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| Meeting | **Fire & Rescue – Performance and Resources Board** | Agenda Item | 8. |
| Meeting Date | 25 March 2019 | Report Number |  |
| Report Author: | Paula Drane, Finance Manager |
| Presented By | Glenn McGuinness, Acting Chief Finance Officer |
| Subject | Treasury Management Strategy 2019/20 |
| Type of Report: | Information and Decision |

## Summary

This paper provides a review of the indicators approved by the Essex Fire Commissioner for 2018/19, in the light of latest assessment of capital spending and actual treasury management activity during the first nine months of 2018/19.

Secondly, the Commissioner is also asked to approve capital financing indicators and the treasury management strategy for 2019/20.

## RECOMMENDATIONS

It is recommended that:

1. the Treasury Management Policy Statement 2019/20 at **Appendix 2** be approved;
2. the Treasury Management Practices 2019/20 at **Appendix 3** be approved;
3. the Treasury Management position for 2018/19 be noted;
4. the performance against the capital financing indicators for 2018/19 be noted;
5. the 2019/20 treasury management indicators outlined in **Appendix 1** be approved; and
6. the continued use of the Depreciation Method for the calculation of the minimum revenue provision for capital financing be approved.

## Background

The 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 the Commissioner’s low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the financing 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 its 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 occasion any debt previously drawn may be restructured to meet Commissioner risk or cost objectives.

# CIPFA defines treasury management 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”*

## Treasury management strategy 2019/20

The strategy for 2019/20 covers two main areas:

# Capital issues

* the capital plans and the capital financing indicators;
* the minimum revenue provision (MRP) policy.

# Treasury management issues

* the current treasury position;
* treasury indicators which will limit the treasury risk and activities of the Commissioner;
* prospects for interest rates;
* the borrowing strategy;
* policy on borrowing in advance of need;
* debt rescheduling;
* the investment strategy; and
* policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

## the Capital Financing Indicators 2019/20 - 2021/22

The Commissioner’s capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the capital financing indicators, which are designed to assist the Commissioner’s overview and confirm capital expenditure plans.

The budgeted, forecast or estimated capital expenditure to be incurred for the current and future years that are recommended for approval, are summarised below:


## the Capital Financing Requirement

The Capital Financing Requirement (CFR) is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Commissioner’s underlying borrowing need. Any capital expenditure above, which has not immediately been paid for or funded by government grant or capital receipts, will increase the CFR. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) for capital financing is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life. Voluntary contributions (VRP) to capital financing costs can also be made.

The comparison of the CFR to the original indicators for 2018/19, and the new indicators to be agreed for 2019/20 are shown below:-


## Minimum Revenue Provision for capitaL financing policy statement

The Commissioner is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement) through a revenue charge (the minimum revenue provision for capital financing - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision for capital financing– VRP).

For 2019/20 the following arrangements are proposed:

* Depreciation Method for any increase in the capital financing requirement based on the average annual depreciation charge for the assets purchased subject to the maximum lives set out below:
	+ ICT - 5 years
	+ Property -  20 years
	+ Plant & Equipment – 8 years
	+ Appliances – 12 years
	+ Other Vehicles – 6 years
	+ Cycle Scheme – 1 year

## Affordability Prudential Indicators

The incremental effects of these plans on our revenue expenditure are shown below:


## Incremental impact of new capital investment on Council tax

The impact of capital investment on the council tax is used for budgeting. The incremental impacts on the 2018/19 and 2019/20 council tax on the capital programmes are shown below;

These figures represent the maximum potential impact, given the assumptions made.

The incremental impact of the proposed capital programme has been determined assuming that the revenue costs of borrowing would be fully met from Council tax. In reality, these costs would be financed from a combination of Revenue Support Grant, non-domestic rates, revenue account savings from earlier investment and Council tax income, though it is not possible to identify the different components.

It should be noted that the incremental impact of capital investment decisions for 2019/20 has been included within the proposed Council tax level, as set out elsewhere on this agenda.

