Buckinghamshire & Milton Keynes Fire Authority

MEETING	Fire Authority
DATE OF MEETING	15 February 2017
OFFICER	David Sutherland, Director of Finance & Assets
LEAD MEMBER	Councillor Peter McDonald
SUBJECT OF THE REPORT	**Treasury Management Strategy 2017/18**
EXECUTIVE SUMMARY	This report is being presented as the Fire Authority is required to approve the Treasury Management Policy Statement, Treasury Management Strategy Statement and the Annual Investment Strategy. These documents (Appendix A) all support the Medium Term Financial Plan. The current strategy is operating effectively and outperforming the benchmark targets. There are currently no significant changes to the proposed strategy for 2017/18. The Authority's professional treasury advisors (Capita) will be attending the Overview and Audit Committee meeting in March 2017. At this meeting they will provide an overview of the economic environment, the risks of current and potential investments and provide an opportunity for Members to discuss potential revisions to the strategy. If any changes are required a mid-year update will be recommended to the Authority for approval during 2017/18.
ACTION	Decision.
RECOMMENDATIONS	It is recommended that the Authority be recommended to approve the Treasury Management Policy Statement, Treasury Management Strategy Statement and the Annual Investment Strategy for 2017/18.
RISK MANAGEMENT	Making investments in the Authority's own name means that the Authority bears the risk of any counterparty failure. This risk will be managed in accordance with the strategy and with advice from external treasury management advisors. The Director of Finance and Assets will act in accordance with the Authority's policy statement; treasury management practices and CIPFA's Standard of Professional Practice on Treasury Management.

	There are no direct staffing implications.
FINANCIAL IMPLICATIONS	The proposed budget for 2017/18 is £100k. It is anticipated that the budget will be met. Detailed information is shown within Appendix A. The advice from the Authority's current treasury management advisers (Capita) is that they are "not aware of any public sector bodies which actually make ethical investments. This is down to the two factors referred to, i.e. security, in that an organisation may be ethical but may not have the required credit ratings and guarantees in place to secure your investment and secondly yield, where returns are well below other secure investments available in the market place. To go down this route may therefore compromise security and yield." "Ethical investments" currently available do not provide the necessary security and yield.
LEGAL IMPLICATIONS	The Authority is required by section 15(1) of the Local Government Act 2003 to have regard to the Department for Communities and Local Government Guidance on Local Government Investments; and by regulation 24 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146] to have regard to any prevailing CIPFA Treasury Management Code of Practice. Under section 12 of the Local Government Act 2003 the Authority has the power to invest for "any purpose relevant to its functions" and "for the purposes of the prudent management of its financial affairs". However it must exercise its investment power in accordance with its fiduciary duty, analogous to that of a trustee, owed to those who contribute to the funds of the Authority.
CONSISTENCY WITH THE PRINCIPLES OF COLLABORATION	No direct impact.
HEALTH AND SAFETY	No direct impact.
EQUALITY AND DIVERSITY	No direct impact.
USE OF RESOURCES	The projected income has been factored into the Medium Term Financial Plan.
PROVENANCE SECTION **&** **BACKGROUND PAPERS**	CIPFA Code of Practice for Treasury Management in the Public Services (CIPFA Code) Department for Communities and Local Government Guidance on Local Government Investments (DCLG Guidance)

APPENDICES	Appendix A – Treasury Management Policy Statement, Treasury Management Strategy Statement and Annual Investment Strategy Appendix B – Provisional Counterparty List Appendix C – Prospects for Interest Rates
TIME REQUIRED	10 minutes
REPORT ORIGINATOR AND CONTACT	Linda Blunt lblunt@bucksfire.gov.uk (01296) 744404

Appendix A – Treasury Management Policy Statement, Treasury Management Strategy Statement and Annual Investment Strategy

Treasury Management Policy Statement

This 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.

This 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.

This 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.

The investment policy objective for this Authority is the prudent investment of its treasury balances. The Authority's investment priorities are the security of capital and liquidity of its investments so that funds are available for expenditure when needed. Both the CIPFA Code and DCLG 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 generation of investment income to support the provision of local authority services is an important, but secondary, objective.

The Authority's borrowing objectives are to minimise the revenue costs of debt whilst maintaining a balanced loan portfolio. The 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.

