that the borrower is left with higher refinancing costs at the time of the option, or that market rates have fallen during the option period and the borrower is locked into uncompetitive rates. The relatively small number of loans that the Authority has, and the long maturity periods associated with LOBOs mean that it would be imprudent to take such loans.

c) Internal Borrowing from Revenue Balances can be used to fund the capital programme. Cash balances are built up over time from the Authority's ongoing activities, and as the Authority builds up reserves and makes provisions these are reflected in the cash balances it holds. The cash held can be used to finance the capital programme, instead of borrowing

externally. In reality the decision to borrow from cash balances will depend on the prevailing interest rate environment.

5.16 The borrowing strategy is affected by the economic outlook and prospects for interest rates. The low investment returns (c.0.5%) compared to the cost of borrowing (c.4%) has meant the Authority has been using its cash balances to fund capital spend rather than borrow. This has resulted in the Authority's level of debt being lower than its CFR. This strategy means the Authority was 'under borrowed' by £6.7m at the last balance sheet date, 31 March 2014. The forecast under borrowed position at 31 March 2015 is £6.1m. This strategy is deemed to be a prudent approach because of current low investment returns and relatively high counterparty risk.

5.17 However, with borrowing costs forecast to increase, as depicted in Chart 1, and given the current relatively high level of internal borrowing, attention needs to be turned to adjusting the balance between internal and external borrowing. Over the next two years it may be prudent to borrow at the current borrowing rates and incur a cost of carry (the difference between the rate of interest earned on investments against the cost of borrowing), in the anticipation that future long term borrowing costs are likely to be higher. The Treasurer will continue to monitor interest rates in the financial markets and adopt a pragmatic approach to changing circumstances when making borrowing and investment decisions.

5.18 The Treasurer will regularly review opportunities to reschedule borrowing whereby debts at a higher rate of interest are repaid and rescheduled at a lower interest rate. However, the restructuring penalties (premiums) charged by the PWLB generally make such restructurings expensive and therefore unviable at current market rates.

6. TREASURY MANAGEMENT PRUDENTIAL INDICATORS 2015/16 TO 2017/18

6.1 The Prudential Code places a number of restrictions on the debt management activities of the Council. These are to restrain the activity of the treasury function within certain limits to manage risk and reduce the impact of any adverse or sudden movements in interest rates. However, the limits have to be with sufficient flexibility to allow costs to be minimised and performance maximised.

Prudential Indicator 5 – External Debt

6.2 The Authority needs to ensure that its long term gross debt does not exceed the projected CFR for the third year of the capital programme plans (the 2017/18 projected CFR in the case of this plan). This prevents the Authority from over borrowing in the long term and thereby taking on excessive levels of debt, which could be unaffordable or unsustainable. However, it does afford the Authority the flexibility to borrow in advance of need if borrowing rates are favourable.

6.3 External debt and other long term liabilities (including PFI contract and finance lease commitments) stood at £25.2m as at the balance sheet date of 31 March

2014. This is less than the CFR, which, at the same date, stood at £31.9m. Estimates of borrowing for 2014/15 to 2017/18 are summarised in Table 5 and reflect a reduction in the amount of under borrowing.

Table 5 – External Debt Actual and Estimates 2013/14 to 2017/18

External Debt	2013/14 Actual £000	2014/15 Estimate £000	2015/16 Estimate £000	2016/17 Estimate £000	2017/18 Estimate £000
Debt at 1 April	13,314	9,158	9,158	10,058	11,558
Expected change in Debt	-4,156	0	900	1,500	1,600
PFI / Finance Lease Liabilities	16,709	16,000	15,295	14,592	13,904
Expected change in PFI Liabilities	-709	-705	-703	-688	-664
Actual gross debt at 31 March	**25,158**	**24,453**	**24,650**	**25,462**	**26,398**

Prudential Indicators 6 and 7 – Operational Boundary and Authorised Limits for External Debt

6.4 These indicators are at the core of the Prudential Code and reflect the limits that the Authority imposes upon itself in relation to external borrowing.

6.5 The Operational Boundary is the limit beyond which external debt is not normally expected to exceed. In the majority of cases this should be a level similar to the CFR, plus an allowance for any short term borrowings that might be required for cash management purposes or unexpected calls on capital resources. It is the key management tool for in year monitoring of the Authority's expected capital and cashflow borrowing position.

