Treasury Management Strategy Statement 2018/19

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Police & Crime Commissioner for Lincolnshire

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1 INTRODUCTION

1.1 Background

The Police & Crime Commissioner (PCC) 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 PCC's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the PCC's capital plans. These capital plans provide a guide to the borrowing need of the PCC, essentially the longer term cash flow planning, to ensure that the PCC 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 PCC risk or cost objectives.

CIPFA defines treasury management as:

> *"The management of the PCC's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

1.2 Reporting requirements

The PCC is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - the first and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid-year treasury management report – This will update the PCC with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the PCC. This role is undertaken within the Resource Governance meeting.

1.3 Treasury Management Strategy for 2018/19

The strategy for 2018/19 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the PCC;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; 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.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

The PCC uses Link Asset Services, Treasury solutions as its external treasury management advisors.

The PCC recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The PCC will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2018/19 – 2021/22

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

2.1 Capital expenditure

This prudential indicator is a summary of the PCC's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The PCC is asked to approve the capital expenditure forecasts:

Capital expenditure £000	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Building Schemes	2,304	2,088	1,300	1,000	1,000	1,000
Business Transformation	-	-	-	-	-	-
Command & Control	-	-	3,690	1,320	-	-
Blue Light	1,751	5,555	14,515	522	-	-
ICT	1,549	1,639	3,569	500	500	500
Vehicles	555	1,600	1,100	1,200	1,200	1,200
Other / ESMCP	198	548	1,000	1,000	-	-
Total	**6,357**	**11,430**	**25,174**	**5,542**	**2,700**	**2,700**

The table below summarises how the above capital expenditure plans are being financed, either by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital expenditure £000	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Total	**6,357**	**11,430**	**25,174**	**5,542**	**2,700**	**2,700**
Financed by:	-	-	-	-	-	-
Capital receipts	-	260	60	60	60	60
Capital grants & Contributions	4,372	5,922	7,566	678	457	457
Capital reserves	-	-	500	-	-	-
Revenue	-	268	-	-	-	-
Net financing need for the year	**1,985**	**4,980**	**17,048**	**4,804**	**2,183**	**2,183**

2.2 The Capital Financing Requirement (PCC's borrowing need)

The second prudential indicator is the PCC's Capital Financing Requirement (CFR). The 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 PCC's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge that broadly reduces the borrowing need in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long-term liabilities (e.g. PFI schemes and finance leases). Whilst these increase the CFR, and therefore the PCC's borrowing requirement, these types of scheme include a borrowing facility and so the PCC is not required to separately borrow for these schemes. The PCC is currently projecting to have £7.9m of such schemes at 31 March 2018 within the CFR (£7.4m in 2016/17).

The PCC is asked to approve the CFR projections below:

£000	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Financing Requirement						
CFR Opening Balance	**28,962**	**29,260**	**32,643**	**47,670**	**50,332**	**49,216**
Movement in CFR	**298**	**3,383**	**15,026**	**2,662**	**(1,116)**	**(1,300)**
Total CFR	**29,260**	**32,643**	**47,670**	**50,332**	**49,216**	**47,916**

Movement in CFR represented by						
Net financing need for the year (above)	1,985	4,980	17,048	4,804	2,183	2,183
Less MRP/VRP and other financing movements	1,687	1,597	2,022	2,142	3,299	3,483
	0	0	0	0	0	0
	0	0	0	0	0	0
Movement in CFR	**298**	**3,383**	**15,026**	**2,662**	**(1,116)**	**(1,300)**

2.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day to day cash flow balances.

Year-end Resources £000	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Fund balances / reserves	18,421	14,755	8,229	7,577	7,577	7,577
Capital receipts	-	260	60	60	60	60
Provisions	268	400	400	400	400	400
Other	-	-	-	-	-	-
Total core funds	**18,689**	**15,415**	**8,689**	**8,037**	**8,037**	**8,037**
Working capital*	(3,886)	(3,886)	(3,886)	(3,886)	(3,886)	(3,886)
Under borrowing	(9,671)	(10,352)	(3,603)	(3,229)	(2,667)	(2,880)
Expected investments	**5,132**	**1,177**	**1,200**	**922**	**1,484**	**1,271**

*Working capital balances shown are estimated year-end; these may be higher mid-year. These are expected to be a deficit at year-end due to the timing that the Police Pension Top Up Grant is received.