Treasury Management Strategy Statement

Current Portfolio Position

The Authority's treasury portfolio position as at 30 September 2016 comprised:

Borrowing

Fixed Rate Funding: £7.382m Average Rate: 4.48%

The Authority made a repayment of £368k in May 2016 with the next loan maturity not due until 2018.

Investments

£25.080m Average Rate 1 April 2016 to 30 September 2016: 0.73%

It is anticipated that a number of large payments will be made before the end of the year. Therefore, projected interest receivable (see 'Prospects for Interest Rates' below) has been modelled on an average fund balance of £20m.

Prospects for Interest Rates

For 2017/18, the Authority will continue with Capita as its external treasury management advisor. Capita's view of the prospects for interest rates can be seen in Appendix C.

Capita advise that the current benchmark rate of return on investments should be Base Rate (currently 0.25%), although the rate may be higher if the Authority is able and willing to commit funds for longer durations (up to one year). Using this benchmark figure would give an annual return of circa £50k on a balance of £20m (the total current projected return for 2016/17 is circa £150k).If the Annual Investment Strategy was to remain unchanged from 2016/17, and the Authority were to achieve an average rate of 0.25%, this would give an annual return of circa £50k on a balance of £20m.

However the average rate of return for 2014/15, 2015/16 and 2016/17 to date has been 0.69%, 0.76% and 0.67% respectively. Therefore the Authority projects that it should achieve the required average interest rate of 0.50% in order to meet the budget of £100k return on investments. The only caveat being that there is a downward risk on the level of return we obtain due to the uncertainty in the markets and the negative impact they have on the interest rates and therefore historical rates of return may not provide a realistic return for the future. This will be closely monitored and reported to Members if the position changes from what we are currently projecting.

Borrowing Strategy

The Authority's borrowing objectives are:

• To minimise the revenue costs of debt whilst maintaining a balanced loan portfolio

• To manage the Authority's debt maturity profile, leaving no one future year with a disproportionate level of repayments

No additional borrowing is forecast to take place during the duration of the medium term financial plan.

Investment Strategy

This Authority maintains investments that are placed with reference to cash flow requirements. Investment of the Authority's funds is in accordance with the Annual Investment Strategy.

Debt Rescheduling

The potential for debt rescheduling is monitored in light of interest rate movements.

Any rescheduling will be in accordance with the borrowing strategy. The reasons for rescheduling include:

• The generation of cash savings at minimum risk

• Fulfilment of the borrowing strategy

• Enhancement of the maturity profile of the borrowing portfolio

Due to the current level of penalties on the early repayment of borrowing, it is not expected that any debt will be restructured over the medium term.

Annual Investment Strategy (AIS)

A prudent investment policy has two objectives (as defined by the DCLG guidance):

- achieving first of all security (protecting the capital sum from loss);
- and then liquidity (keeping the money readily available for expenditure when needed);
- only once proper levels of security and liquidity are determined, it will then be reasonable to consider what yield can be obtained consistent with those priorities.

Investment Policy

In accordance with guidance from the DCLG and CIPFA, and in order to minimise the risk to investments, the Authority has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using the Capita ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

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 has had 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 have effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

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 (CDS) and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Capita in producing its colour coding which show the varying degrees of suggested creditworthiness.

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.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

Creditworthiness Policy

This Authority applies the creditworthiness service provided by Capita. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

• credit watches and credit outlooks from credit rating agencies

• CDS spreads to give early warning of likely changes in credit ratings;

• sovereign ratings to select counterparties from only the most creditworthy countries.

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

• Yellow 5 years

• Purple 2 years

• Blue 1 year (only applies to nationalised or semi nationalised UK Banks)

• Orange 1 year

• Red 6 months

• Green 3 months

• No colour not to be used

The Capita creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Authority use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The Authority is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service.

• if a downgrade results in the counterparty/investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.