Table 6 Operational Boundary for External Debt 2014/15 to 2017/18

	2014/15 £000	2015/16 £000	2016/17 £000	2017/18 £000
Borrowing	17,000	18,000	18,000	19,000
Other long term liabilities	17,000	15,000	14,000	13,000
Total Operational Boundary	**34,000**	**33,000**	**32,000**	**32,000**

6.6 The proposed operational boundaries for external debt set out in Table 6 are based on the most likely, prudent, but not worst case scenario to allow for unusual cash movements, for example. For reference purposes they include the estimated level of CFR, and estimated levels of borrowing for each year.

6.7 The Authorised Limit for external debt uses the Operational Boundary as the starting point but includes a margin to allow for unusual and unpredicted cash movements. By its very nature, this margin is difficult to predict and it will be necessary to keep it under review for future years.

6.8 The Authorised Limit may not be affordable or sustainable in the long term, but represents the absolute maximum level of debt the Authority can hold at any given time. It is a statutory limit determined under section 3 (1) of the Local Government Act 2003, and any breach will be reported to the Authority, with the Government

having the option to control the plans of the Authority. An allowance has been added to the operational boundary to provide for the possibility of extra borrowing becoming available during the year as the result of the Government supporting further schemes, as well as providing some headroom if the projection of cashflow borrowing were to change.

6.9 In respect of its external debt, it is recommended that the Fire Authority approves the authorised limits, set out in Table 7, for its total external debt for the next three financial years. These limits separately identify borrowing from other long term liabilities such as finance leases.

Table 7 Authorised Limit for External Debt 2014/15 to 2017/18

	2014/15 £000	**2015/16 £000**	**2016/17 £000**	**2017/18 £000**
Borrowing	19,000	20,000	20,000	21,000
Other long term liabilities	17,000	15,000	14,000	13,000
Total	**36,000**	**35,000**	**34,000**	**34,000**

6.10 The Authority is asked to delegate authority to the Treasurer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities on both the operational boundary and authorised limits. Any such changes made will be reported to the Authority at its next meeting following the change.

Prudential Indicators 8, 9 and 10 – Limits on interest rate exposure and maturity of debt

6.11 These three PIs are designed to minimise exposure to fluctuations in interest rates and refinancing risks, and also cap the interest costs of borrowing to provide stability to this area of the Authority's finances. The indicators are detailed below and illustrated in Table 8 and Chart 2:

a) Upper limit on fixed interest rate exposure – this identifies a maximum revenue cost of interest paid on fixed rate debts and is intended to prevent the Authority from being locked into rates of interest that it cannot easily exit.

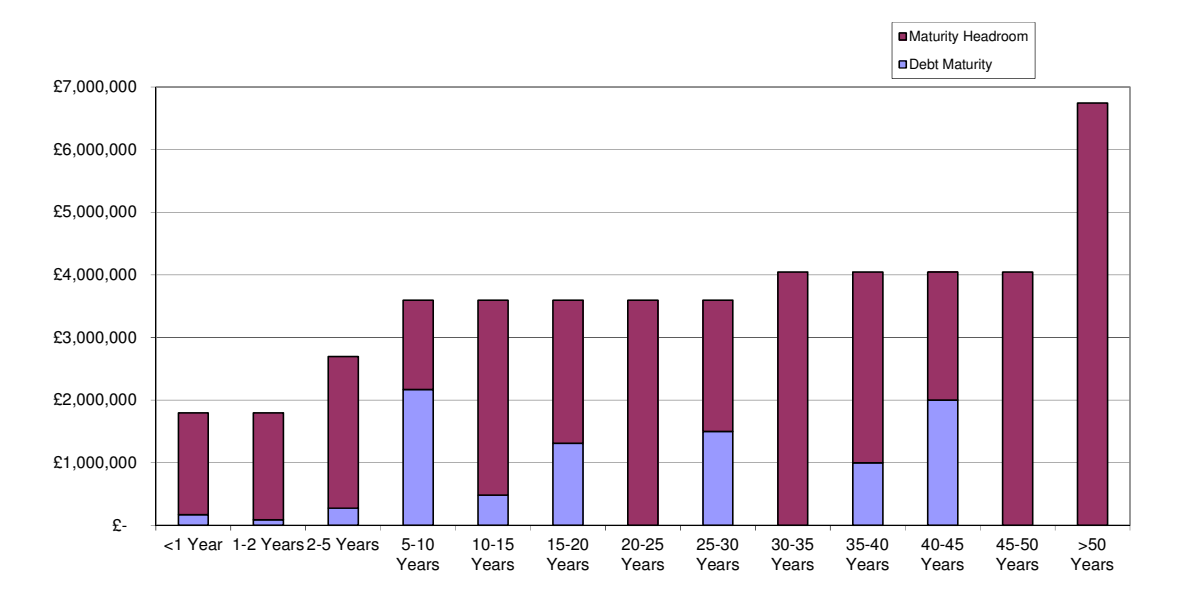
b) Upper limit on variable interest rate exposure – this identifies a maximum revenue cost of interest paid on variable debts, which is designed to minimise the budget exposure of the Authority to movements in interest rates, a sudden increase in variable interest rates can cost the Authority a significant sum of money, which this limit is intended to cap.

