(For information)

The Treasury Management Strategy was approved at the Commissioner's Managemnt Team Meeting on 25 March 2014 and is brought to JAC for information

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Police and Crime Commissioner for Devon and Cornwall
Commissioners Management Team
25 March 2014
Open for the purposes of FOI
Report of the Treasurer

Treasury Management Strategy for 2014-15

RECOMMENDATIONS:

That the Treasury Management / Investment Strategy be approved and specifically:

(i) the Annual Investment Strategy be approved;
(ii) the Borrowing Strategy be approved;
(iii) that the Treasurer should retain the flexibility to invest funds directly in the PCC's Investment Fund within the limits set out in the strategy;
(iv) that the counterparty list attached at Appendix 7 be approved for all new lending;
(v) that the capital expenditure prudential indicators (paragraph 3.1), the external debt indicators (paragraphs 5.2 & 5.6), the Treasury Management Limits on Activity (paragraph 5.15) and the Investment Treasury Indicator (paragraph 6.26) be approved;
(vi) that the Minimum Revenue Provision Statement attached at Appendix 1 be approved;
(vii) the use of Barclays as the Police and Crime Commissioner's bankers be noted.

1.0 Purpose of the Treasury Management Strategy

1.1 The purpose of the Treasury Management Strategy is to ensure that:

(i) Revenue Cash Flow is Adequately Planned

The Police and Crime Commissioner (PCC) is required to operate a balanced budget, which in broad terms means that cash raised during the year will meet cash expenditure. The treasury management operation is designed to:

- ensure that cash flow is adequately planned during the year, with cash being available when it is needed;
- Surplus monies are invested in counterparties or instruments commensurate with the Police and Crime Commissioner's (PCC's) risk appetite, providing adequate liquidity before considering the investment return.

(ii) Funding is Available to meet Capital Expenditure Plans

The second main objective of the treasury management function is the funding of the PCC's capital plans. Capital expenditure does not have to be charged against the income for the year and for this reason longer term cash flow planning is required to ensure that the PCC can meet his 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 the PCC's risk or cost objectives.

1.2 The Treasury Management Strategy is integrated with the Medium Term Financial Strategy and this document should be read in conjunction with the report on the Medium Term Financial Strategy 2014-15 to 2017-18.

2.0 Treasury Management Strategy 2014-15

2.1 The strategy for 2014-15 covers two main areas:

2.2 Capital issues:

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

2.3 Treasury management issues:

- the current treasury position;
- treasury indicators which limit the treasury risk and related 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.

2.4 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Department for Communities and Local Government's (DCLG) MRP Guidance, the CIPFA Treasury Management Code and DCLG Investment Guidance.

2.5 The PCC's objectives for treasury management both investing and borrowing are as follows:

- effective management and control of risk is the prime objective;
- the PCC attaches a high priority to revenue cost stability. This aids stable financial planning and avoids a stop-start approach to service delivery. This means a relatively low-risk attitude to treasury management is adopted, and it is accepted that this may come at a cost;

- the main risks with regard to treasury management activities are security, liquidity and yield risk. The PCC's treasury management policies will prioritise the risks in that order of importance, that is highest priority will be given to security, followed by liquidity and then yield;
- the PCC will pursue best value in treasury management within the context of effective risk management.

3.0 The Capital Prudential Indicators 2014-15 to 2017-18

3.1 The PCC's capital expenditure plans are set out in detail in the Medium Term Financial Strategy and are summarised in table 1.

Table 1

The Capital Programme

	2013-14 £000	2014-15 £000	2015-16 £000	2016-17 £000	2017-18 £000
Capital Expenditure	**9,285**	**10,353**	**19,753**	**13,983**	**5,427**
Funded By					
Gross Borrowing	1,305	1,955	0	700	1,400
Other capital resources	7980	8,398	19,753	13,283	4,027

The gross borrowing in 2013-14 and 2014-15 includes £2.351m of temporary borrowing to fund the Exeter Criminal Justice centre and related works pending the receipt of the proceeds of the sale of land at Middlemoor.