• in addition to the use of credit ratings the Authority will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

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

Country Limits

In 2014/15, the Authority determined that it would not only use approved counterparties based within the United Kingdom during the year but allowed a limited number of counterparties from outside of the UK to be used. Although none of these counterparties were used during 2016/17, these will remain on the lending list for 2017/18. The primary purpose of this is not to increase yield, but to provide additional diversity to the portfolio to effectively manage risk. A number of non-UK banks are ranked higher than some of the UK banks on the Authority's current counterparty list. A list of the proposed counterparties is shown in Appendix B. Although Capita advise that investments can be placed with some of the counterparties for longer than 100 days, the Authority proposes to limit the duration of all non-UK investments to 100 days.

Counterparty Limits

As per the 2016/17 AIS, the Authority has determined that the maximum balance that can be invested with a single counterparty at any point in time will be no more than 30% of the portfolio, up to a limit of £5 million.

The one exception to this limit in the 2016/17 AIS will continue to be Lloyds, where the maximum balance that can be invested will be a limit of £7.5 million. Of this £7.5 million, no more than £5 million will be invested in non-instant access (call) accounts.

The rationale for this is that Lloyds are the Authority's main banking provider, and as part of the contract will pay credit interest on all balances at a rate of Base Rate minus 0.10% (currently giving an effective rate of 0.15%). This means that:

- A higher rate can be achieved than on most other instant-access accounts
- The staff time taken to move money between our main bank account and other instant access account is reduced
- The banking charges associated with the movement of the money between accounts is reduced
- The additional risk exposure to the Authority is minimal as all amounts over the current £5 million limit would be available for withdrawal immediately should circumstances require

Investment Security

Investments are defined as being in one of two categories:

• Specified investments – these are investments with high security and high liquidity. All specified investments are in sterling and have a maturity of no more than one year. They will be with the UK government, a local authority, a parish council or with an investment scheme or body of "high credit quality" (as judged against the Creditworthiness Policy detailed earlier in this paper)

• Non-specified investments – any type of investment that does not meet the specified investment criteria. A maximum of 10% will be held in aggregate in non-specified investments i.e. the Authority may invest funds with other Local Authorities for longer than 364 days – up to a maximum of five years as denoted by the yellow banding on the Capita creditworthiness policy detailed earlier in this paper. Local authorities are Government backed.

Investment Training

Relevant training and updates will be provided to relevant staff by the external treasury management advisors. This will be supplemented by additional training from CIPFA where necessary.

Investment of Money Borrowed in Advance of Need

The Authority does not currently have any money that has been borrowed in advance of need. No further borrowing is planned over the medium term.

Investment Liquidity

In consultation with external treasury advisors, the Authority will review its balance sheet position, level of reserves and cash requirements in order to determine the length of time for which investments can be prudently committed. Investments will be placed at a range of maturities, including having money on-call in order to maintain adequate liquidity.

Appendix B – Provisional Counterparty List

This list is based on information provided by Capita as at 30 December 2016. Please note that all colours indicated refer to Capita's creditworthiness policy (see Appendix A):

UK Based Counterparties

Country	Counterparty	Maximum Duration
UK	Abbey National Treasury Services	Red - 6 mths
UK	Bank of Scotland	Red - 6 mths
UK	Barclays Bank plc	Red - 6 mths
UK	Close Brothers	Red - 6 mths
UK	Clydesdale Bank	No colour - 0 mths
UK	Co-operative Bank Plc	No colour - 0 mths
UK	Goldman Sachs International	Red - 6 mths
UK	HSBC Bank plc	Orange - 12 mths
UK	Lloyds Banking Group	Red - 6 mths
UK	Santander UK PLC	Red - 6 mths
UK	Standard Chartered Bank	Green – 3 mths
UK	Sumitomo Mitsui Banking Corporation Europe Ltd	Red - 6 mths
UK	UBS Ltd	Red - 6 mths
UK	Coventry Building Society	Red - 6 mths
UK	Leeds Building Society	Red - 6 mths
UK	Nationwide BS	Red - 6 mths
UK	Yorkshire Building Society	Green - 100 days
UK	Skipton Building Society	Green – 100 days
UK	Debt Management Office	Yellow - 60 mths
UK	Other Local Authorities	Yellow - 60 mths
UK	Royal Bank of Scotland Group	Blue - 12 mths
UK	National Westminster Bank	Blue - 12 mths

The Authority will also have the ability to invest in AAA rated money market funds (MMFs) and enhanced money market funds.