c) Maturity Structure of Borrowing – this identifies the maximum level of exposure to loans maturing (being repaid) in any given year. The rationale is to prevent the Authority from having adverse cashflow difficulties if a large proportion of its loans have to be repaid in the same year. Chart 3 shows the current maturity profile, in relation to the limits that have been chosen.

Table 8 – Limits on Interest Exposure and Maturity of Debt

	2015/16 Upper £000	2016/17 Upper £000	2017/18 Upper £000
PI 9 Limits on net fixed interest rates payments	1,000	1,000	1,100
PI 10 Limits on net variable interest rate payments	200	200	200
PI 11 Maturity Structure of fixed interest rate borrowing 2015/16		**Lower**	**Upper**
Under 12 Months		0%	15%
12 Months to 2 Years		0%	15%
2 Years to 5 Years		0%	25%
5 Years to 10 Years		0%	35%
10 Years to 15 Years		0%	35%
15 Years to 20 Years		0%	35%
20 Years to 25 Years		0%	45%
25 Years to 30 Years		0%	45%
30 Years to 35 Years		0%	45%
35 Years to 40 Years		0%	45%
40 Years to 45 Years		0%	45%
45 Years to 50 Years		0%	45%
50 Years and above		0%	75%

Chart 3 – Debt Maturity Profile and Headroom – Projected for 31 March 2015



7. ANNUAL INVESTMENT STRATEGY

7.1 Cash balances are invested on a daily basis using the London Money Market, call accounts, pooled money market funds and by making deposits with the Authority's bank. Longer term investments can also be made; and in the current market, such

investments earn more interest than the shorter term investments, however, there is a balance to be achieved between ensuring availability of cash to pay the bills and taking advantage of these higher interest rates. In the current banking and financial climate there is also a higher risk of counterparty default. In practice there will be a range of investments, but with a current bias heavily towards shorter term deposits.

7.2 The primary objectives of the Authority's investment strategy are detailed in the Investment Policy detailed in Appendix 1. The objectives, in order of priority are:

a) The security of funds invested – ensuring that the funds will be repaid by the counterparty to the Authority at the agreed time and with the agreed amount of interest;

b) The liquidity of those funds – ensuring the Authority can readily access funds from the counterparty;

c) The rate of return – ensuring that given a) and b) are satisfied that return is maximised.

7.3 The Investment Policy takes into account the economic outlook and the position of the banking sector in assessing counterparty security risk. Since the banking crisis of 2008, there continue to be underlying concerns about both the shape of the economy and the stability of the banking sector meaning the operational investment strategy adopted by the Authority has tightened the controls already in place in the approved investment strategy. In doing so the Authority will ensure:

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Authority's prudential indicators covering the maximum principal sums invested.

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security. This is set out in the Specified and Non-Specified investment sections explained in Annex A of the Investment Policy. Risk of default by an individual borrower is minimised by placing limits on the amount to be lent.

7.4 The Policy introduces further measures that are taken to minimise counterparty risk, as a result officers work to:

- a prescribed list of countries that it can invest in;

- a list of institutions that it can invest with,

- maximum cash limits that can be invested with these institutions, and

- restrictions on the length of time investments can be held with these approved institutions.

7.5 The counterparty list is maintained by Capita Asset Services, our treasury management advisers, who monitor it on a real time basis. The Authority receives a weekly update, but a new list can be distributed at any time if there is any adverse news about any of the institutions on it.

7.6 The result of the Investment Policy and because of the prevailing economic backdrop, the Authority seeks to maintain liquidity, and as a result has set a Weighted Average Life benchmark for investments of around 1.3 years with a maximum of 2.0 years. As at 19 January 2015 the Weighted Average Life of the Authority's investments was 0.2 years (69 days). This reflects that the Authority had only £2 Million of investments at this time maturing in over six months, £3m maturing in three to six months and the remaining amounts maturing overnight in either Call Accounts or Money Market Funds.

