Alliance Treasury Management Strategy 2016/17

Report of the Treasury

Recommendations

That:

a) the Treasury Management Strategy and Investment Strategy for 2016/17 be approved by the Police and Crime Commissioners for Warwickshire and West Mercia

b) the Prudential Indicators agreed as part of the respective budget settings (see **Appendices A(i) and A(ii)**) are noted;

c) the Commissioners require the Treasurer to ensure that net borrowing does not exceed the Prudential levels specified in **Appendix A**, taking into account current commitments, existing plans, and the proposals agreed in the budget reports;

d) the Commissioners delegate authority to the Treasurer to undertake all the activities listed in **Appendix E** of the report;

e) the Treasurer implements the Minimum Revenue Provision Policy as specified in **Appendix F**.

1 Introduction

Background

1.1 Treasury management is defined, in a local government context, as:

"The management of the local 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."

1.2 Each Commissioner is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with a low risk appetite, providing security of capital and sufficient liquidity initially before considering investment return.

1.3 The second main function of the treasury management service is the funding of the Commissioner's capital plans. These capital plans provide a guide to the borrowing need of the Commissioner, essentially the longer term cash flow planning to ensure that the Commissioner can meet his capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasions, debt previously drawn may be restructured to meet the Commissioner's risk or cost objectives.

Statutory Requirements

1.4 Each Commissioner has a statutory obligation to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable.

1.5 The Commissioners are required, therefore, to set out their treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the policies for managing their investments and for giving priority to the security and liquidity of those investments.

CIPFA Requirements

1.6 The Chartered Institute of Public Finance and Accountancy's (CIPFA) is responsible for publishing and maintaining the Code of Practice on Treasury Management with which the Commissioner is obliged to comply.

1.7 The primary requirements of the Code are as follows:

a. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities.
b. Creation and maintenance of Treasury Management Practices which set out the manner in which the Commissioner will seek to achieve those policies and objectives.
c. Receipt by the Commissioners of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
d. Delegation by each Commissioner of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
e. Delegation by each Commissioner of the role of scrutiny of treasury management strategy and policies to a specific named body. In this respect the Commissioners have chosen to delegate this responsibility to the Joint Audit Committee

Treasury Management Strategy for 2016/17

1.8 The suggested strategy for 2016/17 in respect of the following aspects of the treasury management function is based upon the Treasurer's and the Force Treasury team (who undertake treasury management on behalf of the Commissioner) views on interest rates, supplemented with leading market forecasts provided by treasury advisers.

1.9 The strategy covers:

- Treasury limits for 2016/17 to 2018/19
- Prudential indicators (previously agreed in setting the budgets)
- Prospects for interest rates
- Borrowing strategy
- Debt rescheduling
- Annual investment strategy
- MRP strategy

2 Treasury Limits for 2016/17 to 2018/19

2.1 Each Commissioner is required to determine and keep under review how much he can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales, the Authorised Limit represents the legislative limit specified in the Act.

2.2 The Commissioners must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires them to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon future council tax levels is 'acceptable'.

2.3 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion in corporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. Details of the Authorised Limit can be found in **Appendix A** of this report. Explanations of the terminology employed in the Appendix can be found in **Appendix B.**

2.4 The Commissioners' current treasury portfolios are as follows: (Kay to update)

Warwickshire

Treasury Portfolio at 31 January 2016	**Principal £m**	**Average Rate %**
Fixed Rate Funding Public Works Loans Board	**15.8**	**5.03**
Investments		
In house	**22.5**	**0.44**
Externally managed	**0.0**	**0.00**
Net Debt	**(6.7)**	

West Mercia

Treasury Portfolio at 31 January 2016	**Principal £m**	**Average Rate %**
Fixed Rate Funding Public Works Loans Board	**10.0**	**4.44**
Investments		
In house	**39.0**	**0.46**
Externally managed	**0.0**	**0.00**
Net Debt	**(29.0)**	

2.5 The Commissioners' borrowing requirements are as follows:

Warwickshire

Borrowing Requirement	**14/15 Actual £m**	**15/16 Estimate £m**	**16/17 Estimate £m**	**17/18 Estimate £m**	**18/19 Estimate £m**	**19/20 Estimate £m**
New borrowing *	0.0	0.0	0.2	2.0	5.0	3.2
Replacement borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Total	**0.0**	**0.0**	**0.2**	**2.0**	**5.0**	**3.2**

* This does not include the repayment of existing EIP/Annuity Loans.