Please note that actual figures for 2016/17 for all tables include Regional figures and are therefore as stated in the Financial Statements for 2016/17.

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the PCC. The treasury management function ensures that the PCC'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 / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The PCC's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt.

£000	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt at 1 April	13,252	12,192	14,300	36,948	42,024	41,470
New loans	-	3,000	23,600	6,500	1,000	-
Repayments	(1,060)	(892)	(952)	(1,424)	(1,554)	(1,514)
Finance Lease	7,397	7,992	7,119	5,079	5,079	5,079
Actual gross debt at 31 March	**19,589**	**22,292**	**44,067**	**47,103**	**46,549**	**45,035**

Within the prudential indicators there are a number of key indicators to ensure that the PCC operates its activities within well-defined limits. One of these is that the PCC 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 2018/19 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 Chief Finance Officer reports that the PCC complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

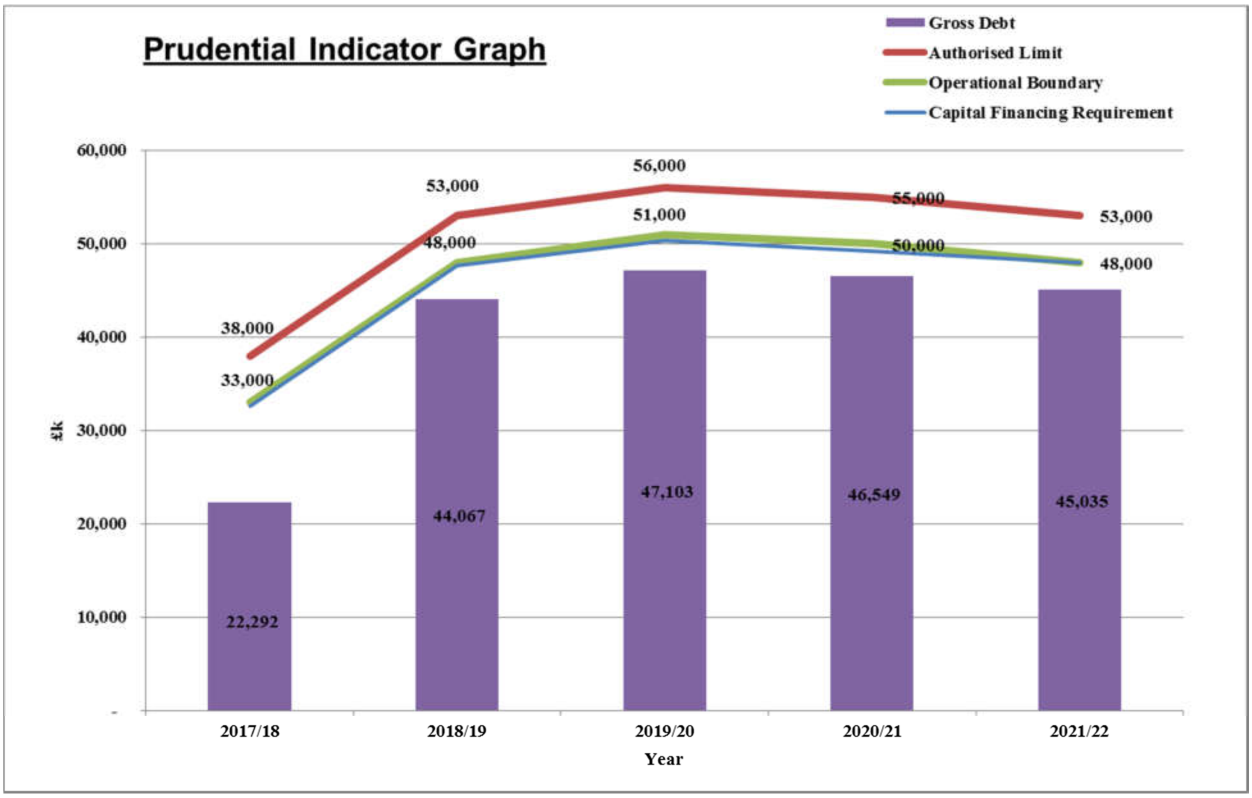
Operational boundary £m	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	33	48	51	50	48

