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It is important to note that the Treasury Strategy Statement is adopted by the Commissioner based upon advice from external treasury advisors, and accordingly the Strategy is tailored to meet the specific and unique needs of the Commissioner. All financial information contained within this Report and Statement should not be used by any individual or organisation as a basis for making investment or borrowing decisions. The Commissioner and the treasury advisors will not accept any liability on behalf of any individual or organisation who seeks to act on the financial information contained within this Report and Statement.

TREASURY STRATEGY STATEMENT 2017/18**1.0 INTRODUCTION**

1.1 This Treasury Strategy Statement details the expected activities of the treasury function in the financial year 2017/18. The suggested strategy is based upon views of interest rates as advised by external advisors, supplemented with leading market forecasts. The strategy covers:

- the current portfolio position
- prudential indicators
- prospects for interest rates
- the borrowing requirement & strategy
- the investment strategy
- debt rescheduling opportunities
- MRP strategy

2.0 CURRENT PORTFOLIO POSITION

2.1 The Commissioner's estimated debt position as at 1st April 2017 is as follows:

	£m
Long-term Debt	
- PWLB fixed rate	47.2
- PWLB variable rate	0.0
	47.2

2.2 The average rate of interest on the above debt is expected to be 4.56%.

2.3 The estimated value of investments at 1st April 2017 is £125m:

- £94.5m maturing between one day and up to a year.
- £30.5m maturing between one and three and a half years.

3.0 PRUDENTIAL INDICATORS for 2017/18 to 2020/21

- 3.1 The 2003 Prudential Code for Capital Finance in local authorities introduced requirements for the manner in which capital spending plans are to be considered and approved. It requires the Commissioner to set a number of prudential indicators over a period of three years.
- 3.2 The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy:

External debt

These indicators are intended to ensure that levels of external borrowing are affordable, prudent and sustainable. The authorised limit for external debt is a statutory limit (section 3 of the Local Government Act 2003) that should not be breached under any circumstances. The proposed limits set out below have been calculated to take account of the current Commissioner's capital expenditure and financing plans and allowing for the possibility of unusual cash movements. If this limit is likely to be breached, it would be necessary for the Commissioner to determine if it is prudent to raise the limit or to instigate procedures to ensure that such a breach does not occur.

The operational boundary for external debt is a management tool for day to day monitoring and has been calculated with regard to the Commissioner's capital expenditure and financing plans allowing for the most likely, prudent, but not worst case scenario for cash flow. Temporary breaches of the operational boundary, due to variations in cash flow, will not be regarded as significant.

	2017/18	2018/19	2019/20
	£m	£m	£m
Authorised limit for external debt -			
Borrowing	100.0	100.0	100.0
Operational boundary -			
Borrowing	90.0	90.0	90.0

The Commissioner's actual external debt as at 31/03/16 is £47.2m, excluding transferred debt managed by Dudley M.B.C.

CIPFA Code of Practice for Treasury Management in the Public Services

The Commissioner continues to adopt the CIPFA Code of Practice for Treasury Management in the Public Services first adopted by the Police Authority in March 2002.

Interest rate exposures

These indicators allow the Commissioner to manage the extent to which he is exposed to changes in interest rates. The upper limit for fixed interest reflects the fact that it is possible to construct a prudent treasury strategy on the basis of using only fixed rate debt and investments, so long as the maturity dates of these debts and

investments are reasonably spread. The same does not apply to variable rates where a 100% exposure could lead to significant year on year fluctuations in the cost of debt. The upper limit for variable rate exposure allows for the use of variable rate debt to offset the exposure to changes in short-term rates on the portfolio of investments. This limit reduces over time as the strategy is to gradually reduce the level of investments.

	2017/18	2018/19	2019/20
	%	%	%
Upper limit for fixed interest rate exposure Net principal fixed rate borrowing / investments	100	100	100
Upper limit for variable rate exposure Net principal variable rate borrowing / investments	20	20	20

Maturity structure of borrowing and Investments longer than 364 days

The purpose of the prudential limits for principal sums invested for periods longer than 364 days is for the Commissioner to contain his exposure to the possibility of loss that might arise as a result of having to seek early repayment of principal sums invested. The maturity structure of fixed rate borrowing is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

Upper limit of principal invested for periods over 364 days	£60m
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Maturity structure of fixed rate borrowing	Upper limit	Lower limit
	%	%
under 12 months	25	0
12 months and within 24 months	25	0
24 months and within 5 years	50	0
5 years and within 10 years	75	0
10 years and above	100	25

- 3.3 In considering the capital programme for 2017/18, the anticipated future borrowing requirements were considered in the context of overall capital resources and the impact on the revenue budget.

	31st March 2016	31st March 2017	31st March 2018	31st March 2019	31st March 2020
	£'m	£'m	£'m	£'m	£'m
Capital financing requirement (CFR)	45.6	44.2	46.9	48.0	48.0
External borrowing	-47.2	-47.2	-51.3	-53.7	-53.1
Variance	-1.6	-3.0	-4.4	-5.7	-5.1

The CFR increases when expenditure is incurred and reduces when provision is made to repay debt.