7.7 In addition to the restrictions that the Authority places upon itself to maximise security, ensure liquidity and maximise yield, the prudential code sets limits on the maximum period of time monies can be invested for. These are illustrated in Table 9.

Table 9 Prudential Indictors 12 – Maximum principal sums invested >364 days

	2015/16 £000	**2016/17 £000**	**2017/18 £000**
Maximum Total Principal sums invested > 364 days	2,000	2,000	2,000
% of which can be up to 2 years	100%	100%	100%

8. SENSITIVITY TO INTEREST RATE MOVEMENTS

8.1 The Authority's accounts are required to disclose the impact of risks on the Authority's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. Table 10 highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year (the Authority has no borrowings at variable rates of interest).

Table 10 Impact on Revenue Budget of a 1% Change in Interest Rates

	Variable Rate Debts / Investments £000	**2015/16 Estimated + 1% £000**	**2015/16 Estimated - 1% £000**
Interest on Borrowing*	0	0	0
Investment Income**	10,000	100	(100)
Net Benefit / (Cost) to Council		100	(100)

**the authority has no variable rate debts **average projected balances*

9. RISK ASSESSMENT

9.1 The primary risks to which the Authority is exposed in respect of its treasury management activities are adverse movements in interest rates and the credit risk of its investment counterparties. Either may jeopardise the Authority's ability to maintain its financing strategy over the longer term.

9.2 The net interest costs of the Authority are not significant in relation to its overall revenue budget. Significant changes in the level of interest rates are unlikely to result in an unmanageable burden on the budget position of the Fire Authority.

9.3 Treasury Management risk is minimised in the following ways:

- diversification of lending by setting criteria and limits for investment categories and individual borrowers. Risk is controlled by the formulation of suitable criteria for assessing and monitoring the credit risk of borrowers and the construction of the lending list comprising time, type, sector and specific counterparty limits. This is covered in more detail in the following section.

- balancing cash flow needs, as determined by the forecast, with the outlook for interest rates, whilst ensuring enough cover for emergencies.

- use of money market funds and longer term lending to enhance diversification.

9.4 In addition, the CIPFA Code requires the policy to show who is responsible for which decision, the limits on the delegation and reporting requirements. This has been in place for some years and is reproduced at Appendix 2.

9.5 The Authority's Treasury Management Practices document sets out in detail the systems and processes (including internal checks) that have been introduced to reduce the risk of losses due to fraud, negligence and error.

10. PERFORMANCE INDICATORS

10.1 The Code of Practice on Treasury Management requires the Authority to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt – Borrowing – Average rate of borrowing for the year compared to average available

- Debt – Change in the average cost of debt year on year

- Investments – Internal returns above the 7 day LIBID rate

10.2 The most effective way of measuring performance is to undertake benchmarking against other similar sized authorities which the Authority will take part in during

2015/16. The results of these indicators and benchmarking will be reported in the Treasury Management Annual Report.

11. TREASURY MANAGEMENT ADVISERS

11.1 The Authority uses Capita Asset Services as its treasury management advisers. Capita provide a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies;

11.2 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice, the final decision on treasury matters remains with the Authority. This service is subject to regular review.

12. MEMBER AND OFFICER TRAINING

12.1 The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. Dorset Fire Authority offers training for members where it is felt to be appropriate and relevant.

12.2 The Dorset County Council's treasury management team is made up of experienced officers who regularly attend national treasury management events and training courses and meet with treasury management advisers in order to stay up to date with latest developments in Treasury Management.

13. CONCLUSION

13.1 This report sets out the Treasury Management Strategy for 2015/16 and in particular shows the anticipated cash flow for the Authority and how in practice this is to be managed to optimise interest earnings and minimise borrowing cost whilst meeting daily cash needs.

13.2 An extensive risk analysis has been carried out on the Treasury Management operation supported by the Fire Authority's treasury management advisers and it is considered that a high level of risk avoidance has been established by the combination of revised policies and working practices in place. Particular attention

is given to the quality of lenders used and the processes used on a day to day basis to avoid any losses due to fraud, negligence, and error.

13.3 Various options exist regarding the precise manner in which the capital programme is financed, and these are highlighted in paragraph 5.15. The Code of Practice provides that final decisions on the actual financing of capital expenditure, rests with the Treasurer after taking advice from Capita Asset Services. Members will be aware that the Treasurer is looking at means of utilising cash balances to minimise the effect of borrowing.

13.4 As required by the Code, the report sets out the required Prudential Indicators and in accordance with the guidance any revisions required will be brought to the Fire Authority for approval.