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the PCC. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is a statutory limit, determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all PCCs' plans, or those of a specific PCC, although this power has not yet been exercised.
2. The PCC is asked to approve the following authorised limits:

Authorised limit £m	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	38	53	56	55	53

Projections of CFR and borrowing



3.3 Prospects for interest rates

The PCC has appointed Link Asset Services as its treasury advisor and part of their service is to assist the PCC to formulate a view on interest rates. The following table gives their central view.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- The result of the October 2017 Austrian general election resulted in a focused anti-immigrant coalition government. In addition, the new Czech prime minister is Andrej Babis who is strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding

bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

Investment and borrowing rates

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.

- Borrowing interest rates increased sharply after the result of the general election in June 2017 and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Apart from that, there has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

3.4 Borrowing strategy

The PCC 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 PCC'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 still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

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

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast* then the portfolio position will be re-appraised. This may arise from acceleration in the start date and in the rate of increase in central rates in the USA and UK; an increase in world economic activity; or a sudden increase in inflation risks. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the Resource Governance meeting at the next available opportunity.

Forecasting will take place in the first half of 2018/19 to determine the timing of any potential borrowing requirements. This planning will facilitate an efficient and informed response to any risk in interest rate increases.

The PCC is able to borrow at advantageous rates from the Public Works Loans Board (PWLB). It is anticipated that any projected future borrowing requirements would also be sourced through PWLB.

Borrowing is undertaken at a time appropriate to coincide with an identified dip in borrowing rates available and as long-term borrowing rates have not increased significantly and cash flows have remained strong, no new external borrowing has yet been taken in 2017/18. Current projections show it is likely to require borrowing prior to the end of the financial year.

The objective is to achieve a debt maturity profile, which ensures that no one year has a high level of repayments. This is a requirement under the Prudential Borrowing Guidelines.

Current loan terms match the life of the asset they are financing. Future loans will be considered for the most appropriate loan length, ensuring compliance with prudential indicators and consideration of long-term borrowing rates and maturity profiles.

All current loans have been taken on the basis of equal instalment of principal (EIP), which ensures payments are spread evenly across the term of the loan. Future strategies are to include the comparison and consideration of other available repayment bases and maturity loans.

With the exception of transferred borrowing, (which is based on a share of the average amount of interest paid on all Lincolnshire County Council debt), all long-term debt is at fixed rates of interest. Consideration has been given to the possible restructuring of the loans outstanding in order to take advantage of lower interest rates. However, the savings offered through the lower interest rates would not cover the significant penalties for early termination of some of the loans. Continued monitoring will be carried out to ensure early termination opportunities are maximised if appropriate.

3.5 Policy on borrowing in advance of need

The PCC 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 PCC can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

* the generation of cash savings and / or discounted cash flow savings;
* helping to fulfil the treasury strategy;
* enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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

All rescheduling will be reported to the Resource Governance, at the earliest meeting following its action.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The PCC'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 PCC's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the PCC applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end, the PCC will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed below. Counterparty limits will be as set through the PCC's treasury management practices – schedules.

4.2 Creditworthiness policy

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

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

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

Yellow	*5 years*
Dark pink	*5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25*
Light pink	*5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5*
Purple	*2 years*
Blue	*1 year (only applies to nationalised or semi nationalised UK Banks)*
Orange	*1 year*
Red	*6 months*
Green	*100 days*
No colour	*Not to be used*

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

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

All credit ratings will be monitored frequently. The PCC is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the PCC's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the PCC will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the PCC's lending list.