The estimate of the incremental impact of capital investment decisions proposed in the capital programme report for the three year period beginning 2019/20, over and above capital investment decisions that have previously been taken by the Commissioner, are:-

The full year effect of these programmes in 2019/20 and future years is £1,535k additional revenue payments per year, with a £2.38 impact on the Council tax. This does not include the effect of any new capital projects started in 2019/20 or later.

## Ratio of financing costs to net revenue stream

Estimates of the ratio of financing costs to budget requirement for the current and future years and the actual figures for 2018/19 are:-

The estimates include interest payable and receivable, and the amounts required for the repayment of external loans. Net revenue streams represent the amounts to be met from government grants and local taxpayers.

## borrowing

The capital expenditure plans set out earlier provide details of the service activity of the Commissioner. The treasury management function ensures that the Commissioner’s cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury or capital financing indicators, the current and projected debt positions and the annual investment strategy.

## Current portfolio position

The Commissioner’s treasury portfolio position at 31 March 2019, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

Within the capital financing indicators there are a number of key indicators to ensure that the Commissioner operates its activities within well-defined limits. One of these is that the Commissioner needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Commissioner met this capital financing indicator at 31 March 2018 and expects to meet it at 31 March 2019. Present PWLB rules mean that there is no advantage to the Commissioner in repaying debt early and so the present cash surplus is expected to remain for 2019/20.

## treasury indicators: limits to borrowing activity

In respect of its external debt, it is recommended that the Commissioner approves the following authorised limits for its total external debt gross of investments for the next three financial years, and agrees the continuation of the current year’s limit as no amendment is necessary. These limits separately identify borrowing from other long-term liabilities, such as finance leases. The Commissioner is asked to approve these limits.

The recommended limits are based upon the estimate of most likely, prudent, but not worst-case scenario, with sufficient headroom for fluctuations in cash balances. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the CFR and estimates of cash flow requirements for all purposes.

The Commissioner is also asked to approve the following operational boundary for external debt for the same time period. The proposed operational boundary is based on the same estimates as the authorised limit, but reflects directly the Chief Finance Officer’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 flow movements, and equates to the maximum external debt projected by this estimate. The operational boundary represents a key management tool for monitoring by the Chief Finance Officer.

The Commissioner has remained within the operational limit during 2018/19 as shown in the graph below which outlines the Commissioner’s total external debt compared to the operational and authorised limits. The actual level of borrowing at 31 December 2018 was **£28.0m**.


## Borrowing Strategy

The Commissioner is 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 relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

## Treasury Management Limits on Activity

It is further recommended that the Commissioner set upper and lower limits for the maturity structure of its borrowings. The proposed limits are calculated as the projected amount of fixed borrowing that is maturing in each period, as a percentage of the total projected borrowing that is fixed rate. The Commissioner is recommended to set a lower limit of 0% for all years.

The Commissioner is in no danger of exceeding the maturity profile upper limit in 2018/19.

## Policy on Borrowing in Advance of Need

The Commissioner 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 within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Commissioner can ensure the security of such funds.

## annual Investment strategy

The Commissioner’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 Commissioner’s investment priorities will be security first, liquidity second, and then return.

Counterparty limits will be set through the Commissioner’s Treasury Management Practices (Appendix 3).

## Investment Counterparty Selection Criteria

The primary principle governing the Commissioner’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. The Commissioner will ensure that 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. It will also ensure that it has sufficient liquidity in its investments.

## BORROWING Strategy

The level of long term debt at 31 March 2019 will be **£27.0m.** The first graph below shows the maturity profile of all outstanding PWLB loans, and the second the cumulative profile.

The longest dated loan is one of £4.5m that runs until December 2034.


## Looking forward - remainder of 2018/19

Currently, indications are that as resources are deployed for capital expenditure there will be a reduction in cash balances during the remainder of the financial year. Existing cash balances will be used to fund this expenditure. Capital expenditure at 31 December was **£2.1m** with a further **£3.1m** projected by year end.

## Cash FLOWS

The table below shows the estimated future cash balances for the Commissioner:


## End of year investment report

At the end of the financial year, the Commissioner will report on its investment activity as part of its Annual Treasury Report.