3.2 The capital financing requirement, is a measure of the Commissioner's underlying need to borrow.

Table 2

Capital Financing Requirement

	2013-14 £000	2014-15 £000	2015-16 £000	2016-17 £000	2017-18 £000
Opening Capital Financing Requirement	**42,234**	**42,144**	**42,678**	**36,302**	**35,581**
Capital expenditure to be funded by borrowing	1,305	1,955	0	700	1,400
Less application of capital receipts to reduce borrowing*	0	0	(4,955)	0	0
Less minimum revenue provision	(1,395)	(1,421)	(1,421)	(1,421)	(1,421)
Closing Capital Financing Requirement	**42,144**	**42,678**	**36,302**	**35,581**	**35,560**

*This is the repayment of temporary borrowing for the Exeter Criminal Justice Centre and realted works.

Capitalisation of Equal Pay

3.3 Following recent changes to legislation the PCC may use capital receipts to fund one off costs in relation to equal pay claims. The proposed capital programme as set out in the MTFS assumes that there will be no need to apply capital receipts to cover the one off costs of equal pay claims. This Treasury Management Strategy and in particular the calculation of the Capital Financing Requirement as set out in table 2 above and the borrowing strategy as set out in paragraph 5.9 below are based on this assumption.

Minimum Revenue Provision (MRP) Policy Statement

3.4 The PCC is required to pay off an element of the Capital Financing Requirement each year through a charge to revenue. DCLG regulations have been issued which require the PCC to approve an MRP Statement in advance of each year. The proposed statement is attached at Appendix 1.

Core Funds and Expected Investment Balances

3.5 Budget decisions with regard to contributions to and from revenue reserves and the application of resources (capital receipts, reserves etc.) to finance capital expenditure have an ongoing impact on investments. The 2014-15 Medium Term Financial Strategy includes a temporary increase to revenue reserves in the period 2014-15 to 2015-16. Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Table 3
Core Funds and Expected Investment Balances

	31/3/14	31/3/15	31/3/16	31/3/17	31/3/18
	£000	£000	£000	£000	£000
Fund balances / reserves	55,400	52,200	49,100	41,100	32,200
Unapplied capital grant/ receipts	3,900	3,900	3,700	3,000	2,500
Provisions	1,400	1,400	1,400	1,400	1,400
Total core funds	**60,700**	**57,500**	**54,200**	**45,500**	**36,100**
Working capital*	7,800	7,800	7,800	7,800	7,800
(Under)/over borrowing	(8,800)	(9,300)	(2,900)	(3,700)	(3,700)
Actual/Expected investments	**59,700**	**56,000**	**59,100**	**49,600**	**40,200**

*Working capital balances shown are estimated year end; these may be higher or lower mid year

Under Borrowing

3.6 Current market conditions are such that the cheapest source of borrowing for new capital expenditure is using revenue cash balances. This approach also has the benefit that it minimises credit risk. Using revenue cash balances to fund capital expenditure means that external debt levels are lower than the underlying need to borrow (see table 6 below) and this is described as under borrowing.

3.7 Decisions with regard to under borrowing need to be based on detailed modelling of cash balances. Table 3 illustrates that cash balances (represented by actual/expected investments) are maintained at a reasonable level throughout the period of the strategy.

4.0 Affordability Indicators 2014-15 to 2017-18

4.1 The affordability indicators demonstrate the impact of the capital investment plans on the PCC's overall finances.

Estimate of the ratio of net capital financing costs to revenue budget

4.2 Capital financing costs comprise minimum repayment of "loan principal" and interest paid on loans, offset by interest received.