Richard Bates

Treasurer

January 2015

APPENDIX 1

Dorset Fire Authority - Investment and Credit Worthiness Policy

1. Introduction: changes to credit rating methodology

1.1 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during 2014/15 and / or 2015/16. The Council has pre-empted these expected changing by making changes to its credit methodology during 2014.

1.2 It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

1.3 Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.

1.4 Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a possibility of external support, but it cannot be relied upon." With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

1.5 As a result of these rating agency changes, the credit element of Capita's future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that Capita have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, Capita will continue to utilise CDS prices as an overlay to ratings in our new methodology.

2. Investment Policy

2.1 The Authority's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Authority's investment priorities will be security first, liquidity second, then return.

2.2 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Authority applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

2.3 Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

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

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

2.6 Investment instruments identified for use in the financial year are listed in Annex A of this Policy under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Authority’s treasury management practices schedules.

3. Creditworthiness Policy

3.1 The primary principle governing the Authority’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Authority will ensure that:

- It maintains this policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in Annex A - Specified and Non-Specified investments; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Authority’s prudential indicators covering the maximum principal sums invested.

3.2 Risk of default by an individual borrower is minimised by placing limits on the amount to be lent. These limits use, where appropriate, credit ratings from Fitch, Standard and Poors, and Moodys Credit Rating Agencies. All banks and building societies used by Dorset Fire Authority will have a long term rating of at least A and a minimum short term rating of F1. Long/term ratings vary from AAA (the highest) down to D the lowest. Short term ratings vary from F1+ (the highest) down to D. Individual ratings vary from A (the highest) down to E, and these are now being replaced by viability ratings (aaa the highest, to c the lowest) and estimate how likely the bank is to need assistance from third parties. Local authorities are not generally rated. The limits to be used are set out in paragraph 3.8.

3.3 The Treasurer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the Authority for approval at

least annually. These criteria are separate to that which determines which type of investment instrument are either Specified or Non-Specified investments as it provides an overall pool of counterparties considered to be high quality that the Authority may use, rather than defining what its investments are.

3.4 The minimum rating criteria uses the Lowest Common Denominator (LCD) method of selecting counterparties and applying limits. This means that the application of the Authority's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Authority's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

3.5 Credit rating information is supplied by the Authority's treasury management advisers on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Authority criteria will be suspended from use, with all others being reviewed in light of market conditions.

3.6 A development in the revised Codes and the CLG Investment Guidance is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting, although the application of these is more subjective in nature.

3.7 Security and Liquidity benchmarks are simple guides to maximum risk and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Annual Report.

Security

3.8 The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) are:

i. Sovereign Ratings

3.8.1 The Authority will only lend to counterparties in countries with the highest Sovereign Credit Rating of AAA. The maximum that can be deposited with banks in any one sovereign is £3 Million at any time. The exception to both rules is the United Kingdom.

ii. Counterparties with Good Credit Quality

3.8.2 The Authority will lend to counterparties with the following counterparty ratings:

Table 1 Counterparty Ratings

Category	Minimum Credit Rating	Limit
Any Local Authority	n/a	£1.5 Million
Banks & Building Societies	Short F1, Long A-	£1.5 Million
Money Market Funds	AAA	£1.5 Million (individual)
Money Market Funds Notice Account	AAA	£1.0 Million (individual)
UK Government including gilts and the Debt Management Account Deposit Facility (DMADF)	n/a	no limit

3.8.3 Where a counterparty is part of a larger group, it is appropriate to limit the Authority's overall exposure to the group. Individual counterparties within the group will have their own limit, but will be subject to an overall limit for the group. The limit for any one group will be £1.5 Million, except in the case of the four major UK banking groups where the limit would be £3 Million.

iii. Part Nationalised Banking Groups

3.8.4 The Authority will continue to use banking groups whose ratings fall below the criteria specified above if that banking group remains part nationalised, up to a limit of £3m for the group.

iv. Authority's own banker

3.8.5 The limit for the Authority's own bank is £3 Million, however, due to occasional short term unexpected cashflows this limit may be breached. For this reason additional flexibility of an additional £250k is allowed to cover such movements, and to minimise the transaction costs involved with moving small sums of money. Over the long term the £3 Million should be the maximum. The breaches of the £3 Million limit will be monitored and reported to the Treasurer on a monthly basis.