## Use of Resources

There are two implications for the Commissioner regarding the use of resources and value for money implications of the approach to funding capital expenditure. Firstly, there is the balance between utilising cash surplus generated by the Commissioner and held as Reserves, and external borrowing. The Commissioner’s approach to the retention of reserves is considered as part of the budget setting process. The intention is to provide funds to enable significant fluctuations in expenditure within a budget year to be absorbed, whilst maintaining on-going expenditure funded by government grants and council tax.

The cash generated as reserves are used to reduce borrowings, should the reserves be needed to fund expenditure, the borrowings of the Commissioner will increase.

The second implication is in the choice of lender. The lender of choice for the Commissioner is the Public Works Loan Board.

## EQUALITY AND DIVERSITY IMPLICATIONS

There are no Equality Implications arising from this report.

## BENEFITS AND Risk Implications

The purpose of this report is to set out the risks and the approach to risk in the financing of capital expenditure.

## Legal Implications

The Chief Finance Officer must ensure that all relevant matters with regard to setting or revising these indicators are reported to the Commissioner. The Chief Finance Officer is also responsible for establishing procedures for monitoring performance against the treasury management indicators.

It is for the Commissioner, to make the judgement between the constraints of affordability and the demands of services for capital investment. The advice of the Chief Finance Officer is, however, important as there are specific duties placed upon the Chief Finance Officer, by section 114 of the 1988 Act, for proper financial administration.

## Financial Implications

The financial implications are set out in the report.

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| LOCAL GOVERNMENT (ACCESS TO INFORMATION) ACT 1985 |
| **Appendices**Appendix 1 - Treasury Management IndicatorsAppendix 2 - Treasury Management Policy Statement Appendix 3 – Treasury Management Practices |
| **List of background documents** - None |
| Proper Officer: | Chief Finance Officer |
| Contact Officer: |  |


## Treasury Management Policy Statement 2019/20

# Definition

The Essex Police, Fire and Crime Commissioner Fire and Rescue Authority (the Commissioner) defines its treasury management activities as:

The management of the Commissioner’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.

The Commissioner 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 Commissioner.

The Commissioner 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 on treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

## Principles

The Commissioner will create and maintain, as the cornerstones for effective treasury management:

* a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities; and
* suitable treasury management practices, setting out the manner in which the Commissioner will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The Commissioner will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

The Commissioner delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Performance and Resources Board and for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with the Commissioner’s policy statement and Treasury Management Practices and CIPFA’s Standard of Professional Practice on Treasury Management.

The Commissioner nominates the Performance and Resources Board to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

## Treasury Management Practices

# 1 Risk management

The Chief Finance Officer will design, implement and monitor all arrangements for the identification, management and control of treasury management risk.

# Credit and counterparty risk management

The Commissioner will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited. It will have a formal counterparty policy in respect of those organisations.

The following counter parties are included on the lending list as it acts as the main banker to the Commissioner - Lloyds plc.

Other money market funds, banks and similar institutions with “high Grade” credit ratings as defined in the table below may be used, subject to the agreement of the Chief Finance Officer. Should the rating for an institution vary across ratings agencies the Fitch rating will be used. Both the short and long term rating criteria must be met.

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| --- | --- | --- | --- |
| **Moody's** | **S&P** | **Fitch** |  |
| **Long-term** | **Short-term** | **Long-term** | **Short-term** | **Long-term** | **Short-term** |  |
| Aaa | P-1 | AAA | A-1+ | AAA | F1+ | Prime |
| Aa1 | AA+ | AA+ | High grade |
| Aa2 | AA | AA |
| Aa3 | AA- | AA- |
| A1 | A+ | A-1 | A+ | F1 | Upper medium grade |
| A2 | A | A |

# Alternative Investment Funds

The Commissioner may invest funds in the CCLA managed Local Authorities Property Fund. The amounts invested will be determined by the Chief Finance Officer and must comprise cash balances not expected to be required within the next two years. The value of funds invested shall be limited to the higher of £2m or 30% of the Commissioner’s net cash funds.

# Liquidity risk management

The Commissioner will ensure it has adequate though not excessive cash resources, borrowing arrangements, and overdraft facilities to enable it to have the level of funds available to it which are necessary for the achievement of its service objectives. The Commissioner will only borrow in advance of need where there is a clear case for doing so and will only do so for the current years capital programme or to finance future debt maturities.

