Appendix A

Treasury Management Strategy Statement 2021/22

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Police and Crime Commissioner for Lincolnshire

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1. INTRODUCTION

1.1. Background

The Police and 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, when it is prudent and economic, any debt previously drawn may be restructured to meet PCC risk or cost objectives.

The contribution the treasury management function makes to the PCC is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

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."*

The PCC has not engaged in any commercial investments and does not hold any non-treasury investments.

1.2. Reporting requirements

1.2.1. Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require the PCC to prepare a capital strategy report, which will provide the following:

- a high-level, long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed;
- the implications for future financial sustainability.

The aim of this capital strategy is to ensure that the PCC understands the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

1.2.2. Treasury Management reporting

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

a) **Prudential and treasury indicators and treasury strategy (this report)**

The first and most important report is forward looking and 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).

b) **A mid-year treasury management report**

This is primarily a progress report and will update the PCC on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, a quarterly capital monitoring report will go to the Police and Crime Strategy Board meeting.

c) **An annual treasury report**

This is a backward looking review document and 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 require adequate scrutiny before recommendation to the PCC. This role is fulfilled by the Joint Independent Audit Committee.

1.3. Treasury Management Strategy for 2021/22

The strategy for 2021/22 covers two main areas:

a) **Capital issues**

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

b) **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, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

1.4. Training

The CIPFA Code requires the responsible officer to ensure that employees 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 the services of our external service providers. All decisions will be undertaken with regard to all available information, including, but not solely, our treasury advisers.

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 2021/22 – 2024/25

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	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
£000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Building Schemes	1,033	2,511	1,550	1,000	1,000	1,000
Command & Control	311	1,685	1,744	-	-	-
Blue Light	2,767	228	-	-	-	-
ICT Projects	1,793	1,856	2,387	1,250	250	250
Vehicles	802	2,167	1,230	1,063	1,200	1,200
ESMCP	-	170	300	4,876	-	-
Other	809	1,542	250	250	250	250
Total	**7,515**	**10,159**	**7,461**	**8,439**	**2,700**	**2,700**

The table below summarises the above capital expenditure plans and how capital or revenue resources are financing these plans. Any shortfall of resources results in a funding borrowing need.

Capital expenditure	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
£000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Total	**7,515**	**10,159**	**7,461**	**8,439**	**2,700**	**2,700**
Financed by:						
Capital receipts	56	60	60	60	60	60
Capital grants & Contributions	779	464	293	100	100	100
Capital reserves	-	273	-	-	-	-
Revenue	205	1,000	-	-	-	-
Net financing need for the year	**6,475**	**8,362**	**7,108**	**8,279**	**2,540**	**2,540**

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

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 indebtedness and so the underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge, which broadly reduces the indebtedness in line with each asset's 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, finance leases). Whilst these increase the CFR, and therefore the PCC borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the

PCC is not required to separately borrow for these schemes. The PCC currently has £5.4m of such schemes within the forecasted CFR.

The PCC is asked to approve the CFR projections below:

Capital Financing Requirement £000	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
CFR Opening Balance	39,820	43,585	49,230	53,052	57,388	54,627
Movement in CFR	3,765	5,645	3,822	4,336	(2,761)	(2,753)
Total CFR	**43,585**	**49,230**	**53,052**	**57,388**	**54,627**	**51,874**

Movement in CFR represented by:						
Net financing need for the year (above)	6,475	8,362	7,108	8,279	2,540	2,540
Less MRP/VRP and other financing movements	2,711	2,717	3,285	3,943	5,301	5,293
Movement in CFR	**3,764**	**5,645**	**3,822**	**4,336**	**(2,761)**	**(2,753)**

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	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Fund balances / reserves	16,365	9,805	8,552	8,524	8,498	8,498
Provisions	1,421	600	600	600	600	600
Total core funds	**17,786**	**10,405**	**9,152**	**9,124**	**9,098**	**9,098**
Working capital*	(4,041)	(4,041)	(4,041)	(4,041)	(4,041)	(4,041)
Under borrowing	(7,591)	(4,806)	(4,096)	(4,036)	(2,108)	(158)
Expected investments	**6,154**	**1,558**	**1,015**	**1,047**	**2,949**	**4,899**

*Working capital balances shown are estimated year-end; these will fluctuate throughout the year.

Please note that actual figures for 2019/20 for all tables include Regional figures and are therefore as stated in the Financial Statements for 2019/20.

2.4. Minimum revenue provision (MRP) policy statement

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

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

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Based on CFR.** MRP will be based on the outstanding CFR. MRP is calculated on a 4% reducing balance basis.

From 1 April 2008 for all unsupported borrowing the MRP policy will be:

- **Asset life method.** MRP will be based on the estimated 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.

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

Repayments included in finance leases are applied as MRP.