West Mercia

Borrowing Requirement	14/15 Actual £m	15/16 Estimate £m	16/17 Estimate £m	17/18 Estimate £m	18/19 Estimate £m	19/20 Estimate £m
New borrowing	0.0	0.0	5.4	6.9	6.1	5.5
Replacement borrowing	0.0	0.0	0.0	0.0	0.0	0.0
Total	**0.0**	**0.0**	**5.4**	**6.9**	**6.1**	**5.5**

3 Prudential Indicators for 2016/17 to 2018/19

3.1 Prudential and Treasury Indicators (**Appendix A** to this report) are relevant for the purposes of setting an integrated treasury management strategy.

3.2 The indicators are based on the currently agreed capital programme.

4 Prospects for Interest Rates

4.1 The prospects for interest rates are key to the Treasury Management Strategy. Set out in the table below are projections for the Bank Rate from Arlingclose.

Bank Rate Forecast

	%
March 2016	0.50
June 2016	0.50
September 2016	0.50
December 2016	0.50
March 2017	0.50
June 2017	0.50
September 2017	0.50
December 2017	0.50
March 2018	0.50
June 2018	0.50
September 2018	0.75
December 2018	0.75
March 2019	0.75

Economic outlook

Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Low oil and commodity prices were a notable feature of 2015, and contributed to annual CPI inflation falling to 0.1% in November. Wages are growing at 2.4% a year, and the unemployment rate has dropped to 5.2%. Mortgage approvals have risen to over 70,000 a month and annual house price growth is around 4.5%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was 2.1% a year in the third quarter of 2015. Although speeches by the Bank of England's Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 82nd consecutive month at its meeting in December 2015. Quantitative easing (QE) has been maintained at £375bn since July 2012.

The outcome of the UK general election, which was largely fought over the parties' approach to dealing with the deficit in the public finances, saw some big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics. Uncertainty over the outcome of the forthcoming referendum could put downward pressure on UK GDP growth and interest rates.

China's growth has slowed and its economy is performing below expectations, reducing global demand for commodities and contributing to emerging market weakness. Financial markets have reacted extremely negatively on concerns that the Chinese slowdown will present a significant drag on global growth. US domestic growth has accelerated but the globally sensitive sectors of the US economy have slowed. Strong US labour market data and other economic indicators suggested recent global turbulence has not knocked the American recovery off course, although activity has weakened a little. The Federal Reserve raised policy rates at its meeting in December as expected, but accompanying statements suggested that the tightening cycle will be gradual and very much data dependent. In contrast, the European Central Bank finally embarked on QE in 2015 to counter the perils of deflation and undertook further monetary easing late in the year.

Credit outlook

4.3 The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK Banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government's stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the UK, USA and Germany. The rest of the European Union will follow suit in January 2016, while Australia and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain stubbornly low.

Interest rate forecast:

4.4 The Authority's treasury advisor Arlingclose projects the first 0.25% increase in UK Bank Rate in the second quarter of 2018, rising by 0.5% a year thereafter, finally settling at or below 2% several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.

A shallow upward path for medium term gilt yields is forecast, as continuing concerns about the Eurozone, emerging markets and other geo-political events weigh on risk appetite, while inflation expectations remain subdued. Arlingclose projects the 10 year gilt yield to rise from its current 1.8% level by around 0.3% a year. The uncertainties surrounding both the timing of UK and US interest rate rises, and the fallout from slower Chinese growth are likely to prompt short-term volatility in gilt yields.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.40%, and that new long-term loans will be borrowed at an average rate of 3.08%.