Sole reliance will not be placed on the use of this external service. In addition this PCC will also use market data and market information, information on any external support for banks to help support its decision making process.

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

	Colour (and long term rating where applicable)	Money and/or % Limit	Time Limit
Banks	yellow	£4m / 20%*	5yrs
Banks	purple	£4m / 20%*	2 yrs
Banks	orange	£4m / 20%*	1 yr
Banks – part nationalised	blue	£4m / 20%*	1 yr
Banks	red	£4m / 20%*	6 mths
Banks	green	£4m / 20%*	100 days
Banks	No colour	Not to be used	
DMADF	AAA	unlimited	6 months
Local authorities	n/a	£4m / 20%*	1 yr
	Fund rating	Money and/or % Limit	Time Limit
Money market funds	AAA	£4m / 20%*	liquid

*Whichever is the higher

4.3 Country limits

The PCC has determined that it will use any UK counterparties irrespective of rating and approved counterparties from non-UK countries with a minimum sovereign credit rating of AAA from Fitch. The list of countries that qualify using this credit criteria are provided by Link and is regularly reviewed. Changes will be notified to us should ratings change in accordance with this policy.

4.4 Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations.
Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:

- 2017/18 0.50%
- 2018/19 0.75%

- 2019/20 1.00%
- 2020/21 1.25%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

	Now
2017/18	0.40%
2018/19	0.60%
2019/20	0.90%
2020/21	1.25%
2021/22	1.50%
2022/23	1.75%
2023/24	2.00%
Later years	2.75%

The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the PCC's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end, shown below:

The PCC is asked to approve the treasury indicator and limit:-

Maximum principal sums invested > 365 days			
£m	**2017/18**	**2018/19**	**2019/20**
Principal sums invested > 365 days	£m Nil	£m Nil	£m Nil

For its cash flow generated balances, the PCC will seek to utilise its business reserve instant access and notice accounts, money market funds and the UK Government Debt Management Office, in order to benefit from the compounding of interest.

4.5 End of year investment report

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

5 APPENDICES

A Prudential and treasury indicators and MRP statement

B Treasury management scheme of delegation

C The treasury management role of the section 151 officer

A. The Capital Prudential and Treasury Indicators 2018/19 – 2021/22

Minimum revenue provision (MRP) policy statement

The PCC is required to charge an element of the accumulated capital spend each year through a revenue charge (minimum revenue provision - MRP). The PCC is allowed to make additional voluntary MRP payments, where it is considered prudent, to accelerate the payment of the debt or to ease cost pressures in future years.

CLG regulations have been issued which require the PCC to approve an **MRP Statement** in advance of each year. A variety of options are provided to PCCs, so long as there is a prudent provision.

The PCC's current policy is:

- For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP will be based on the CFR. This option is based on a 4% reducing balance MRP charge.
- From 1 April 2008 for all unsupported borrowing the MRP will be based on the life of the assets, in accordance with the regulations, however it does not need to reflect the same asset life as the asset policy recommends as long as the decision to vary this is prudent.

These options provide for a reduction in the borrowing need over the asset's life. It is possible to make a voluntary MRP charge (VRP) if required. This will be reviewed annually each year.

Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the PCC's overall finances. The PCC is asked to approve the following indicators:

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Ratio of financing cost to net revenue stream	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	%	%	%	%	%	%
Ratio %	2.01	1.94	2.79	2.34	3.11	3.20

The estimates of financing costs include current commitments and the proposals in this budget report.

Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the four year capital programme recommended in this budget report compared to the PCC's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a four year period.