4.0 PROSPECTS FOR INTEREST RATES

4.1 The Commissioner continues to use Capita Asset Services as a treasury advisor and has made use of their services in formulating a view on interest rates. Capita has in turn drawn upon the work of a number of City economic forecasters. Having discussed these, the following view of the prospects for interest rates over the next twelve months has been derived:

- **Short-term rates.**

The Bank of England Base Rate had been unchanged at 0.5% since March 2009 but was lowered to 0.25% in August 2016. It is expected to remain there during 2017/18 with a gradual rise to 0.75% by December 2019. The continuing low rate is a consequence of turbulence in the global economy. The uncertainty around the negotiations surrounding "Brexit" is the main factor affecting interest rates. If economic growth continues to be slow, as currently forecast, Base Rate may rise more slowly, or remain low for longer. For 2017/18 an investment return of 0.30% can be expected because a proportion of the funds are already invested at rates above 1.0% but it is expected that the majority of maturities during 2017/18 could be at rates of 0.25% or less.

- **Long-term rates.**

The 50 year PWLB rate is expected to be around 2.70% in 2017/18 before rising to 3.00% by the March 2019. Similarly, the 25 year PWLB rate is estimated at 2.90% for much of 2017/18 and then gradually rising to 3.20% by March 2019. Again the result of the "Brexit" negotiations, low economic growth and inflation will have an impact on these interest projections.

4.2 The overall strategy will be based on the projections above. However, the Commissioner will maintain flexibility to take account of unexpected variations from the forecast.

5.0 ANNUAL INVESTMENT STRATEGY

- 5.1 The Commissioner's investment activities have regard to guidance issued by the Government and CIPFA from time to time.
- 5.2 In making investment decisions, the priorities will be security of the Commissioner's funds and liquidity. Pursuit of the best possible return on investments will only be allowed to the extent that this is consistent with very low levels of risk in terms of security and liquidity.
- 5.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Commissioner will not engage in such activity.
- 5.4 The Commissioner will make use of both specified investments and non-specified investments. Specified investments are those that satisfy the following conditions:
- a) The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.
 - b) The Commissioner requires that the investment be repaid or redeemed within 12 months of the date on which the investment was made.
 - c) The investment does not involve the acquisition of share capital or loan capital in any corporate body.
 - d) The investment satisfies any of the following conditions:

The investment is made with the UK government (Debt Management Agency Deposit Facility), a local authority, a parish council or a community council.

The investment is made with a body which has been awarded a "high credit rating" by a credit rating agency.

If the body is not a UK bank, the sovereign country must be awarded a "high credit rating" by a credit rating agency.

- 5.5 For the purposes of this strategy use is made of the creditworthiness service provided by Capita Asset Services to define a "high credit rating" as follows (credit ratings taken from Fitch IBCA):

UK banks and building societies – short-term rating F1 or higher and viability rating of "a-" or higher.

Foreign banks – short-term rating F1+, and a viability rating of a minimum of "a" with a sovereign rating of AAA.

These will be supported by other accredited rating systems (Standard & Poor's and Moody's), credit watches and outlooks, Credit Default Swap data, and information from the financial press.

5.6 Since the credit crisis, there are several semi-nationalised banks in the UK with credit ratings which do not conform to the credit criteria usually used to identify banks which are of high credit worthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for the rating agencies to assign them an individual rating for their stand alone financial strength. However, these institutions are now recipients of an F2 short term rating as they effectively take on the creditworthiness of the Government itself. That is deposits made with them are effectively being made to the Government.

5.7 The Commissioner's CFO will monitor credit ratings through the receipt of credit rating bulletins from the treasury management consultants at Capita Asset Services. Institutions that cease to meet the criteria above will immediately cease to be treated as specified investments.

5.8 Non-specified investments are those that do not meet the criteria in 5.4 to 5.6 above. In determining which categories of non-specified investments may prudently be used, account will be taken of advice from the advisors, Capita, and, if investments are for 12 months or more, long-term credit ratings as determined by Fitch IBCA.

5.8 So far, the following categories of investment have been identified as prudent for use. The table also shows the maximum value of investments that may be held:

Category of investment	Maximum value for this category of investments
Sterling deposits in excess of 364 days with Local Authorities and UK banks (where these are not "specified investments" as defined above).	£60m

5.10 In determining the maximum period for which investments may be held, regard to the most recent cash flow forecast (Schedule 15 to the Treasury Management Practices) will be taken. No investment will be entered into where the cash-flow forecast indicates that, as a result of that investment, the Commissioner would be forced to borrow money in a future year that would not otherwise have had to be borrowed.

5.11 Also at the time of making a new investment, long-term investments (investments of one year's duration or more) should not constitute more than 30% of the total pool of investments.

5.12 Investments with a single institution should not exceed 25% (15% for Building Societies) of the total pool of investments at month end. Investments with a group of banks should not exceed 30% of the total pool of investments at month end.