5 Borrowing Strategy

5.1 Both Commissioners are currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Commissioner's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high. Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. From 2017/18 onwards the Commissioners intend to fund a significant proportion of the capital programme from reserves, reducing the need for long term borrowing and minimising future capital financing costs. The Treasury Team will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. Any decisions will be reported to the Commissioner at the earliest available opportunity.

5.2 The Arlingclose forecasts for the PWLB new borrowing rate are as follows:

Date	PWLB Certainty Rate			
	5 yr	10 yr	20 yr	50 yr
01/03/2016	1.05	1.05	1.05	1.05
01/06/2016	1.10	1.10	1.10	1.10
01/09/2016	1.10	1.10	1.10	1.10

01/12/2016	1.20	1.20	1.20	1.20
01/03/2017	1.30	1.30	1.30	1.30
01/06/2017	1.35	1.35	1.35	1.35
01/09/2017	1.35	1.35	1.35	1.35
01/12/2017	1.40	1.40	1.40	1.40
01/03/2018	1.40	1.40	1.40	1.40
01/06/2018	1.40	1.40	1.40	1.40
01/09/2018	1.40	1.40	1.40	1.40
01/12/2018	1.40	1.40	1.40	1.40
01/03/2019	1.40	1.40	1.40	1.40

5.3 In view of the above forecast, the Commissioners' borrowing strategy will be based upon the following:

- The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates.
- Internal borrowing will be weighed against potential long term costs that will be incurred if market loans at long term rates are higher in future years.
- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio.
- PWLB borrowing for periods under ten years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing, which will spread debt maturities away from a current concentration in longer dated debt.

In addition, it is important to note that the both Commissioners will seek to minimize their future borrowings by using revenue budget underspendings to defray borrowing where this is feasible and prudent. The Commissioners will also consider minimizing future borrowing during 2016/17 by reprofiling the planned use of reserves in the Medium Term Financial Plan.

5.4 In normal circumstances, the main sensitivities of the forecast are likely to be the two scenarios noted below. The Treasurer, in conjunction with the Director of Finance and the treasury advisors, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

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

- If it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be reappraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

Policy on borrowing in advance of need

5.5 The Commissioners will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Commissioners can ensure the security of such funds.

5.6 In determining whether borrowing will be undertaken in advance of need, the Commissioners will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use;
- consider the impact of borrowing in advance of temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

6 Debt Rescheduling

6.1 PWLB debt restructuring is now much less financially attractive than it used to be. Consideration is given to the large premiums incurred by prematurely repaying existing PWLB loans. It is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing, although other market loans may be available as the source of replacement financing.

6.2 As short term borrowing rates will be considerably cheaper than longer term rates, there could be significant opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing those short term loans, once they mature, compared with the current rates of longer term debt in the existing debt portfolio.

6.3 The reasons for any rescheduling to take place will include:
- the generation of cash savings and discounted cash flow savings;
- helping to fulfil the strategy outlined in Section 5 above; and
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

6.4 Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

7 Annual Investment Strategy

Investment Policy

7.1 The Commissioners will have regard to the DCLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

7.2 The Commissioners' investment priorities are the security of capital and the liquidity of investments.

7.3 The Commissioners will also aim to achieve the optimum return on his investments, commensurate with proper levels of security and liquidity. The risk appetites of the Commissioners are extremely low in order to give overriding and absolute priority to the security of their investments.

7.4 In accordance with the above, and in order to minimise the risk to investments, the Commissioners have below stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list takes account of the ratings and watches published by all three ratings agencies, with a full understanding of what the ratings represent. Using information from Arlingclose, service banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

7.5 Furthermore, the Commissioners' officers recognise that ratings should 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 the institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Commissioners' officers will engage with the advisors, Arlingclose, to monitor market pricing and overlay that information on top of the credit ratings.

7.6 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.

7.7 Investment instruments identified for use in the financial year are listed in **Appendix C** under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set and documented in discussion between the Treasury team and the Treasurer.

7.8 **Liquidity Management**:

The Authority uses cash flow forecastingto determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Force being made to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority’s medium term financial plan and cash flow forecast.