3.8.6 It is inconceivable that the Authority would not be able to use its own banker, NatWest for transactional purposes if the bank fell below the Authority's criteria. If this occurred then NatWest would continue to be used for transactional and clearing purposes with the maximum position limited to £250k.

v. Major UK Banks

3.8.7 The Authority may invest up to £3 Million with each of the four major UK banking groups, Barclays Bank PLC, HSBC Bank PLC, Lloyds Banking Group PLC, and The Royal Bank of Scotland PLC (which owns the Authority's bank, National Westminster Bank PLC), taking into account the restrictions of group limits and any other limits which apply. These four banking groups were added explicitly to the Treasury Management Strategy with the rationale that in a worst case scenario, all of the Authority's cash could be placed across these four banks.

vi. Use of Additional Information other than Credit Ratings

3.8.8 Additional requirements under the Code of Practice now require the Authority to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches / outlooks) will be applied to compare the relative security of differing investment counterparties.

3.9 Security is a subjective area to measure and assess. Whilst the approach above embodies the security considerations of credit ratings, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Authority's investment strategy. Table 1 shows average defaults for differing periods of investment grade products for Fitch, Moody's and Standard and Poors long term rating category over the period 1990 to 2011.

Table 2 Long term risks of default

Years	1	2	3	4	5
AAA	0.00%	0.01%	0.05%	0.10%	0.17%
AA	0.03%	0.06%	0.08%	0.14%	0.20%
A	0.08%	0.22%	0.37%	0.52%	0.70%
BBB	0.24%	0.68%	1.19%	1.79%	2.42%
BB	1.22%	3.24%	5.34%	7.31%	9.14%
B	4.06%	8.82%	12.72%	16.25%	19.16%
CCC	24.03%	31.91%	37.73%	41.54%	45.22%

3.10 The average expectation of default for a one year investment in a counterparty with a "A" long term rating would be 0.08% of the total investment (e.g. for a £1m investment the average loss would be £800). This is only an average – any specific counterparty loss is likely to be higher, but these figures do act as a proxy benchmark for risk across the portfolio.

Liquidity

3.11 Liquidity is defined as an organisation "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice).

3.12 In addition it is prudent to have rules for the balance of investment between short term and longer term deposits to maintain adequate liquidity. They are:

i. Fixed Term Investments

3.13 A minimum cash balance of £1.5 Million must be maintained in call accounts or instant access Money market Funds. Any amount above this can be invested in fixed term deposits.

ii. Notice Money

3.14 The amount of notice money (short term) will be a minimum of £1.5 Million, up to a maximum of 100%.

iii. Time and Monetary limits applying to Investments

3.15 The time and monetary limits for institutions on the Authority's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

Table 3 – Time and Monetary Limits

	Minimum Long Term and Short Term Counterparty Rating (LCD Approach)	**Money Limit**	**Time Limit**
Any Local Authority	n/a	£1.5 Million	5 Years
Banks & Building Societies	AA- / F1+	£1.5 Million	5 Years
Banks & Building Societies	A- / F1	£1.5 Million	364 Days
Major UK Banks*	n/a	£3 Million	5 Years
Money Market Funds	AAA	£1.5 Million (individual)	Overnight
Money Market Funds	AAA	£1 Million (individual)	7 Day Notice
UK Government including gilts and the DMADF	n/a	Unlimited	6 Months
Part Nationalised Banking Groups	n/a	£3 Million	5 Years
Authority's Own Banker	n/a	£3 Million	Overnight
*(Barclays Bank PLC, HSBC Bank PLC, Lloyds Banking Group PLC and The Royal Bank of Scotland PLC)			

iv. Longer Term Instruments

3.16 The use of longer term instruments (greater than one year remaining on the loan) will fall in the Non-Specified investment category. These instruments will only be used where the Authority's liquidity requirements are safeguarded. This will be limited to counterparties rated AA- long term, and F1+ short term. The level of overall investments should influence how long cash can be invested for. For this reason it has been necessary to introduce a sliding scale of limits that depend on the overall size of cash balances. The smaller the size of the overall cash balances the more important it is that the money is kept liquid to meet the day to day cashflows of the organisation. Likewise if cash balances are large, a greater proportion of the funds can be invested for longer time periods. Table 5 sets out the investment limits.

Table 4 Time Limits for Investments over 365 days

Time Limit	**Money Limit invested with Counterparties rated AA/ / F1 + and above**	
Projected Annual Balances	**%**	
More than 1 year, no more than 2 years	100%	£2M

3.17 In the normal course of the Authority's cash flow operations it is expected that both Specified and Non-Specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

3.18 A summary of the proposed criteria for investments is shown in Annex B, and a list of counterparties as at 19 January 2015 in accordance with these criteria is shown as Annex C to this policy for information.

