



**Ethics Transparency and Audit Panel
5 February 2020**

TREASURY MANAGEMENT STRATEGY 2020/2021 (Fire) Item 4 (ii)

Report of the Director of Finance / S151 Officer

1. Background

- 1.1 In addition to the existing role overseeing Staffordshire Police, the Staffordshire Commissioner became responsible for the governance of the Staffordshire Fire and Rescue Service from August 2018. However, both remain separate organisations, with separate budgets and governance processes.
- 1.2 This report will detail the treasury management strategy for the Staffordshire Commissioner Fire and Rescue Authority only; a separate report has been completed for the Staffordshire Police and Crime Commissioner. Therefore, reference is made only to **Staffordshire Commissioner Fire and Rescue Authority ('the Authority')** as part of this report.

2. Introduction

- 2.1 This report outlines the reasury Management Strategy for the 2020/21 financial year.
- 2.2 Treasury management comprises the management of the Authority's cash flows, borrowings and investments, and their associated risks. The Authority is exposed to financial risks, including the effects on revenue from changing interest rates on borrowings and investments, and the risks of a potential loss of invested funds. Therefore, it is essential that the Authority successfully identifies, monitors and controls financial risk as part of prudent financial management.
- 2.3 The Authority conducts its treasury risk management within the framework of the Chartered Institute of Public Finance and Accountancy's (CIPFA) *Treasury Management in the Public Services Code of Practice 2017 Edition* (the CIPFA Code). The CIPFA Code requires that the Authority approves a treasury management strategy before the start of each financial year. In addition, this report fulfils the legal obligation to have regard to the CIPFA Code under the Local Government Act 2003.
- 2.4 The Annual Investment Strategy (AIS) for 2020/21 meets the requirements of the statutory guidance issued by the Ministry of Housing, Communities and Local Government's (MHCLG) in its *Guidance on Local Government Investments 2018 Edition*.
- 2.5 This strategy has been prepared in conjunction with the Treasury and Pensions team at Staffordshire County Council (SCC), after consultation with the Director of Finance and Section 151 Officer.

3. **Recommendations**

- 3.1 That ETAP note the proposed borrowing strategy for the 2020/21 financial year comprising:
- a) a borrowing strategy to operate within the prudential limits set out in **Appendix 2**;
 - b) a borrowing strategy, to use cash as far as is practical with the option to borrow up to £3m long-term where the Director of Finance, Assets and Resources (the Director) considers this appropriate in 2020/21;
 - c) a forward borrowing strategy that will not be used in 2020/21; and
 - d) a loan restructuring strategy that is potentially unlimited where this rebalances risk.
- 3.2 That, in accordance with the MHCLG's Guidance on Local Authority Investments, approval is given for the adoption of the Annual Investment Strategy (AIS) 2020/21 as set out in **Section 7** of this report and **Appendix 4**. Also that approval is given for policies on:
- a) reviewing the strategy;
 - b) the use of external advisors; and
 - c) training.

4. **External Context**

Economic background

- 4.1 In its November 2019 Monetary Policy Report, the Bank of England confirmed UK GDP growth had slowed materially to 1% in 2019, moving further away from its long-term trend rate of about 2%. This was due to weaker global growth driven by trade protectionism, and the domestic impact of Brexit-related uncertainties. However, the Bank still expects an orderly transition to a free trade agreement between the UK and the EU, with forecasts for UK economic growth to pick up and reach 1.6% in 2020 and 1.8% in 2021.
- 4.2 The UK's progress in negotiating an exit from the European Union (EU), together with any future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21.
- 4.3 Brexit has been delayed until 31 January 2020. However, with the recent Conservative victory in the General Election, it is thought that the UK-EU Withdrawal Agreement will now be approved by Parliament, providing some level of near-term certainty.
- 4.4 The Bank of England's Monetary Policy Committee (MPC) maintained Bank Rate at 0.75% in November 2019, following a 7-2 vote. Despite keeping rates on hold, MPC members indicated they would be prepared to cut interest rates if Brexit uncertainties and the slowdown in global growth continued. UK inflation remained below the Bank of England target of 2%, with Consumer Price Inflation (CPI) falling to 1.5% in October 2019. This supports the view that MPC members may be less inclined to raise interest rates even if there is a Brexit deal.
- 4.5 The global economy is entering a period of slower growth, mainly due to the trade policy stance of the US. Growth in the US economy slowed to 1.9% in Q3 2019 on

the back of its ongoing trade war with China. The Federal Reserve continued to ease monetary policy and at its last meeting in October 2019, it cut rates to the range of 1.5% to 1.75%. Financial markets expect further loosening of US monetary policy in 2020.

- 4.6 Growth in Europe remains soft; Germany, its largest economy avoided recession in Q3 2019, but the outlook remains weak. Eurozone inflation was 0.7% year on year in October 2019, the lowest it had been for 3 years and well below the European Central Bank (ECB) target of 2%. In response, the ECB has recommenced quantitative easing and has maintained the policy of ultra-low interest rates; the main interest rate is at 0% and the deposit facility rate at -0.5%.

Credit outlook

- 4.7 In 2015, the Bank Recovery and Resolution Directive (BRRD) introduced a significant risk for local authorities whereby a failing bank will need to be 'bailed-in' by current investors instead of being 'bailed out' by government. The risk of loss for local authorities in a bail-in situation is much greater, as any unsecured fixed-term deposits would be ranked near the bottom of the capital structure and would be one of the first to suffer losses.
- 4.8 As the risk under bail-in regulations has increased, the Authority will continue to work with the Treasury and Pensions team at the County Council to monitor developments on bank credit risk.
- 4.9 Ring-fencing legislation adopted by UK financial regulators means the larger UK banks have separated their core retail banking activity (ring-fenced) from the rest of their business (non ring-fenced) i.e. investment banking. The aim is to protect retail banking activity from unrelated risks elsewhere in the banking group, as occurred during the global financial crisis. Credit rating agencies have adjusted the ratings of some of the legally separate entities with ringfenced banks generally better rated than their non-ringfenced counterparts.
- 4.10 The uncertainty caused by the protracted negotiations between the UK and EU continues to weigh on the creditworthiness for UK and European banks with substantial operations in both jurisdictions. However, with the recent Conservative victory in the General Election, some certainty may be provided if Parliament agree the UK-EU Withdrawal Agreement.