Non-UK Based Counterparties

Country	Counterparty	Maximum Duration (as rated by Capita)
Germany	Deutsche Bank AG	No colour - 0 mths
Germany	DZ BANK AG Deutsche Zentral-Genossenschaftsbank	Orange - 12 mths
Germany	Landesbank Berlin AG	Orange - 12 mths
Germany	Landesbank Hessen-Thueringen Girozentrale	Orange - 12 mths
Germany	Landwirtschaftliche Rentenbank	Purple - 24 mths
Sweden	Nordea Bank AB	Orange - 12 mths
Sweden	Skandinaviska Enskilda Banken AB	Orange - 12 mths
Sweden	Svenska Handelsbanken AB	Orange - 12 mths
Sweden	Swedbank AB	Orange - 12 mths

As noted in Appendix A, the duration of all non-UK investments will be limited to 100 days, even where Capita advise that a longer duration is acceptable.

There are a number of other non-UK based counterparties that have not been included on the list, as either the rates offered are significantly lower than available elsewhere, or that the counterparty is unlikely to take deposits of the size the Authority would be able to offer.

Counterparties Rated ‘No Colour’ by Capita

As noted in Appendix A, sole reliance will not be placed on the use of Capita ratings. The Authority will also use market data and market information, information on government support for banks and the credit ratings of that supporting government. The Authority added four building societies to its counterparty list in 2014/15, at which time they were all rated ‘No Colour’ by Capita. These are all now rated by Capita and appear on our Provisional Counterparty Listing above.

Appendix C – Prospects for Interest Rates

The following table gives the Capita central view:

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2016	0.25	1.60	2.90	2.70
Mar 2017	0.25	1.60	2.90	2.70
Jun 2017	0.25	1.60	2.90	2.70
Sep 2017	0.25	1.60	2.90	2.70
Dec 2017	0.25	1.60	3.00	2.80
Mar 2018	0.25	1.70	3.00	2.80
Jun 2018	0.25	1.70	3.00	2.80
Sep 2018	0.25	1.70	3.10	2.90
Dec 2018	0.25	1.80	3.10	2.90
Mar 2019	0.25	1.80	3.20	3.00
Jun 2019	0.50	1.90	3.20	3.00

The following paragraphs provide Capita's commentary on the current economic situation:

The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post positive growth numbers through the second half of 2016 and in 2017, albeit at a slower pace than in the first half of 2016.

The Monetary Policy Committee (MPC) meeting in August was dominated by consideration of the initial shock fall in business surveys and the expected sharp slowdown in growth. The result was a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing for banks to use to lend to businesses and individuals.

The Bank of England quarterly Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8% and the forecast for 2018 to 1.8%. However, some forecasters think that the Bank has been too pessimistic with its forecasts; since then, later statistics and the sharp recovery in business surveys have provided support for this view.

The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI had already started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 18% fall in the value of sterling on a trade weighted basis (as at late October), is likely to result in additional upward pressure on CPI. However, this further increase in inflationary pressures will take 2-3 years to gradually work its way through the economy so is unlikely to cause major concern to the MPC unless the increases are stronger than anticipated. The MPC is, therefore, on balance, expected to look thorough this one off upward blip in inflation from the devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures *arising from within* the UK economy. The Bank of England will most probably have to revise its inflation forecasts significantly higher in its 3rd November quarterly Inflation Report: this rise in inflation expectations has caused investors in gilts to demand a sharp rise in longer term gilt yields, which have already risen by around fifty basis points since mid-August. It should be noted that 27% of gilts are held by overseas investors who will have seen the value of their gilt investments fall by 18% as a result of the devaluation of sterling, (if their investments had not been currency hedged). In addition, the price of gilts has fallen further due to a reversal of the blip up in gilt prices in early August after further quantitative easing was announced - which initially drove yields down, (i.e. prices up). Another factor that is likely to dampen gilt investor sentiment will be a likely increase in the supply of gilts if the Chancellor slows down the pace of austerity and the pace of reduction in the budget deficit in the Autumn Statement - as he has already promised. However, if there was a more serious escalation of upward pressure on gilt yields, this could prompt the MPC to respond by embarking on even more quantitative easing, (purchases of gilts), to drive gilt yields back down.