Incremental impact of capital investment decisions on council tax	2015/16 Actual	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£	£	£	£	£	£	£
Band D Council tax £	-	-	0.82	5.30	2.97	2.28	2.13

	PRUDENTIAL INDICATOR TARGETS	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	External Debt						
1	**Authorised limit for external debt:**						
	The PCC will set for the forthcoming financial year and the following three years an authorised limit for its total external debt, gross of investments, separately identifying borrowing from other long term lliabilities						
	Authorised limit for external debt:	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
	Borrowing	27,603	30,008	45,881	50,921	49,921	47,921
	Other long term liabilities	7,397	7,992	7,119	5,079	5,079	5,079
	Total	35,000	38,000	53,000	56,000	55,000	53,000
2	**Operational boundary:**						
	The PCC will set for the forthcoming financial year and the following three years an operational boundary for its total external debt, gross of investments, separately identifying borrowing from other long term liabilities	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
	Operational boundary:						
	Borrowing	22,603	25,008	40,881	45,921	44,921	42,921
	Other long term liabilities	7,397	7,992	7,119	5,079	5,079	5,079
	Total	30,000	33,000	48,000	51,000	50,000	48,000
	Treasury Management Indicators						
	Interest Rate Exposures						
	The PCC will set for the forthcoming financial year and the following three years upper limits to its exposures to the effect of changes in interest rates	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
3	Upper limit for fixed interest rate exposure:						
	Net principal re fixed rate borrowing less investments	14,457	21,114	42,867	46,181	45,065	43,765
4	Upper limit for variable rate exposure:						
	Net principal re variable rate borrowing less investments	4,337	6,334	12,860	13,854	13,519	13,129
	Gross and Net Debt						
	The PCC will set for the forthcoming financial year and the following three years upper limits on the proportion of net debt compared to gross debt						
5	Upper limit for net debt as percentage of gross debt:	100%	100%	100%	100%	100%	100%
6	Ratio of financing costs to net revenue stream:						
	The PCC will estimate for the forthcoming financial year and the following three years the ratio of financing costs to net revenue stream	2.01%	1.94%	2.79%	2.34%	3.11%	3.20%
7	Capital financing requirement:						
	The PCC shall make reasonable estimates of the total of capital financing requirement at the end of the forthcoming financial year and the following three years	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
	Estimate of the capital financing requirement for the PCC	29,260	32,643	47,670	50,332	49,216	47,916
8	Estimate of the incremental impact of capital investment decisions on the council tax:						
	The PCC will calculate the addition or reduction to council tax that results from any proposed changes to the capital programme						
	Band D council tax	£0.00	£0.82	£5.30	£2.97	£2.28	£2.13
9	Maturity structure of new fixed rate borrowing:						
	The PCC will set for the forthcoming financial year both upper and lower limits with respect to the maturity structure of borrowing						
		Upper Limit	.ower Limit				
	Under 12 months	20%	0%				
	12 months and within 24 months	30%	20%				
	24 months and within 5 years	40%	30%				
	5 years and within 10 years	50%	0%				
	10 years and above	80%	10%				

B. Treasury management scheme of delegation including Section 151 Officer responsibilities.

The Commissioner has adopted CIPFA's 'Treasury Management in the Public Services: Code of Practice' ("the Code").

The Commissioner's CFO shall borrow, temporarily invest and repay monies, subject to any constraints imposed by statute or the CIPFA Code of Practice, and subject to the general directions and within any limits prescribed from time to time by the Commissioner. The Chief Constable does not have the power to undertake any borrowing or investment activity.

The Commissioner will approve the Treasury Management Strategy prior to the commencement of each financial year having first taken the advice of the Commissioner's CFO. The Commissioner's CFO shall report to the Commissioner from time to time during each financial year on treasury management activity and shall submit a Treasury Annual Report by the end of September each year.

The Commissioner's CFO may make arrangements for the Force Chief Finance Officer, other officers or a strategic partner to undertake or procure, in a manner acceptable to the Commissioner's CFO, the daily management of cash, loans and investment work.

No person shall borrow money on behalf of the Commissioner without the prior written approval of the Commissioner's CFO.

The Commissioner's Chief Finance Officer will approve the arrangements for the treasury management function, including the day to day management, the production of the treasury management strategy, and supporting policies and procedures.

C. The Commissioner's CFO, Section 151 Officer, Responsibilities:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.