Interest rate forecast

- 4.11 In terms of treasury management activity, the Bank Rate is fundamental to the income received and may also affect expenditure on loan interest where new loans are taken out or variable rate loans are held.
- 4.12 The County Council is forecasting that Bank Rate will remain at 0.75% until the end of 2022. There are risks to this forecast due on-going Brexit uncertainties and the continuing global economic slowdown. As such, the risks to the interest rate forecast are considered firmly to the downside.
- 4.13 The Bank of England's MPC had previously maintained a bias towards tighter monetary policy. MPC members have now stated an interest rate rise is less likely, even if a Brexit agreement is reached.

- 4.14 Gilt yields have risen recently although they remain at historically low levels. County Council projections indicate only a modest upward movement is expected from current levels; 10-year and 20-year gilt yields are forecast to rise to around 1.00% and 1.40% by 2022 respectively. However, volatility arising from both economic and political events are likely to continue.
- 4.15 Due to the risks of financial market volatility, the treasury strategy retains the low risk approach adopted in recent years, based on prioritising security, liquidity and then yield. The Authority's full creditworthiness approach is detailed in the Authority's Annual Investment Strategy (AIS) outlined in **Section 7**. This also sets out where cash will be invested.

5. **Local Context**

- 5.1 On 30 November 2019, the Authority held £17.6m of external borrowing and had £15.5m temporarily invested. The Authority's future requirements for borrowing and investments can be considered by reviewing its balance sheet forecasts.

Balance sheet

- 5.2 In terms of borrowing, the Authority discloses its Capital Financing Requirement (CFR) as part of its Statement of Accounts. This represents the underlying need to borrow for capital purposes i.e. the amounts that have been financed through external and internal borrowing rather than being permanently financed.
- 5.3 If the Authority increases debt to fund additional capital expenditure, this will increase its Loans CFR; conversely repaying debt through the Minimum Revenue Provision (MRP) will reduce its Loans CFR. The table below shows forecasts for the Authority's Loans CFR and how this will be financed through external and internal borrowing:

	31.03.19 Actual £m	31.03.20 Estimate £m	31.03.21 Forecast £m	31.03.22 Forecast £m	31.03.23 Forecast £m
Loans CFR	25.8	26.9	28.6	27.2	27.6
Less: External borrowing	(18.1)	(17.6)	(17.1)	(17.1)	(16.8)
Less: Capital financing from reserves	(1.4)	(1.6)	(2.6)	(0.0)	(0.0)
Internal / (over) borrowing	6.3	7.7	8.9	10.1	10.8

- 5.4 The table shows that the Authority's Loans CFR is forecast to increase steadily over the period, primarily because of its replacement of vehicles and property capital programme. The Authority's internal borrowing requirements move in line with the Loans CFR projections; there is a greater increase from 2021/22 as it predicts it will no longer use reserves for capital financing in the latter period.
- 5.5 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total external borrowing should be lower than its highest forecast CFR over the next three years; the previous table shows the Authority will comply with this recommendation in this period.

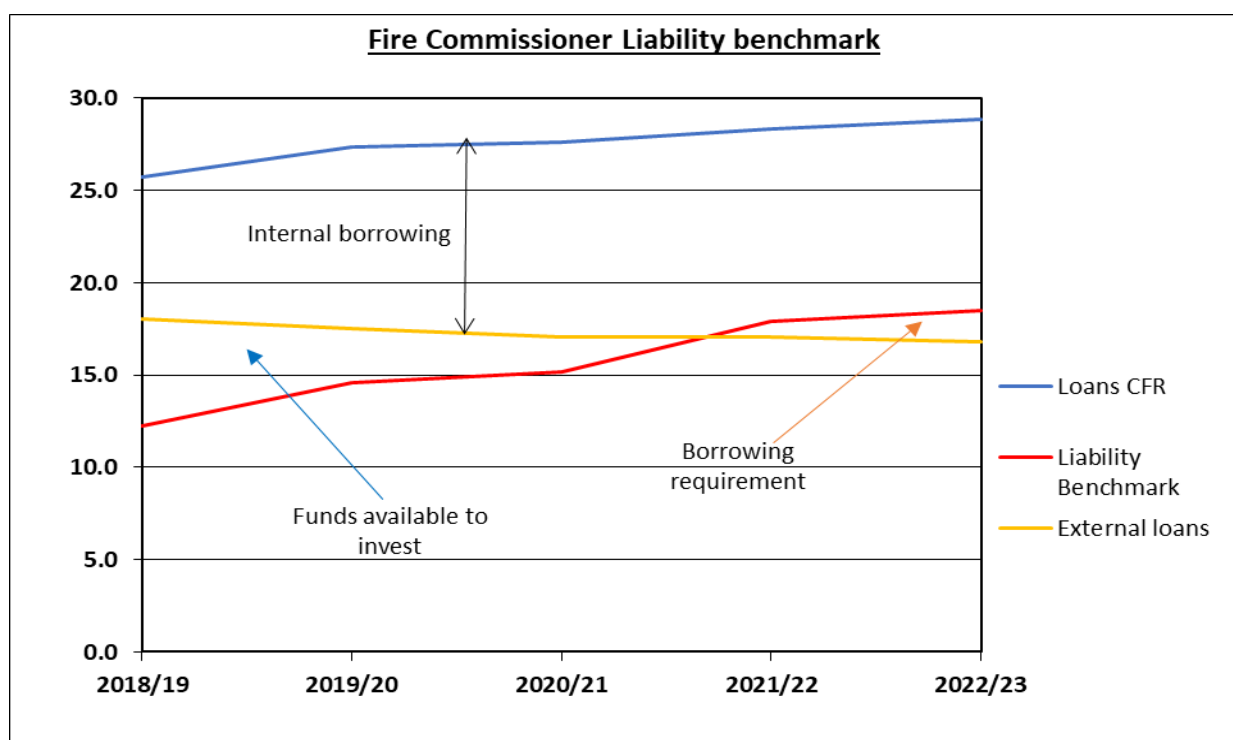
- 5.6 For investments, the Authority's total resources available are measured by its usable reserves and working capital less any amounts that have been internally borrowed. This is shown in the following table:

	31.03.19 Actual £m	31.03.20 Estimate £m	31.03.21 Forecast £m	31.03.22 Forecast £m	30.03.23 Forecast £m
Usable reserves	15.7	14.7	13.3	13.3	13.3
Working capital surplus	0.0	0.0	0.0	0.0	0.0
(Less Internal) / Add Over Borrowing	(6.3)	(7.7)	(8.9)	(10.1)	(10.8)
Investments/ (New borrowing)	9.4	7.0	4.4	3.2	2.5

- 5.7 This demonstrates the Authority's recent strategy in using internal borrowing to reduce the need for external borrowing and as a result, temporary investment levels. However, this strategy may not be sustainable from 2021/22 as it is forecast that the Authority will not have sufficient internal resources to cover the internal borrowing requirement; it may need to borrow from external sources.

Liability benchmark

- 5.8 The CIPFA Prudential Code encourages local authorities to develop their own liability benchmark to manage treasury management risk. The liability benchmark represents the minimum amount of loans required to maintain cash balances at nil i.e. when all usable reserves and working capital surpluses are used to offset the amount of loans borrowed.
- 5.9 Forecasts for the liability benchmark can be used to predict when further borrowing may be required or when cash is available to invest. Forecasts for the Authority's liability benchmark are shown in the following chart:



- 5.10 The chart shows that the Authority's Loans CFR (blue line) has been financed through a combination of external borrowing (yellow line) and internal borrowing (the difference between the yellow line and the blue line).
- 5.11 The chart indicates that Authority will have funds available to invest up until 2021/22, at which point its level of external loans falls below the minimum required by the liability benchmark. This is because the Authority's Loans CFR, and hence its liability benchmark, has been steadily increasing whilst its level of external loans has been steadily decreasing with loans being repaid upon maturity.
- 5.12 The Authority may need to borrow externally in 2021/22 as it will not have sufficient usable reserves and working capital to cover the amounts required internally. Therefore, the liability benchmark will have an impact on the Authority's borrowing strategy for 2021/22.

6. Borrowing Strategy 2020/21

- 6.1 The Authority is likely to hold £17.1m in external loans in 2020/21, as part of its strategy for funding previous years capital programmes. The Authority will need to ensure total amounts borrowed do not exceed the authorised limit of £114.6 million, as disclosed in **Appendix 2**.

Objectives

- 6.2 The primary objective for the Authority when considering borrowing money is to strike an appropriate balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. Although relatively low interest costs may be secured for the short term, it is more difficult to predict interest costs over the long term.

Strategy

- 6.3 Given the significant cuts to public services and to local government funding, the Authority continues to address the key issue of affordability without compromising the long-term stability of its debt portfolio. As short-term interest rates have been lower than long term rates, it is more cost effective to use internal resources in lieu of borrowing in the short term.
- 6.4 The balance sheet analysis at **paragraph 5.7** and the liability benchmark analysis at **paragraph 5.12** both indicate the Authority may not have sufficient internal resources for use in lieu of borrowing from 2021/22 and is likely to have a need to borrow externally.
- 6.5 It is important to understand that not all of the borrowing requirement needs to be closed with loans; an important aspect of using some cash is its risk reduction effects:
- Using cash reduces security risk as investment balances are lower. Regulations emphasise the importance of minimising this risk and is discussed later in this report. This is even more important to the Authority with the advent of bail-in risk.
 - There is less exposure to variable interest rate changes; this exposure arises when a fixed term loan is taken out with corresponding variable rate investments. This is avoided when cash is used.

- The low interest rate environment allows a portion of the capital programme to be funded at low cost through the use of cash and this opportunity should continue to be maximised.

6.6 The Authority will monitor the benefits of internal borrowing on a regular basis as this strategy must be balanced against the possibility that long-term borrowing costs may increase in future years, leading to additional costs incurred in deferring borrowing. The Authority will need to determine whether it borrows additional sums at long term fixed rates in 2021/22 with a view to keeping future interest costs low. To this end, the Authority will consult with the treasury team at Staffordshire County Council.

6.7 The strategy proposed is one that still aims to balance the liquidity needs of day to day cash management with the low risk approach that is offered by using cash. As cash balances may not be sufficient in the future, the Authority will need to consider what loans should be raised to provide the liquidity necessary to allow it to continue to pay its bills.

Sources of borrowing

- 6.8 The approved sources of long term and short-term borrowing are:
- Public Works Loans Board (PWLB) and any successor body
 - UK Municipal Bonds Agency Plc and any other special purpose companies created to enable local authority bond issues
 - Other UK public sector bodies
 - UK public pension funds
 - Approved banks or building societies authorised to operate in the UK
 - Any institutions approved for investments.

Short-term loans

6.9 Short-term loans raised from money markets are typically under 6 months duration. These are low cost and the Authority can respond flexibly to liquidity pressures by raising these when needed. The disadvantage of short-term loans is one of availability and it can be difficult to raise quickly from banks and building societies.