3.19 The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio. The WAL can be calculated by multiplying the term of a loan by the weighting of that loan to the portfolio to give an average term for all loans. A shorter WAL would generally embody a lower risk to the portfolio in terms of counterparty risk and interest rate risk.

Investment Policy - Treasury Management Practice 1- ANNEX A

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

The CLG issued Investment Guidance on April 2010, and this forms the structure of the Authority's policy below. The CLG is currently consulting over revisions to the Guidance and where applicable the Consultation recommendations have been included within this policy. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Authorities to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Authority to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross/Sector Guidance Notes. This Authority adopted the Code during 2002 and will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy

The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Authority will use. These are high security (i.e. high credit rating, although this is defined by the Authority, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Authority is set out below.

Strategy Guidelines

The main strategy guidelines are contained in the body of the treasury strategy statement (the Investment Strategy).

Specified Investments

These investments are sterling investments of not more than one/year maturity, or those which could be for a longer period but where the Authority has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Office, UK Treasury Bills or gilt with less than one year to maturity).

2. Supranational bonds of less than one year's duration.

3. A local authority, parish council or community council.

4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.

5. A body that is considered of a credit quality (such as a bank or building society). This covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies. Within these bodies, and in accordance with the Code, the Authority has set additional criteria to set the time and amount of monies which will be invested in these bodies.

Non-Specified Investments

Non-specified investments are any other type of investment (i.e. not defined as specified above). This would include investments greater than 1 year in duration. It is proposed that counterparties will be restricted to those in the specified category above when investing for more than a year. In total these longer term loans will be limited to £2m of the total investment portfolio and this has been determined with regard to the forecasts of future cash flow.

The Monitoring of Investment Counterparties

The credit rating of counterparties will be monitored regularly. The Authority receives credit rating information (changes, rating watches and rating outlooks) from Capita Asset Services as and when ratings change, and counterparties are checked promptly On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Treasurer, and if required new counterparties which meet the criteria will be added to the list.

Summary of Investment Criteria **INVESTMENT POLICY ANNEX B**

Paragraph	Criteria	Minimum Rating		Maximum Investment and Exceptions
		Long	Short	
Sovereign Limit for All Loans				
3.8.1	**AAA Sovereign Rating**	n/a	n/a	£3 Million with any one sovereign, UK no limits
Notice Money				
A minimum of 10% of total investments, up to a maximum of 100%				
3.8.5	**Council's own Banker**	n/a	n/a	£3 Million
3.8.2	**Money Market Funds**	AAA		£1.5 Million individual
3.8.2	**Money Market Fund Notice Account**	AAA	n/a	£1 Million individual
Fixed Term Investments				
Limited to the amount of excess balances for that term less a margin of £10 Million				
Up to 6 months				
3.8.2	**UK Government including gilts and DMADF**			Unlimited
Up to 364 Days				
3.8.2	**Any Local Authority**			£1.5 Million
3.8.2	**Banks & Building Societies**	A-	F1	£1.5 Million Note that no more than £2 Million can be invested with banks in the same group where the highest rated counterparty has a minimum of these ratings See 3.8.4, 3.8.5, 3.8.6, 3.8.7 for exceptions
3.8.7	**Four Major UK Banking Groups**: Barclays Bank PLC, HSBC Bank PLC, Lloyds Banking Group PLC, The Royal	N/a	N/a	£3 Million
Up to 5 years				
3.18	**Major Banks & Building Societies**	AA-	F1+	£1.5 Million per bank Note that no more than £2 Million can be invested with banks in the same group where the highest rated counterparty has a minimum of these ratings See 3.8.4, 3.8.5, 3.8.6, 3.8.7 for exceptions
3.8.4	**Part Nationalised Banking Groups:** Lloyds Banking Group PLC, The Royal Bank of Scotland PLC (including National Westminster Bank PLC)	n/a	n/a	£3 Million