Table 4

Ratio of Net Capital Financing Costs to Revenue Budget

	2013-14	2014-15	2015-16	2016-17	2017-18
	£000	£000	£000	£000	£000
Minimum Revenue Provision	1,347	1,421	1,421	1,421	1,421
Interest payable on Long Term Borrowing	1,329	1,344	1,345	1,431	1,494
Interest Received (net)	(417)	(325)	(392)	(546)	(679)
Capital Financing Costs	**2,259**	**2,440**	**2,374**	**2,306**	**2,236**
Net Budget Requirement	287,538	284,491	279,998	276,085	271,286
Ratio of financing costs to net revenue stream	0.79%	0.86%	0.85%	0.84%	0.82%

Incremental Impact on Council Tax

4.3 This indicator shows the incremental impact on the Band D council tax payer of the additional capital expenditure funded from borrowing included in the 2014-15 capital programme.

Table 5

Incremental Impact on Council Tax

	2014-15	2015-16	2016-17	2017-18
Incremental increase in Council Tax arising from Capital Expenditure Plans	£0.03p	£0.04p	£0.04p	£0.05p

5 Borrowing

5.1 The capital expenditure plans set out in Section 3 above provide detail of the service activity of the PCC. This section shows how those plans impact on the need to borrow and the forecast level of external borrowing.

5.2 **Current Position**

The PCC's borrowing position at 31 March 2014, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing. It is based on certain assumptions with regard to new borrowing which are set out in paragraph 5.9 below.

Table 6

External Debt

		2013-14 Est £000	2014-15 Est £000	2015-16 Est £000	2016-17 Est £000	2017-18 Est £000
1	Debt at 1 April	32,778	32,778	32,778	32,778	31,278
2	Debt maturing	0	(2,000)	0	(4,500)	0
3	New Debt	0	2,000	0	3,000	0
4	Debt as at 31 March	32,778	32,778	32,778	31,278	31,278
5	Capital Financing Requirement	42,144	42,678	36,302	35,581	35,560
6	Finance Lease Laibilities	(590)	(590)	(590)	(590)	(590)
7	Underlying need to borrow	41,554	42,088	35,712	34,991	34,970
8	(Under)/over borrowing	**8,776**	**9,310**	**2,934**	**3,713**	**3,692**

5.3 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 2014-15 and the following two financial years.

5.4 The Treasurer reports that the PCC complied with this prudential indicator in the current year and does not envisage difficulties for the future (row 4 of table 6 is always lower than row 5). This view takes into account current commitments, existing plans, and the proposals in the Medium Term Financial Strategy.

Prudential Indicators for External Debt

5.5 **The operational boundary** is the limit which external debt is not normally expected to exceed.

5.6 **The Authorised Limit** represents the maximum level at which the Commissioner is able to borrow and enter into other long term liabilities. Additional borrowing beyond this level is prohibited unless the limit is revised by the Commissioner.

Table 7

Prudential Indicators for External Debt

	2014-15 £000	2015-16 £000	2016-17 £000	2017-18 £000
Long term borrowing for capital purposes	42,678	36,302	35,581	35,560
Maximum cash-flow deficit arising from revenue budget operations	10,000	10,000	10,000	10,000
Operational Boundary	**52,678**	**46,302**	**45,581**	**45,560**
Additional margin for unforeseen circumstances	3,000	3,000	3,000	3,000
Authorised Limit	**55,678**	**49,302**	**48,581**	**48,560**

Prospects for Long Term Interest Rates

5.7 The PCC has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Commissioner to formulate a view on interest rates. The Appendix 4 gives the Capita Asset Services's central view with regards to long term interest rates.

. **Borrowing Strategy 2014-15 to 2017-18**

5.8 The overall aims of the borrowing strategy are:

- borrowing at the lowest possible rates in the most appropriate periods
- minimising borrowing costs and expenses
- the management of debt maturities to avoid large levels of maturities in any one year.