Creditworthiness Policy

7.9 The Commissioners have access, through the Force Treasury Team, to the creditworthiness service provided by Arlingclose. This service uses credit ratings from all three rating agencies, Fitch, Moodys and Standard and Poors.

7.10 Treasury officers do not rely solely on the current credit ratings of counterparties but also use the following as overlays:

- credit watches and credit outlooks from credit rating agencies;
- credit default swap spreads giving warning of changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

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

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

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

7.11 In line with the last two years' approved strategies, the Commissioners will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as, at any point in time, one of the agencies may be very much more aggressive in giving low ratings than the other two agencies, as happened in 2012/13 with Moodys. This would therefore be unworkable and leave the Commissioner with few banks on his approved lending list.

7.12 All credit ratings will be monitored continuously. Through its use of services from Arlingclose, the Treasury team receives monthly credit ratings, supplemented by daily alerts of changes to ratings of all three agencies. If a downgrade results in the counterparty/investment scheme no longer meeting the Commissioner's minimum criteria, its further use as a new investment will be withdrawn immediately.

7.13 Sole reliance will not be placed on the use of this external service. In addition the Commissioner will also use market data, broker intelligence/advice, the financial press and all other relevant information.

Investment Counterparty Selection Criteria

7.14 The Commissioners' investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Commissioner's investment priorities will be security first, liquidity second, then lastly return. Investment instruments identified for use in the financial year are listed in **Appendix C** under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set and documented in discussion between the Treasury team and the Treasurer.

Specified Investments: The CLG Guidance defines specified investments as those:

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

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

Non-specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£5m
Total investments without credit ratings or rated below [A-]	£10m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below [AA+]	£0m
Total non-specified investments	£15m *(=sum of the above?)*

7.15 The Commissioners will ensure that they maintain a policy covering both the categories of investment types in which to invest, criteria for choosing investment counterparties with adequate security, and monitoring their security. Moreover, they will ensure they have sufficient liquidity in their investments. For this purpose they will follow procedures for determining the maximum periods for which funds may prudently be committed according to future cash flow requirements. The Treasurer will maintain a counterparty list in compliance with the stated criteria, providing an overall pool of counterparties considered to be very high quality which the Commissioner may use.

7.16 Credit rating information is supplied by Arlingclose, our treasury consultants, on all active counterparties that comply with the stated criteria. Any counterparty failing to meet the criteria will be deleted from the counterparty lending list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

7.17 It should be noted that following the implementation of the bail in provisions in the Banking Reform Act 2014, investments in accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail However investments such as Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments. Consequently the authorised cash limits for banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is A- or above is being reduced from £10m to £5m with the time limit remaining at 1 year. In case of the Commissioners' and the Forces' current account banks the cash limit will be reduced from £10m to £7.5m with the time limit remaining at 1 year. This reflects the greater volatility and the need for greater flexibility in daily cash flow management.

Country Limits

7.18 The Commissioners have determined that they will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix D**. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Investment Strategy

7.19 The Commissioners have in-house managed funds that are mainly cash-flow derived and a core balance available for investment over a maximum one-year period. Accordingly, investments will be made with reference to the core balance and cash requirements, and the outlook for short-term interest rates, (i.e., rates for investments up to twelve months).

7.20 There is downside risk to the Arlingclose interest rate forecasts if recovery from the recession proves to be weaker and slower than currently expected. The Commissioner will avoid locking into longer term deals while investment rates are down at historically low levels, unless exceptionally attractive rates are available which make longer term deals worthwhile.

7.21 For its cash flow generated balances, the Commissioners will seek to utilise their business reserve accounts and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

End of Year Investment Report

7.22 At the end of the financial year, the Commissioners will report on their investment activity as part of an Annual Treasury Report.