6.10 The local authority lending market has progressed considerably in recent years and funds are generally available in the short to medium term. However future availability cannot be predicted as loans raised depend upon other local authorities still having cash balances and being prepared to lend it to the Authority.

Long-term loans

6.11 Long-term loans are those for a duration of more than 12 months. The Authority has previously raised the majority of its long-term borrowing from the PWLB, a statutory body that issues loans to local authorities. Government consent is not required hence the PWLB continues to be seen as the 'lender of first resort' because of the flexibility and ease of access. However local authorities are required by law to have regard to the Prudential Code and only borrow within relevant legislation and its borrowing powers.

6.12 On 9 October 2019, HM Treasury, the government department responsible for the PWLB, increased the margin over gilt yields from 80bps to 180bps, for PWLB

certainty rate loans. The government reasoned that the cost of borrowing had fallen to record lows and some local authorities have substantially increased their use of PWLB borrowing. This new shift in policy was aimed to restore PWLB lending rates to 'normal' levels.

- 6.13 The new rates are substantially higher than the rates under the old policy although they are still low when compared to historical PWLB rates. Where the Authority has a long-term borrowing need, it will need to consider the alternative sources of borrowing highlighted in **paragraph 6.8**. Seeking lower interest costs may introduce greater administrative and resource costs as well as increased risk and this would need to be balanced against the ease of access to loans from the PWLB.
- 6.14 The exact type of loan to be raised by the Authority and its duration would have to be considered at the time; but with current interest rates and the maturity profile of the existing loan portfolio, loans towards the shorter end of the yield curve offer better value for money.
- 6.15 The optimum timing for borrowing cannot be foreseen and decisions often need to be taken at short notice. Because of this, it is proposed to delegate the decision to borrow long-term loans to the Director at the Authority, and reported retrospectively to the Staffordshire Police, Fire and Crime Panel. In addition, the outturn and half-year reports will update the position later in the year.
- 6.16 The overall strategy of maximising the use of cash in lieu of borrowing is still considered a relatively low risk strategy, although it is impossible to eliminate all treasury risk. The consequences of using cash are the possibility of increased costs in the future if interest rates rise; this must be balanced with the extra cost now if loans are raised (the cost of carry).

Loan restructuring

- 6.17 Movements in interest rates over time may provide opportunities to restructure the loan portfolio in one of two ways:
- Replace existing loans with new loans at a lower rate (known as loan rescheduling).
 - Repay loans early without replacing the loans. However this would increase the use of cash which may not be possible under current forecasts for reserves.
- 6.18 Currently loan restructuring would be very expensive and unattractive for the Authority. This is because:
- Gilt yields are still historically low. This would lead to large penalties to compensate the PWLB or its successor body if loans were repaid early; and
 - new loans are much more expensive than in the past even though gilt yields are so low. Since 2019 the Government has increased the margin on top of gilts at which it onward lends to local government via the PWLB or its successor body (the margin is now 2.00% but can be reduced by 0.20% if the PWLB Certainty Rate is applied).
- 6.19 Market conditions and regulations can change and the outcome cannot be foreseen. It is therefore proposed to allow unlimited loan restructuring with the decision being delegated to the Director at the Authority reported retrospectively to the Staffordshire Police, Fire and Crime Panel.
- 6.20 The loans position includes a £1m LOBO (Lender Option Borrower Option) loan held with Dexia Bank where the maturity date is not certain. The bank has an option

to amend (i.e. increase) the loan interest rate on pre-determined dates in 2020/21; if this option is exercised then the Authority as a matter of policy will repay the loan.

- 6.21 In recent years, some banks owning LOBO loans, such as Commerzbank, have been actively removing these non-core assets from their balance sheet, and were willing to significantly reduce the repayment penalty. Dexia Bank are not currently offering such favourable repayment terms for their LOBO loans, although it is conceivable to think they may do so in the future.
- 6.22 Aside from a potential restructure, it is judged unlikely in the current interest rate environment that LOBO loans options will be exercised. A repayment of the LOBO loan would further increase the “gap” funded from cash; alternatively the Authority could take up an alternative loan, say with the Public Works Loan Board (PWLb), or its successor body. A decision would be taken at the time.
- 6.23 Market conditions and regulations can change and the outcome cannot be foreseen. It is therefore proposed to allow unlimited loan restructuring with the decision being delegated to the Director at the Authority, and reported retrospectively to the Staffordshire Police, Fire and Crime Panel.

Policy on Borrowing in Advance of Need

- 6.24 As the borrowing strategy proposed for 2020/21 involves maximising the use of cash until borrowing is required, the policy is not to borrow in advance this year. This will be revisited annually as part of the overall borrowing strategy.

7. Annual Investment Strategy (AIS) 2020/21

- 7.1 It is the Authority’s borrowing strategy that determines its investment strategy. The current economic environment of relatively low interest rates also favours the use of cash instead of borrowing, hence balances available for temporary investments are likely to be less.
- 7.2 Nevertheless, the Authority may have significant level of funds to invest at different points of the year; this usually represents income received in advance of expenditure plus balances and reserves held. In the previous financial year, the Authority’s investment balance averaged at around £16 million.

Brexit risks

- 7.3 In the UK’s exit from the EU, there are substantial issues that remain unresolved, meaning that several potential outcomes still exist. One of the more critical outcomes for the UK economy would be a no-deal Brexit and the Authority has considered the possible repercussions of this in the context of its treasury risk management. In this respect, the Authority will continue to seek support from the Treasury team at the County Council.
- 7.4 Bank of England stress tests have shown the strongest UK banks can withstand a no-deal Brexit scenario. Banks used by money market funds (MMFs) for their underlying investments continue to have strong credit ratings. Meanwhile investments held with central and local government are less exposed to such credit risk. Despite these assurances, a high-risk scenario is still a possibility in which case the Authority proposes to use their account with central government’s Debt Management Office (DMO), for any short-term investment needs.