5.9 The borrowing strategy assumes that of the £6.5m of existing debt that matures over the next 4 years is replaced by £5m of new debt as set out in table 6. During this period the capital financing requirement reduces as set out in table 2. As a result there is a small increase in internal borrowing from £8.8m as at 31 March 2014 to £9.3m as at 31 March 2015 and then a reduction in the level of internal borrowing to approximately £3m as at 31.3.2016. In the final two years of the strategy internal borrowing is stable at £3.7m .

5.10 In current market conditions internal borrowing is, in the short term, the most cost efficient method of borrowing. This is because the opportunity cost of not lending working balances and reserves (i.e. the interest returns on short term loans) is significantly below the cost of borrowing to finance the capital programme. Internal borrowing also has the advantage of reducing credit and counter party risk as external lending by the PCC is reduced.

5.11 An alternative to the strategy set out at prargraph 5.9 would be maintain the internal borrowing at approximately the current level by not replacing the maturing debt. Two additional factors do, however, need to be taken into account when evaluating the level of internal borrowing, these are:

- longer trends in interest rates - borrowing rates are forecast to rise over the next four years – as set out in Appendix 4;
- the long term ability of the PCC to sustain internal borrowing - as revenue reserve levels decline it will be more difficult to fund capital expenditure by using internal cash resources.

5.12 Detailed modelling work will be undertaken in conjunction with the PCC's advisers Capita Asset Services to illustrate the outcome of different interest rate and borrowing scenarios to test whether the proposed strategy is the most beneficial for the PCC in the short, medium and long term. However for the purpose of calculating the revenue budget and setting this strategy it has been assumed that internal borrowing will reduce as set out in paragraph 5.9 and table 3.

Debt Rescheduling

5.13 Opportunities to restructure the existing debt have been reviewed. This has shown that the cost of debt repayment in terms of premiums incurred exceeds the savings in interest. Restructuring would not therefore generate any savings at the present time.

Policy on Borrowing in Advance of Need

5.14 The debt strategy is based on internal borrowing (or under borrowing). Borrowing in advance of need will not occur under this strategy. For the purposes of clarity this strategy makes clear that the PCC will not borrow more than or in advance of needs, purely in order to profit from the investment of the extra sums borrowed.

Treasury Management Limits on Activity

5.15 **Interest Rate Exposures**

Upper limit on fixed and variable interest rate exposures for 2014-15 to 2017-18 are:-

This indicator sets a limit for the exposure to change in interest rates.

	Upper Limit
Upper limit on fixed rate exposures - debt	100%
Upper limit on variable rate exposures - debt	30%

This means 70% - 100% of borrowing will be at rates fixed until the loan is repayable, while no more than 30% will be at variable rates and so liable to change at short notice. All of the variable rate borrowing will be internal borrowing.

5.16 **Maturity Structure of Borrowing**

Maturity Structure of Fixed Interest Rate Borrowing

	Lower Limit %	Upper Limit %
Under 12 Months	0	10
12 Months to 2 Years	0	15
2 years to 5 Years	0	25
5 Years to 10 Years	0	33
10 Years and Above	67	100

This indicator shows a maximum of 33% of the Commissioner's borrowing may be taken out for period of less than 10 years. The remaining debt will be for periods of 10 years or more.

5.17 The actual maturity profile of the PCC debt is provided in Appendix 10.

6 Annual Investment Strategy

6.1 The PCCs investment policy has regard to the DCLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code").

6.2 The overall aims of the PCC's investment strategy are:

- to limit the risk of the loss of capital
- ensure funds are always available to meet cash-flow requirements
- to maximise investment returns consistent with the first two aims.

The overriding objective will be to invest prudently, with priority being given to security and liquidity before yield.

6.3 The PCC's risk appetite can be characterised as follows:

- the PCC looks to invest in banks and building societies of a high credit quality and sets lending limits against each one;
- lending to other Local Authorities and Public Bodies can be undertaken;
- the PCC may lend to the Debt Management Office (central government), this lending is seen as having the highest level of security;
- the PCC may use Treasury Bills and Certificates of Deposit;
- the PCC may invest in money market funds and enhanced money market fund with a AAA credit rating;

6.4 The PCC has two different mechanisms for investing surplus funds:

- The PCC's Investment Fund managed by the Treasurer - this fund is invested solely in fixed interest deposits. The remit of the fund is contained at Appendix 2
- Very short term deposits varying from overnight to 3 months which are used to facilitate short term cash management.