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 and the PCC's capital strategy. 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 overall treasury management portfolio as at 31 March 2020 and for the position as at Dec 2020 are shown below for both borrowing and investments:

Treasury Portfolio	2019/20	2019/20	Dec-20	Dec-20
£000	**Actual**	**Actual**	**Current**	**Current as %**
Banks	-	-	12,000	81%
Money Market Funds	6,600	100%	2,750	19%
Total treasury investments (managed in house)	**6,600**	**100%**	**14,750**	**100%**
PWLB	29,718	99%	28,914	99%
SALIX	224	1%	174	1%
Total external borrowing	**29,942**	**100%**	**29,088**	**100%**
Net treasury investments / (borrowing)	**(23,342)**		**(14,338)**	

The PCC's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Borrowing	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
£000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Debt at 1 April	28,628	29,942	39,070	48,956	53,352	52,519
New loans	2,000	10,000	10,750	5,250	-	-
Repayments	(686)	(872)	(864)	(854)	(833)	(803)
Actual gross debt at 31 March exc Finance Lease	**29,942**	**39,070**	**48,956**	**53,352**	**52,519**	**51,716**
Finance Lease	6,052	5,353	-	-	-	-
Actual gross debt at 31 March	**35,994**	**44,424**	**48,956**	**53,352**	**52,519**	**51,716**
The Capital Financing Requirement	43,585	49,230	53,052	57,388	54,627	51,874
Under / (Over borrowing)	7,591	4,806	4,096	4,036	2,108	158

Within the range of prudential indicators there are a number of key indicators to ensure that the PCC's activities operate 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 2021/22 and the following three financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative 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 and the ability to fund under-borrowing by other cash resources.

Operational boundary £m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt	50	54	58	55	52

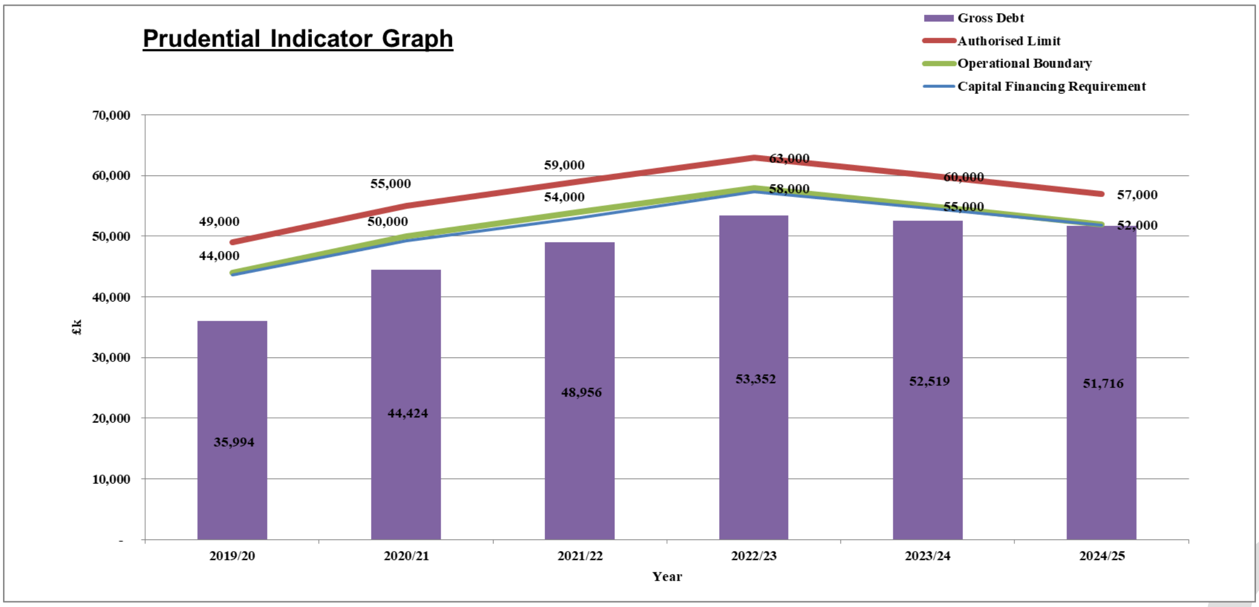
The authorised limit for external debt

This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal 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.

- This is the 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;
- The PCC is asked to approve the following authorised limit:

Authorised limit £m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt	55	59	63	60	57

3.3. Projections of CFR and borrowing



3.4. 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 and narrative gives the Link Asset Services central view.

Link Group Interest Rate View	9.11.20												
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20													
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 16th December, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as economic recovery is expected to be only gradual and, therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31.12.20: as this has now occurred, these forecasts do not need to be revised.

3.5. PWLB rates

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. 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, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

3.6. Investment and borrowing rates

- **Investment returns** are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. It also introduced the following rates for borrowing for different types of capital expenditure: -

    - **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
    - **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)

- As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.

- On 25th November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -.

    - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)

- While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.7. 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 2021/22 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it were felt that there is a significant risk of a sharp FALL in borrowing rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.
- if it were felt that there is a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration 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, then the portfolio position will be re-appraised. Most likely, fixed rate funding would 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 PCC at the next available opportunity.

3.8. 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.

3.9. Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

If rescheduling was done, it will be reported to the PCC, at the earliest meeting following its action.