Policy on the Use of External Service Providers

7.23 The Commissioners use Arlingclose as their external treasury management advisers via the Force's Treasury team. The Commissioners recognise that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

7.24 **Investment Training:** The needs of the Force's treasury management staff for training in investment management are assessed every 12 months as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.
Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Role of the Section 151 Officer

7.25 Please see **Appendix E**.

8 Minimum Revenue Provision

8.1 The Authority's policy on Minimum Revenue Provision (MRP) is shown in **Appendix F**.

Report of the Treasurer	Elizabeth Hall

APPENDICES

A. Prudential and Treasury Indicators

B. Prudential Term Explanations

C. Schedule of Specified and Non Specified Investments

D. Approved Countries for Investments

E. The Treasury Management Role of the S151 (Responsible) Officer: Head of Finance

F. Minimum Revenue Provision

Warwickshire Prudential and Treasury Indicators

1. AFFORDABILITY PRUDENTIAL INDICATORS	2015/16 Estimate	2015/16 Forecast Outturn	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£'000	£'000	£'000	£'000	£'000
Capital Expenditure	9,065	6,346	7,874	5,789	7,539
	%	%	%	%	%
Ratio of financing costs to net revenue stream	2.44	2.34	2.20	2.34	2.09
	£'000	£'000	£'000	£'000	£'000
In Year borrowing requirement					
- in year borrowing requirement	5,728	1,831	6,124	1,923	5,026
	£'000	£'000	£'000	£'000	£'000
In year Capital Financing Requirement	5,728	481	4,723	299	3,614
	£'000	£'000	£'000	£'000	£'000
Capital Financing Requirement 31 March	28,406	23,675	28,398	28,697	32,311
	£	£	£	£	£
Increase per council tax payer	£1.25	£0.13	(£0.19)	£0.37	(£0.43)
2. TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**2015/16 Estimate**		**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
	£'000		£'000	£'000	£'000
Authorised limit for external debt					
- Borrowing	40,000		40,000	40,000	40,000
	£'000		£'000	£'000	£'000
Operational boundary for external debt					
- Borrowing	30,000		30,000	30,000	35,000
Upper limit for fixed rate interest exposure					
- net principal re fixed rate borrowing / investments	£40m		£40m	£40m	£40m
Upper limit for variable rate exposure					
- net principal re variable rate borrowing / investments	£5m		£5m	£5m	£5m
365 days money	£0	£0	£0	£0	£0

Maturity structure of new fixed rate borrowing during 2013/14	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Appendix A(ii)

West Mercia Prudential and Treasury Indicators

1. AFFORDABILITY PRUDENTIAL INDICATORS	2015/16 Estimate	2015/16 Forecast Outturn	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure	17,550	12,956	23,919	14,367	13,089
	%	**%**	**%**	**%**	**%**
Ratio of financing costs to net revenue stream	1.12	0.96	0.88	1.16	1.37
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
In Year borrowing requirement					
- in year borrowing requirement	13,587	0	14,959	7,107	6,459
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
In year Capital Financing Requirement	12,646	(1,613)	13,455	5,005	4,096
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Financing Requirement 31 March	46,537	32,210	45,665	50,670	54,766
	£	**£**	**£**	**£**	**£**
Increase per council tax payer	£1.20	(£0.15)	(£0.10)	£0.56	£0.46
2. TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**2015/16 Estimate**		**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
	£'000		**£'000**	**£'000**	**£'000**
Authorised limit for external debt					
- Borrowing	40,000		40,000	50,000	60,000
	£'000		**£'000**	**£'000**	**£'000**
Operational boundary for external debt					
- Borrowing	30,000		35,000	50,000	55,000
Upper limit for fixed rate interest exposure					
- net principal re fixed rate borrowing / investments	£40m		£40m	£50m	£60m
Upper limit for variable rate exposure					
- net principal re variable rate borrowing / investments	£5m		£5m	£5m	£5m

Maturity structure of new fixed rate borrowing during 2013/14	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Appendix B

PRUDENTIAL INDICATORS

Ratio of financing costs to net revenue stream

The ratio of financing costs to net revenue stream shows the estimated annual revenue costs of borrowing, less net interest receivable on investments, plus repayments of capital, as a proportion of annual income from council taxpayers and central government. The estimates of financing costs include current and future commitments based on the capital programme.