6.0 CAPITAL BORROWING REQUIREMENT & STRATEGY

- 6.1 The Commissioner's CFO has undertaken a review of capital investment requirements and likely resource levels. Although there is some uncertainty around specific requirements and future funding levels, it is likely that there may be a need to borrow to fund the Capital Programme at some point over the next five years.
- 6.2 If there is a need to borrow, forecasts suggest that there are potential options available. Variable rate borrowing may be attractive throughout 2017/18 as it is expected to be cheaper than long term fixed borrowing. Under 10 year PWLB rates are forecast to be lower than longer term borrowing which could enable the spread of debt maturities as the focus in recent years has been to concentrate on long dated debt.
- 6.3 Little difference between 25 and 50 year borrowing is forecast, however, borrowing in the 25 to 30 year period could be more attractive than 50 year borrowing as the spread between the PWLB new borrowing and early repayment rates is considerably less. This strategy would also allow for debt rescheduling in the future; again improving the spread in the debt maturity profile.
- 6.4 Should PWLB rates fall below the forecast rates, borrowing could be undertaken at any time to take advantage of low rates.
- 6.5 However, the next financial year is expected to see a continuation of the relatively low Bank Rate which may present an opportunity to review the Commissioner's external borrowing strategy. As investments exceed the borrowing requirement over the next year, and cash can be accessed from maturing investments, consideration needs to be given to the potential of internal borrowing.
- 6.6 As long term borrowing rates are expected to be higher than rates on the loss of investment income, and look likely to be so for the next couple of years, it may be preferable to avoid some new external borrowing to maximise savings in the short term. A reduction of investments also has the benefit of reducing exposure to interest rate and credit risk.
- 6.7 The Commissioner's CFO will continue to cautiously monitor the interest rate market and adopt a pragmatic approach to any changing circumstances.

7.0 TEMPORARY INVESTMENTS STRATEGY

- 7.1 Capita has forecast Bank Base Rate to be 0.25% for all of 2017/18 which suggests that an investment return of 0.30% can be achievable assuming that the Bank rate does not decrease.
- 7.2 Capita also predict that Bank Base Rate may begin to rise by mid 2019 back to about 0.75% by December 2019 which suggests locking into long term investments while rates are so historically low should be resisted. If investment opportunities arise at greater rates than the anticipated Base Rate then they should be considered.

8.0 DEBT RESCHEDULING AND PREMATURE REPAYMENT OPPORTUNITIES

- 8.1 The introduction of different PWLB rates on 1 November 2007 for new borrowing as opposed to early repayment of debt, and the setting of a spread between the two rates (of about 40 – 50 basis points for the longest period loans narrowing down to 25 – 30 basis points for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive.
- 8.2 Due to short term borrowing rates expected to be considerably cheaper than longer term rates, there may be opportunities to generate savings by switching from long term debt to short term debt. These savings will need to be considered in the light of their short term nature and the cost of refinancing short term loans as they mature. Any rescheduling and repayment of debt is likely to cause a rebalancing of the Commissioner's debt maturities towards a flatter maturity profile because in the past there has been a concentration on longer dated PWLB loans.
- 8.3 The potential for making savings by reducing investment balances by repaying debt prematurely should also be considered as short term rates on investments will be lower than rates paid on currently held debt. However, this will need careful consideration in the light of premiums that may be due on early debt repayment.

9.0 MINIMUM REVENUE PROVISION STRATEGY

- 9.1 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, and machinery. As it would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred, such expenditure is spread over several years to try to match the useful life of the asset. This is done by an annual Minimum Revenue Provision, which was previously determined under regulation but now is determined under guidance.
- 9.2 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 which came into force on 31 March 2008 states that an annual MRP statement needs to be produced which details the methodology for the charge to revenue for debt redemption. The Regulations require that the Commissioner "shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent".
- 9.3 Methods of making prudent provision for MRP include four options. Options 1 and 2 should only be used in relation to Capital expenditure incurred before 1 April 2008 and Capital expenditure incurred on or after that date which the Commissioner is satisfied forms part of Supported Capital Expenditure. For all unsupported borrowing covered by the Prudential Code on or after 1 April 2008, Options 3 or 4 must be used.
- 9.4 The MRP options are:
- **Option 1 – Regulatory Method.** MRP is equal to the amount determined in accordance with the former sections 28 and 29 of the 2003 Regulations as if they had not been revoked.
 - **Option 2 – Capital Financing Requirement Method.** MRP is equal to 4% of the Capital Financing Requirement at the end of the previous year.

- **Option 3 – Asset Life Method.** Revenue provision is spread over the determined useful life of the Asset either in equal instalments or using an annuity method. The first charge can be delayed until the asset is operational.
- **Option 4 – Depreciation Method.** MRP is equal to the provision required in accordance with depreciation accounting in respect of the asset.

9.5 It is recommended that for 2017/18, Option 2 will continue to be used for Capital expenditure incurred before 1 April 2008. For all subsequent Capital expenditure financed by Borrowing, the equal instalment method of Option 3 will be used. In the future it will be necessary to choose which assets are financed by borrowing carefully since the useful lives of the assets could increase or decrease MRP charges.