Long-term borrowing, undertaken for periods in excess of 364 days, will only be undertaken for the purpose of financing capital spending. Short-term borrowing will be undertaken to cover temporary shortfalls of cash arising from timing differences between income and expenditure. It may also be used to temporarily finance capital spending, if the long-term borrowing rates are not favourable, in order to defer longer-term borrowing until interest rates are more advantageous. Consideration will therefore be given to a mix of short and long-term borrowing, having regard to the cash flow position and prevailing interest rates.

Borrowing will not be undertaken solely for the purposes of profiting from onward investment.

Short term borrowing will only be undertaken in accordance with the arrangements in place with the Commissioner’s bankers (Lloyds plc). In February 2019, these arrangements provide for a short term overdraft facility of £0.5m.

It is the government’s aim that the Public Works Loan Board (PWLB) should be able to meet all of the Commissioner’s legitimate need for long-term loans. It is therefore anticipated that if it is necessary to undertake long-term borrowing within the forthcoming year this will be secured from the PWLB. Alternative borrowing arrangements from the money market or other financing options will continue to be considered as well.

# Interest rate risk management

The Commissioner will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues. It will achieve this by the prudent use of its approved financing and investment instruments, methods and techniques to create stability and certainty of costs and revenues, at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates.

The Commissioner set the following upper limits on net exposure to variable and fixed interest rates:

These limits were set based on limiting surplus cash balances which are invested at variable rates of interest and to reflect the current practice of securing all long-term loans at fixed rates. The position for 2018/19 is set out in the chart below:


# Exchange rate risk management

The Commissioner will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

# Refinancing risk management

The Commissioner will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

# Legal and regulatory risk management

The Commissioner will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements.

# Fraud, error and corruption, and contingency management

The Commissioner will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements.

# Market risk management

The Commissioner will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect it from the effects of such fluctuations.

# 2 Performance measurement

The Commissioner is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement. Accordingly the treasury management function will be the subject of on-going analysis of the value it adds in support of the Commissioner’s service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements.

# 3 Decision-making and analysis

The Commissioner will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time.

# 4 Approved instruments, methods and techniques

The Commissioner will undertake its treasury management activities by employing appropriate instruments, methods and techniques, and within the limits and parameters defined in *TMP1 Risk management.*

# 5 Organisation, clarity and segregation of responsibilities, and dealing arrangements

The Commissioner considers it essential that all treasury management activities are structured and managed in a fully integrated manner and that there is at all times clarity of treasury management responsibilities. The principles on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies.

The responsible officer will ensure that there are clear written statements of the responsibilities for those engaged in treasury management, ensure that policies and procedures are followed at all times and ensure that there is proper documentation for all deals and transactions.

# 6 Reporting requirements and management information arrangements

The Chief Finance Officer will ensure that regular reports are prepared and considered on the implementation of its treasury management policies.

The Commissioner will receive an annual report on the strategy and plan for the coming year. The Performance and Resources Board will receive a mid-year review and an annual report on the performance of the treasury management function.

# 7 Budgeting, accounting and audit arrangements

The Chief Finance Officer will prepare an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function. The Chief Finance Officer will exercise effective controls over this budget and will report upon and recommend any changes required accordingly.

# 8 Cash and cash flow management

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of the Commissioner will be under the control of the Chief Finance Officer. Cash flow projections will be prepared on a regular and timely basis.

# 9 Money laundering

The Commissioner is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions to an appropriate Commissioner.

# 10 Training and qualifications

The Commissioner recognises the importance of ensuring that all staff involved in the treasury management function is fully equipped to undertake the duties and responsibilities allocated to them.

# 11 Use of external service providers

The Commissioner recognises that responsibility for treasury management decisions remains with the organisation at all times. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure it does so for reasons which have been submitted to a full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods by which their value will be assessed are properly greed and documented, and subject to regular review. Where services are subject to formal tender, legislative requirements will always be observed.

# 12 Corporate governance

The Commissioner is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty integrity and accountability.