- 7.5 The liquidity of certain funds from banks and MMFs domiciled outside the UK could be affected by unforeseen regulatory issues from a no-deal Brexit position. For this reason, the Authority proposes not to hold the entirety of its liquid cash outside of the UK over the Brexit period.

MiFID II

- 7.6 Following the introduction of the second Markets in Financial Instruments Directive (MiFID II) regulations from January 2018, local authorities will automatically be treated as retail clients by financial services firms, unless they meet the criteria and 'opt up' to be professional clients. As a retail client, the Authority would receive enhanced protections, but this would also mean it may face increased costs and restricted access to certain products including money market funds, pooled funds, treasury bills and treasury advice.
- 7.7 The Authority meets the criteria set out under MiFID II and will continue to be treated as a professional client by regulated financial services firms in 2020/21.

Objectives

- 7.8 The CIPFA Code requires the local authorities to invest their funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return or yield.
- 7.9 The Authority's objective when investing its cash is to strike an appropriate balance between risk and return, thereby minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Strategy

- 7.10 The main characteristics which should determine an investment strategy are:
- the credit risk of the counterparties invested with;
 - the length of the investment; and
 - the type of financial instrument that is used.
- 7.11 The Authority has taken a low risk approach to investment and the AIS for 2020/21 will continue to do so. Short term unsecured bank investments have generally provided very low returns with the increasing risk from bail-in regulations (see **paragraph 4.7**). The Authority will continue to concentrate its short-term investments in more secure MMFs and government investments.
- 7.12 MHCLG Guidance on Local Government Investments specifies the types of financial instruments that local authorities can invest in and the Authority has divided its approved treasury investments into Standard Investments and Non-Standard Investments.

Standard investments

- 7.13 The Authority considers Standard Investments to be those made with approved counterparties that do not require further approval from the Director of Finance at the Authority. These investments tend to be for a period of less than a year and are those most frequently used by the Authority. Standard Investments can be invested with:

- UK Government – central government or local authority, parish council or community council
- short term MMFs
- bank and building society investments

i) Government

- 7.14 The Authority invests with central government by using its Debt Management Account Deposit Facility (DMADF) account. Funds held in the DMADF account are backed by the UK Government so they are very secure; however returns tend to be lower than those received elsewhere.
- 7.15 The Authority invests in term deposits with local authorities which can provide a higher return depending on the availability of, or the need for cash in the local authority lending market. Like central government investments, local government investments are not subject to bail in risk.
- 7.16 Although investments in the local authority lending market have a low risk of insolvency, they are not completely without risk. The financial risks of a few local authorities have been documented in the press; the Authority will continue to monitor such developments and seek information from the County Council's Treasury team where necessary.

ii) Money Market Funds (MMFs)

- 7.17 Money Market Funds have high credit quality and are pooled investment vehicles consisting of money market deposits and similar instruments. Short-term MMFs that offer same day liquidity can be used as an alternative to instant access bank accounts. The Authority has used same day notice MMFs for some time as they have tended to provide greater security and a higher yield than bank accounts.
- 7.18 EU regulation introduced in January 2019 has meant most same day notice MMFs have converted from a Constant Net Asset Value (CNAV) to a Low Volatility Net Asset Value (LVNAV) structure. The assets of LVNAV MMFs are marked to market, meaning the dealing NAV (unit price) may fluctuate. However, LVNAV MMFs are allowed to maintain a constant dealing NAV provided they meet strict criteria and minimum liquidity requirements. Public debt CNAV MMFs are still available where 99.5% of assets are invested in government debt instruments.
- 7.19 The Authority will continue to use same day notice MMFs that meet the criteria listed below. These are considered to have sufficient high credit quality to be included on the Authority's Approved Lending List:
- Diversified – MMFs invest across many different investments meaning they achieve more diversification than the Authority could achieve on its own account.
 - Short liquidity – cash can be accessed daily.
 - Ring-fenced assets – the investments are owned by investors and not the fund management company.
 - Custodian – the investments are managed by an independent bank known as a custodian, who operates at arms-length from the fund management company.
- 7.20 Like all treasury instruments, MMFs do carry an element of risk:
- The failure of one or more of an MMF's investments could lead to a run on MMFs, especially during a financial crisis; however, the new MMF regulations do limit this risk to some extent.

- If the UK enters a recession, there is a possibility that the Bank Rate could be set to near or below zero. This could mean interest earned from MMFs could become negative after the deduction of their fee. In this instance, the Authority could move funds to an alternative category of investment.

iii) Bank and building society accounts

- 7.21 The Authority can make investments with approved banks and building societies by using call accounts or term deposits. Investments held with banks and building societies run the risk of credit loss via a bail in, if the regulator determines that the bank is failing or likely to fail.

iv) Operational bank account

- 7.22 The Authority's banking provider is Lloyds Bank. Cash is retained with Lloyds Bank each night earning interest at a market rate; the amount retained will be set in line with the diversification policy set out at **paragraph 7.29**.
- 7.23 In respect of the Bank ring-fencing legislation referred to in **paragraph 4.9**, Lloyds Bank has a relatively small investment banking operation meaning that 97% of the bank's assets remain within the 'retail bank' ring-fence. The Authority's business with Lloyds Bank will take place within the 'retail bank' ring-fence (Lloyds Bank Plc) and not form part of their investment banking operations (Lloyds Bank Corporate Markets).
- 7.24 Lloyds Bank Plc has seen a credit ratings upgrade since ring-fencing legislation was introduced; should the Lloyds credit rating fall, then small balances may be retained with the bank for operational efficiency. The Authority will continue to seek support from the County Council's Treasury team on bank credit risk and any changes will be determined by the Director of Finance at the Authority.
- 7.25 The Authority's commercial banking contract with Lloyds Bank was originally agreed alongside the County Council and is due to expire in March 2020. The Authority intends to utilise the ESPO 'Framework Agreement for Banking Services' to procure a new banking contract. However, a new ESPO Framework Agreement is currently being negotiated and will not be available when the current banking contract ends. As an Exception to Procurement Regulations, the Authority, alongside the County Council, has agreed to extend the current banking contract with Lloyds Bank for two years, by which time the new ESPO Framework Agreement should be in place.