Net Borrowing

Net borrowing refers to the Authority's total external borrowing.

Actual and Estimated Capital Expenditure

Actual and estimates of capital expenditure for the current and future years.

Capital Financing Requirement

The Capital Financing Requirement (CFR) represents capital expenditure financed by external debt and not by capital receipts, revenue contributions, capital grants or third party contributions at the time of spending. The CFR measures the Authority's underlying need to borrow externally for a capital purpose. The Authority has a treasury management strategy which accords with the CIPFA Code of Practice for Treasury Management in the Public Services.

Authorised Limit

In respect of its external debt, the Authority approves authorised limits for its total external debt gross of investments. These limits separately identify borrowing from other long-term liabilities such as finance leases. Authorised limits are consistent with the Authority's current commitments, service plans, proposals for capital expenditure and associated financing, cashflow and accord with the approved treasury management policy statement and practices. The Authorised limit is based on the estimate of most likely prudent, but not necessarily the worst-case scenario and provides sufficient additional headroom over and above the Operational Boundary.

Operational Boundary

The operational boundary for external debt is based on the same estimates as the authorised limit but reflects the Head of Finance's estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the authorised limit to allow for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in-year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified.

Limits on Interest Rate Exposures

This means that the Authority will manage fixed interest rate exposures within the ranges and variable interest rate exposures within the ranges. This provides flexibility to take advantage of any favourable movements in interest rates.

Appendix C

Counterparty		Cash limit	Time limit †
Specified			
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's (with the exception of the Commissioners' and the Forces' current account bank)	AAA AA+ AA AA- A+ A A-	£3m each	1 year
The Force(s)'s current account bank HSBC / Lloyds if it meets the above criteria		£5m	1 year
The Force(s)'s current account bank HSBC / Lloyds if it fails to meet the above criteria		£1m	next day
UK Central Government (irrespective of credit rating)		unlimited	50 years**
UK Local Authorities (irrespective of credit rating)		£5m	1 years**
Building Societies		£3m	1 Year
Unspecified			
UK Building Societies without credit ratings		£1m each	6 months
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's	BBB+	£1.5m	3 months

There is no intention to restrict investments to bank deposits, and investments may be made with any public or private sector organisations that meet the above credit rating criteria. This reflects a lower likelihood that the UK and other governments will support failing banks as the bail-in provisions in the Banking Reform Act 2014 and the EU Bank Recovery and Resolution Directive are implemented.

Appendix D

Approved Countries for Investments (All AAA or AA+)

- Australia
- Canada
- Denmark
- Finland
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- UK
- USA

Appendix E

The Treasury Management Role of the S151 (Responsible) Officer

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance.
- Reviewing the list of approved counterparties in accordance with recommendations from appointed treasury advisers (currently Arlingclose)
- Submitting regular treasury management policy reports.
- Submitting budgets and budget variations.
- Receiving and reviewing management information reports.
- Reviewing the performance of the treasury management function.
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.
- Ensuring the adequacy of internal audit, and liaising with external audit.
- Recommending the appointment of external service providers.

Appendix F

Minimum Revenue Provision

1. What is a Minimum Revenue Provision?

Capital expenditure is generally expenditure on assets, which have a life expectancy of more than one year, e.g., buildings, vehicles, machinery, etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred and so such expenditure is spread over several years so as to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP).

2. Statutory Duty

Statutory Instrument 2008 no. 414 s4 lays down that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.

3. Government Guidance

Along with the above duty, the Government issued guidance in February 2008, which requires that a Statement on the Commissioner's policy for its annual MRP should be agreed before the start of the financial year to which the provision will relate.

The Commissioner is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made with an overriding recommendation that the Commissioner should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to "have regard" to the guidance therefore means that:

a. Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which the Commissioner may consider his MRP to be prudent.

b. It is the responsibility of each Commissioner to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

4. PCC Policy

The Minimum Revenue Provision will be based on the Asset Life Method (Equal Installment Method).

For budget purposes the MRP will be linked to the expected life cycle of each capital project.