INVESTMENT POLICY ANNEX C

Counterparty list as at 19 January 2015

	Lowest Long Term Rating*	Lowest Short Term Rating*	Money Limit (£m)	Time Limit
UK Banks and Building Societies				
HSBC Bank PLC	AA-	F1+	3	5 YEARS
Lloyds Banking Group:				
Bank of Scotland PLC	A	F1	3 (group) (M)	5 YEARS
Lloyds Bank PLC	A	F1	3 (group) (M)	5 YEARS
Royal Bank of Scotland Group:				
National Westminster Bank	BBB+	F2	3 (group) (M)	5 YEARS
Royal Bank of Scotland	BBB+	F2	3 (group) (M)	5 YEARS
Barclays Bank	A	F1	3 (M)	5 YEARS
Santander UK Plc	A	F1	1.5	364 DAYS
Standard Chartered Bank	A+	F1	1.5	364 DAYS
Nationwide Building Society	A	F1	1.5	364 DAYS
Goldman Sachs International Bank	A	F1	1.5	364 DAYS
Citibank International Plc	A	F1	1.5	364 DAYS
Sumitomo Mitsui Banking Corporation Europe Limited	A-	F1	1.5	364 DAYS
Merrill Lynch International	A	F1	1.5	364 DAYS
MBNA Europe Bank	A-	F1	1.5	364 DAYS
UBS Ltd	A	F1	1.5	364 DAYS
Abbey National Treasury Services	A	F1	1.5	364 DAYS
Australian Banks				
National Australia Bank Limited	AA-	F1+	1.5	5 YEARS
Australia and New Zealand Banking Group	AA-	F1+	1.5	5 YEARS
Commonwealth Bank of Australia	AA-	F1+	1.5	5 YEARS
Macquarie Bank Limited	A	F1	1.5	364 DAYS
Westpac Banking Corporation	AA-	F1+	1.5	5 YEARS
Canadian Banks				
Canadian Imperial Bank of Commerce	A+	F1	1.5	364 DAYS

Bank of Montreal	A+	F1	1.5	364 DAYS
Bank of Nova Scotia	A+	F1	1.5	364 DAYS
National Bank of Canada	A	F1	1.5	364 DAYS
Royal Bank of Canada	AA-	F1+	1.5	5 YEARS
Toronto-Dominion Bank	AA-	F1+	1.5	5 YEARS
National Bank of Canada	A	F1	1.5	364 DAYS
German Banks				
Landwirtschaftliche Rentenbank	AAA	F1+	1.5	5 YEARS
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	A+	F1+	1.5	364 DAYS
KfW	AAA	F1+	1.5	5 YEARS
Landesbank Hessen-Thuringen Girozentrale	A	F1	1.5	364 DAYS
Landesbank Baden-Wurttemberg	A	F1+	1.5	364 DAYS
Sparkassen-Finanzgruppe	A+	F1+	1.5	364 DAYS
Luxembourg Banks				
BGL BNP Paribas SA	A	F1	1.5	364 DAYS
Banque et Caisse d'Epargne de l'Etat	AA+	F1+	1.5	5 YEARS
Clearstream Banking	AA	F1+	1.5	5 YEARS
Singaporean Banks				
DBS Bank Ltd.	AA-	F1+	1.5	5 YEARS
Oversea-Chinese Banking Corp	AA-	F1+	1.5	5 YEARS
United Overseas Bank Limited	AA-	F1+	1.5	5 YEARS
Swedish Banks				
Svenska Handelsbanken	AA-	F1+	1.5	5 YEARS
Swedbank AB	A+	F1	1.5	364 DAYS
Skandinaviska Enskilda Banken	A+	F1	1.5	364 DAYS
Swiss Banks				
UBS AG	A	F1	1.5	364 DAYS
Credit Suisse AG	A	F1	1.5	364 DAYS

**Fitch equivalent ratings have been used for comparative purposes.*

APPENDIX 2

Delegation

The Code requires the policy of delegation to show who is responsible for which decision, the limits on the delegation and reporting requirements.

The code also requires the responsibilities of the Authority, and its officers to be set out. In summary they are as follows: -

The Fire Authority – approval and review of the Treasury Policy statement, the receipt of annual reports from the Treasurer of the Fire Authority on treasury management activities and annually the borrowing limits, and for ensuring effective scrutiny of the Treasury Management strategy and policy.

Treasurer to the Fire Authority – approval and review of draft policy statement, appointment of money brokers, regular monitoring of activities and reporting of these activities to the Authority.

Head of Financial Services – monitor implementation of policy.

Treasury Management Contractor – preparation of draft monitoring reports for the Treasurer to the Fire Authority and the placement and approval of deals on a day to day basis in accordance with the approved policy.

Chief Fire Officer – that the system is laid down and resourced, and that the Treasurer to the Fire Authority makes the required regular reports to the Authority.

Monitoring Officer – ensuring compliance by the Treasurer to the Fire Authority.

Internal Audit – the policing of the arrangements.

In addition to these delegations there is in place a comprehensive system of checks undertaken by the Treasury Management contractor in accordance with the terms of the contract specified by the Authority