Standard Investment diversification

- 7.26 Risks to investments, such as those discussed for MMFs in **paragraph 7.20**, point towards the fundamental need for diversification across counterparties and investment categories, where possible. Diversification can help to protect the security of investments by limiting the Authority's loss in the event of a counterparty default. Diversification will not protect the Authority from a systemic failure of the banking sector even if the risk of this has diminished following the bail-in banking regulations.
- 7.27 Diversification can be achieved by setting a maximum amount to be invested with each counterparty, to limit risk and to ensure a spread of investments.
- No limits are proposed for government investments as these may be utilised for all the Authority's investments in certain circumstances.

- For MMF's a standard limit of £1.5m per MMF is in place to meet liquidity requirements.

- 7.28 To allow short-term flexibility for investments, the Director of Finance at the Authority has agreed to increase the standard limits for MMFs to temporary limits of £2.5m. The Authority will continue to use the higher temporary limits in 2020/21 until the level of cash balances fall to allow reverting to using the standard limits.
- 7.29 For Lloyds Bank a limit is set of the lower of 10% of total balances or £1.0m (subject to a minimum upper level of £500k); this amount will minimise processing costs and provide additional liquidity for the Authority. The Treasury team at Staffordshire County Council will review and reset this limit once a month with reference to forecast future balances.
- 7.30 Where cash balances are low then this may mean that all investments are placed with the MMFs and Lloyds Bank. However, balances will be within the limits stated above.
- 7.31 It is proposed that both the application and amendment of this policy are delegated to the Director of Finance at the Authority with the outcome reported in the regular treasury management reports to the Staffordshire Police, Fire and Crime Panel.

Non-Standard Investments

- 7.32 The Authority considers Non-Standard Investments to be all other types of approved investment counterparties that are not included as part of Standard Investments i.e. those investments that are used less frequently and may require further approval from the Director of Finance at the Authority.
- 7.33 Collective Investment Schemes are Non-Standard Investments that range from enhanced MMF's to property and equity funds. These all have varying risk and return profiles. The Authority approved a decision to use this category of investment in 2016/17 by committing to the Royal London Fund, a AAA rated enhanced Cash Plus MMF with a 3-day liquidity notice period.
- 7.34 The Royal London Cash Plus Fund allows the Authority to earn an increased yield in a low interest rate environment, and where the Authority has high cash balances. Security is maintained as it invests in highly sought after covered (secured) bonds, which are exempt from bail-in. These enhanced duration MMF's have the same characteristics as same day liquidity MMF's but typically have a 3-5 day notice period. They also have a recommended investment duration of at least 6 months, due to their longer investment horizon.
- 7.35 The financial limit for the Royal London Cash Plus MMF has been set at £1.5m.

The Credit Management Strategy

- 7.36 Investments made by the Authority should be of 'high credit quality'. Although this can be difficult to define, credit ratings can be used as published by external credit rating agencies (the three main agencies are Moody's, Standard & Poors and Fitch). Credit ratings can be obtained from the County Council's Treasury team, where available.

- 7.37 For 2020/21, the minimum credit-rating thresholds are set at a long-term rating of 'A- 'where available. Counterparties that are rated below this level are excluded. However, credit ratings are not the only aspect of how creditworthiness is assessed.
- 7.38 The following elements are also factored in when evaluating creditworthiness:
- Potential government support.
 - Credit Default Swap prices (CDS) (i.e. the cost of insuring against counterparty default).
 - Share prices and bond yields.
 - Balance sheet structure.
 - Macro-economic factors.
 - A subjective overlay, i.e. a judgement being made about whether the counterparty should be recommended or not.
- 7.39 The Authority remains responsible for all its investment decisions. The County Council's Treasury team will continue to have treasury management meetings with the Authority on a quarterly basis where a review of the Lending List will take place.
- 7.40 Under stressed market conditions, additional meetings with County Council's Treasury team may take place at very short notice. A decision may be made to adjust the Authority's investment risk profile; the end result may involve moving investments to lower risk counterparties or instruments.

Non-treasury investments

- 7.41 Under the CIPFA Codes and MHCLG Guidance, local authorities may invest in other financial assets and property for financial return, and also make loans and investments for service purposes.
- 7.42 Such non-treasury investments should be assessed as part of a separate investment strategy. They should set out the specific policies and arrangements for non-treasury investments and ensure the same robust procedures for the consideration of risk and return are applied to these, as for treasury investments.
- 7.43 The Authority does not currently hold any non-treasury investments.

Risk

- 7.44 Although guidance sets out security and liquidity as being the main treasury risks, they are not the only investment risks faced by the Authority. **Appendix 5** sets out a high-level risk assessment for six of the key risks which are summarised in the following table:

Risk	Assessment
Security	Low
Liquidity	Low to Medium
Interest rate	Low to Medium
Market	Low
Refinancing	Low to Medium
Regulatory and legal	Low

- 7.45 Within the Authority's AIS there is a balance to be struck between the security of investments and liquidity; the safest investments are not necessarily the most liquid and so a pragmatic approach must be taken.
- 7.46 The proposed AIS has been evaluated against these risks and the judgement is that the most significant risks have been reduced as far as possible. This is not to say that all risk has been eliminated which is not possible in treasury terms.

8. Review of strategy

- 8.1 The Authority will prepare a revised strategy when there are significant changes to the following factors:
- the economic environment;
 - the financial risk environment;
 - the budgetary position; or
 - the regulatory environment.
- 8.2 The responsibility for assessing these circumstances and proposing changes to the strategy is allocated to the Director of Finance at the Authority.