3.10. New financial institutions as a source of borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a "cost of carry" or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

With the Financial Institutions and Municipal Bonds Agency the minimum amount they lend to an individual organisation is above what we would forecast to borrow in any period. Our advisors are looking at possible options for smaller borrowing requirements such as some sort of aggregate product, but currently the PWLB is our only real source for long term borrowing.

4. ANNUAL INVESTMENT STRATEGY

4.1. Investment policy – management of risk

The PCC's investment policy has regard to the following:

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

The PCC's investment priorities will firstly be security, secondly portfolio liquidity and then yield (return).

The above guidance from the MHCLG and CIPFA places a high priority on the management of risk. The PCC has adopted a prudent approach in managing risk and defines his risk appetite by the following means:

a) Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings;

b) 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 achieve this consideration 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;

c) **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;

d) The PCC has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are under the categories of 'specified' and 'non-specified' investments;

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year;
- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.

e) **Non-specified investments limit.** The PCC has determined that a limit of 0% will be applied to the use of non-specified investments;

f) **Lending limits** (amounts and maturity) for each counterparty will be set through applying the matrix table in paragraph 4.2;

g) **Transaction limits** are set for each type of investment (see paragraph 4.2);

h) The PCC will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 4.4);

i) Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3);

j) The PCC has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year;

k) All investments will be denominated in **sterling**;

l) As a result of the change in accounting standards for 2020/21 under **IFRS 9**, the PCC will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.)

However, the PCC will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

There have been no changes in risk management policy. The above criteria are unchanged from last year.

4.2. Creditworthiness policy

The 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 & 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, and any assigned Watches and Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. 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 Ultra-Short Dated Bond Funds with a credit score of 1.25*
Light pink	*5 years for Ultra-Short Dated Bond Funds 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 other 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 uses 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 European Financials 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 the 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)	**Transaction 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		**Time Limit**
Money market funds LVNAV	**AAA**	**£4m**	**liquid**

* Whichever is the higher

In addition to the above, a further £1m operational limit applies against the PCC's own banker, HSBC, for transactional purposes.

Creditworthiness

Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.20 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during Q1 and Q2 2020, banks made provisions for *expected* credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on *actual* levels of credit losses. (Quarterly earnings reports are normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets. This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the UK banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on Negative Outlook, but with a small number of actual downgrades.

CDS prices

Although bank CDS prices, (these are market indicators of credit risk), spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. Nevertheless, prices are still elevated compared to end-February 2020. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

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). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed:

- if it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable;
- conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations

Bank Rate is unlikely to rise from 0.1% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

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 (the long term forecast is for periods over 10 years in the future):

Average earnings in each year	
2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.25%
Long term later years	2.00%

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

Negative investment rates

While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short-term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

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.

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

Upper limit for principal sums invested for longer than 365 days			
£m	**2020/21**	**2021/22**	**2022/23**
Principal sums invested for longer than 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 short-dated deposits, (overnight to 100 days) in order to benefit from the compounding of interest.

4.5. Investment performance / risk benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

Security

The PCC's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.05% historic risk of default when compared to the whole portfolio.

Liquidity

In respect of this area the PCC seeks to maintain:

- Liquid short term deposits of at least £1m available with a week's notice;
- Weighted average life benchmark is expected to be 3 months, because the PCC will keep the cash relatively short dated to manage security and cash flow measures.

4.6. End of year investment report

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

5. APPENDICES

1. Prudential and treasury indicators
2. Treasury management scheme of delegation
3. The treasury management role of the section 151 officer

Appendix 1

The Capital Prudential Treasury Indicators 2019/20 – 2024/25

	PRUDENTIAL INDICATOR TARGETS	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
	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	42,948	49,647	59,000	63,000	60,000	57,000
	Other long term liabilities	6,052	5,353	-	-	-	-
	Total	49,000	55,000	59,000	63,000	60,000	57,000
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	37,533	43,876	53,052	57,388	54,627	51,874
	Other long term liabilities	6,052	5,353	-	-	-	-
	Total	43,585	49,230	53,052	57,388	54,627	51,874
	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	29,840	42,866	47,941	52,305	49,570	46,817
4	Upper limit for variable rate exposure:						
	Net principal re variable rate borrowing less investments	8,952	12,860	14,382	15,691	14,871	14,045
	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	2.19	2.56	3.51	4.16	5.17	5.10
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	43,585	49,230	53,052	57,388	54,627	51,874
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	Lower 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%				

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	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
	%	%	%	%	%	%
Ratio %	2.19	2.56	3.51	4.16	5.17	5.10

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

Appendix 2

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.

Appendix 3

The Treasury Management role of the Section 151 Officer

The S151 (responsible) officer is responsible for:

- 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.
- preparation of a capital strategy
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all investments and is in accordance with the risk appetite of the PCC.
- ensure that the PCC has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the PCC does not undertake a level of investing which exposes it to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by the PCC
- ensuring that the PCC has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following *(TM Code p54): -*
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

- *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*
- *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*
- *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*
- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*