9. Policy on the use of external service providers

- 9.1 Currently the Authority has no contracted external treasury adviser and this is considered appropriate with the simple arrangements set out.
- 9.2 The treasury service for the Authority is provided by the County Council's Treasury team, who use Arlingclose as their external treasury management adviser. The County Council's contract with Arlingclose was renewed in 2017 following a tender process. The Authority could use Arlingclose to provide consultancy advice on an ad-hoc basis should this be considered necessary.

10. Investment management training

- 10.1 Treasury management is a specialised area requiring high quality and well-trained staff with an up to date knowledge of current issues, legislation and treasury risk management techniques.
- 10.2 The County Council's treasury team who provide the treasury service are experienced and attend regular CIPFA and treasury consultant training seminars throughout the year.
- 10.3 Training needs for Authority's staff who attend quarterly meetings with the County Council's Treasury team are assessed on an ongoing basis by local managers.

11. Service Level Agreement

- 11.1 Staffordshire County Council provides treasury management and banking services as part of a Service Level Agreement (SLA) with the Authority. The SLA does not constitute a contract but is a document of good practice; it outlines the range of services offered by the Council and the degree of co-operation required from the Authority in order for the Council to fulfil its role.

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Background Documents:

1. Treasury Management in the Public Services: Code of Practice (CIPFA) (2017)
2. The Prudential Code for Capital Finance in Local Authorities (CIPFA) (2017)
3. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. Statutory Guidance on Local Government Investments – Issued under Section 15(1) (a) of the Local Government Act 2003 (2018)
5. Statutory Guidance on Minimum Revenue Provision – Issued under section 21 (1A) of the Local Government Act 2003 (2018)

Financial Implications

All financial implications are covered in the body of this report.

Legal Implications

Approval of Prudential Indicators and an AIS are necessary in order to meet the requirements of the Local Government Act 2003.

Equality & Diversity Implications

There are no equality and diversity implications.

Risk Implications

Risk is inherent in treasury management operations and is dealt with throughout this report. **Appendices 3 and 5** show a risk assessment for borrowing and investment activities.

Consultation and Engagement Undertaken

Staffordshire County Council's Treasury and Pension Fund Team have provided the economic background and forecasts for this report.

Procurement and Social Value Implications

The daily treasury management function is carried out on behalf of the Authority by Staffordshire County Council, under a Service Level Agreement (SLA).

Protective Security Considerations

Data protection and protective security policies are implemented within Staffordshire County Council and all departments within the Council. Treasury management activities are undertaken in line with these policies and the agreed SLA.

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Treasury Management Indicators

Indicator	Estimate 2020/21	Estimate 2021/22	Estimate 2022/23
1. External Debt	£m	£m	£m
Authorised Limit	32.6	33.3	33.9
Authorised Limit for other liabilities	82.0	79.5	77.0
TOTAL	114.6	112.8	110.9
Operational Boundary	28.6	28.6	31.3
Operational Boundary for other liabilities	82.0	79.5	77.0
TOTAL	110.6	108.1	108.3
External Loans	17.1	17.1	16.8
<p><i>The Authorised Limit is the maximum level of external borrowing which should not be exceeded. It is linked to the estimated level of borrowing assumed in the Capital Programme.</i></p> <p><i>The Operational Boundary represents the Director's estimate of the day to day limit for Treasury Management activity based on the most likely i.e. prudent but not worst case scenario</i></p> <p><i>Other liabilities relate to PFI schemes on the balance sheet.</i></p>			
2. Interest Rate Exposures	£m	£m	£m
a. Upper Limit (Fixed)	27.6	28.3	28.9
b. Upper Limit (Variable)	(25)	(25)	(25)
<p><i>Upper limits of fixed and variable borrowing and investments are required to be set. This limits the Authority's exposure to both fixed and variable interest rate movements as part of the overall risk management strategy for treasury management activities. Negative figures are shown in brackets; these relate to investments at a variable rate which are not offset by variable borrowings.</i></p>			
3. Maturity Structure of Borrowing	Upper Limit	Lower Limit	
Under 12 months	10%	0%	2.9%
12 months and with 24 months	10%	0%	0.0%
24 months and within 5 years	30%	0%	5.1%
5 years and with 10 years	50%	0%	3.7%
10 years and above	100%	25%	88.3%
<p><i>This indicator identifies the amount of loans maturing in specified periods. The overarching principle is that steps should be taken from a risk management point of view to limit exposure to significant refinancing risk in any short period of time.</i></p> <p><i>The Authority currently applies the prudent practice of ensuring that no more than 10% of its total gross fixed rate loans mature in any one financial year.</i></p>			
4. Total principal sums invested for periods longer than a year	£	£	£
<i>Any investments made for longer than a year will be in accordance with the limits on non-specified investments.</i>	nil	nil	nil

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Risk assessment – Borrowing strategy

Risk heading	Risk description	Relevance to borrowing	Key control	Assessment	Borrowing strategy
Security	A third party fails to meet its contractual obligations (i.e. counterparty risk).	Unlikely that there is a failure between the agreement to borrow and sums being received a few days later. However, if we borrow in advance we must invest until this is needed and this increases exposure to investment risk.	Usually borrow from the Government (PWLB or its successor body) with funds received within 3 working days from the date of agreement to borrow.	LOW	Use of cash to fund borrowing reduces this risk further i.e. less money is held with banks and third parties as a result.
Liquidity	Cash is not readily available when it is needed.	Only borrow for capital – usually borrow from Government (PWLB or its successor body) with a maximum limit of £3m for long-term borrowing set in 2019/18.	Prudential rules on borrowing and consideration of whether Government is secure.	LOW	Use of cash to fund borrowing increases this risk as liquidity is reduced when borrowing is avoided. However, the Authority is able to borrow money temporarily using the money markets should it need to, so the overall risk remains low.
Interest rate	Unexpected <u>reduction</u> in short term Interest rates.	Depends on the mix between fixed rate borrowing and variable rate borrowing. Higher exposure to variable rate borrowing helps the budget.	The control is set out below.	LOW to MEDIUM	Pursuing a strategy of using cash reduces the overall net exposure to sudden interest rate falls.
Interest rate	Unexpected <u>increase</u> in short term interest rates.	Mix of variable and fixed rates – Lower exposure to variable rate borrowing helps the budget.	Limit variable rate borrowing to a relatively small proportion (e.g. 20%).	LOW to MEDIUM	20% limit provides a suitable risk control.

Appendix 3 (continued)

Risk heading	Risk description	Relevance to borrowing	Key control	Assessment	Borrowing strategy
Market	The market value of loans changes substantially (i.e. how much is the borrowing strategy exposed to long term interest rate change).	How much risk is built into the maturity profile of the loans structure. LOBO's (5% of all loans) are the only 'market' instrument in borrowing terms currently used.	This is inversely linked to refinancing risk below.	MEDIUM	Use of cash will shorten the duration of the loan portfolio and reduces this risk. Without the use of cash this risk assessment would probably be high.
Refinancing risk	Maturing transactions cannot be renewed on similar terms.	Need to avoid a high level of borrowing over a short period where you are exposed to high interest rates.	The Authority has a policy of limiting maturing loans to 10% of the loans portfolio.	MEDIUM	Using cash to fund borrowing potentially increases the refinancing risk. Without the use of cash this risk assessment would probably be low.
Regulatory and legal risk	Rules governing local government borrowing are changed or amended without notice, which has happened in the recent past.	Local government is heavily reliant upon PWLB (or its successor body); cost and ability to reschedule / manage loans are determined by the Government The Government could close the PWLB (or its successor body) and force local authorities to use market loans for all new borrowing.	Market loans will be evaluated and taken if these are good overall value and dilute reliance on the PWLB (or its successor body). The newly set up UK Municipal Bonds Agency may provide an alternative in the future.	MEDIUM	One LOBO loan is held. Use of cash means that PWLB (or its successor body) loans are not being taken. If the PWLB (or its successor body) was closed to new business then market loans would be the only option.

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Lending List – January 2019	
	Time Limit
Regulation Investments	
UK Government DMADF account	6 months
UK Local Authority	12 months
Banks	
Lloyds Group (£1.0m max)	call only
MMF	
Federated (£2.5m max)	call only
Morgan Stanley (£2.5m max)	call only
Aberdeen Standard (£2.5m max)	call only
Enhanced MMF	
Royal London Cash Plus (£1.5m max)	3 day notice

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Risk assessment - Investments

Risk heading	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Security	A third party fails to meet its contractual obligations (i.e. counterparty risk).	Crucial that money invested is returned (principal and interest).	Relies on credit management policy including; credit risk, diversification, duration and amount of investment, and an ongoing review of the credit environment. Prudential limit on investment over 1 year.	LOW	Use of the counterparties identified within the AIS reduces this risk to a low level. The borrowing strategy identified will reduce cash balances and the resulting security risk. With the exception of regulation investments, counterparties have a financial limit to ensure funds are spread amongst them. Overall this remains a low risk strategy.
Liquidity	Cash is not readily available when it is needed.	Need to plan investment to match cash requirements.	Managed through detailed cash flow forecast and investment in highly liquid funds – can also borrow temporarily (Local Authorities are a good credit risk if lent money).	LOW	Same day access accounts are currently held with: <ul style="list-style-type: none"> • Federated MMF • Morgan Stanley MMF • Aberdeen Standard MMF • Lloyds Banking Group (as banker) Cash flow plans are completed annually and regularly updated. Overall the risk is low.

Appendix 5 (continued)

Risk heading	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Interest rate	Unexpected <u>reduction</u> in Interest rate.	Reduces the return on investment and reduces the level of reserves.	Can reduce risk by; A) netting off investment against borrowing to reduce net exposure B) investing for longer periods.	LOW	Investments will be short term, this does not protect against an interest rate reduction. The current interest rate environment has interest rates at historically low levels.
Interest rate	Unexpected <u>increase</u> in interest rates.	In order to take advantage of the unexpected return, would need to keep investment short term and increase the amount of cash invested (e.g. by not using cash in lieu of borrowing).	Controlled through the overall strategy.	MEDIUM	Current policy allows upturns to be taken advantage of as investments are not fixed for long periods. Using cash to fund borrowing (the proposed borrowing strategy) reduces this risk as the overall exposure to short term interest rates is less.
Market	Unexpected need to liquidate market instrument quickly and accept 'price on the day'.	Only relevant if invest in market instruments (e.g. CD's, Gilts).	Limit investment in market instruments or alternatively have capacity to borrow to avoid need to liquidate. Controlled by limits on Non-Specified Investments.	LOW	Market instruments are not in use by the Authority.
Refinancing risk	Maturing transactions cannot be renewed on similar terms.	Reflected in the term (duration) of investments. If everything invested shorter term there is a higher refinancing risk.	Proportion of investments maturing in the short term.	LOW/ MEDIUM	The current policy is to invest in the relatively short term. There is an increased risk with this strategy due to frequent 'refinancing' but this is expected to be advantageous in a rising interest rate environment. Using cash to fund borrowing (the proposed borrowing strategy) reduces this risk as the overall exposure to short term interest rates is less.

Appendix 5 (continued)

Risk heading	Risk description	Relevance to investment	Key control	Assessment	Approved Investment Strategy (AIS)
Regulatory and legal risk	Rules governing local government investment powers are changed or amended without notice.	Investment powers are granted through statute and guidance.	None.	LOW	<p>The current policy of using cash in lieu of borrowing reduces the Authority's dependency on interest receipts.</p> <p>The AIS is low risk and uses liquid and conservative investment instruments.</p>