6.5 Prior to January 2014 the PCC used a cash fund manager to invest a portion of the PCC's cash balances. This managed fund has been wound up following a period of poor performance and the cash and investments have been transferred to the PCC's Investment Fund. It is important that the transfer of funds does not lead to an over concentration of investment in any one organisation or sector. For this reason the counter party list has been expanded by adding a number of banks outside the UK and the euro-zone. In addition £10m has been deposited with other local authorities.

6.6 The externally managed fund held UK gilts with a nominal value of £1.8m. This holding has been transferred to the PCC's custodian King and Shaxon and becomes part of the PCC's Investment Fund. This has necessitated a change to the PCC's investment strategy to recognise the gilt holding. It should be noted that this holding is an exception to the overall strategy and the PCC will not in normal circumstances invest in UK gilts. The strategy in relation to the gilt holding is set out in paragraph 6.24 below.

6.7 The closure of the externally managed fund and also the low level of return currently available for fixed term deposits has led to the consideration of a number of alternative investment approaches. The options have been discussed with the PCC's advisers and a number of options are set out in Appendix 5. It can be seen that the option of seeking an alternative cash fund manger with a similar mandate to the previous fund manager has been deferred for the time being as market conditions are not favourable to this approach. A number of the other alternatives have also been set aside either because they do not meet the PCC's risk criteria or they are only suitable for relatively long term deposits and the PCC's future cash flow profile does not provide a sufficient degree of certainty for long term deposits.

6.8 The options of using either a property fund or a corporate bond fund require more detailed investigation and whilst they have not been rejected they are not included in the strategy at present.

Investment Strategy Principles

6.9 It should be borne in mind that it would be impossible for the PCC to mitigate all of the possible risks inherent in investing cash balances. Further economic or banking problems could impact on the security or returns achieved from the investment strategy.

6.10 In exceptional circumstances, the Treasurer will be empowered to invest in foreign currencies but only with the explicit approval of the PCC.

6.11 The investment strategy for the PCC Investment Fund is set out in Appendix 2. The investment fund will hold all internally managed cash investments with durations of more than 100 days. Short term deposits of less than 100 days will be managed separately. Specifically the performance benchmark of 3 month LIBID will not apply to short term deposits. Also short term deposits do not require approval from the Treasurer as set out in Treasury Management Practices.

Creditworthiness Policy

6.12 The PCC will utilise a creditworthiness policy that:

i. fully accounts for the ratings and outlook watches published by all three ratings agencies with a full understanding of what they reflect in the eyes of each agency
ii. recognises that ratings should not be the sole determinant of the quality of an institution and that 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
iii. takes account of information that reflects the opinion of the market, such as “Credit Default Swaps”
iv. Uses other information sources, for example, 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

6.13 To comply with the above the PCC will utilise the creditworthiness service supplied by Capita Assets Services which meets all of the requirements set out above. When using this service the PCC will be aware that the ultimate responsibility for ensuring the creditworthiness of counterparties will lie with the PCC.

6.14 For ease of reference the Capita Assets Services approach uses colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the PCC to determine the duration for investments. The PCC will therefore use counterparties within the durational bands set out in table 9.

Table 9

Yellow	5 years *
Dark Pink	5 Years **
Light Pink	5 Years ***
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

* This category is for AAA rated Government debt or its equivalent
** This category is for enhanced money market funds with a credit score of 1.25
*** This category is for enhanced money market funds with a credit score of 1.5

6.15 The PCC has determined that he will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This list will be added to, or deducted from by officers should ratings change in accordance with this policy.

6.16 If Barclays, the PCC's bankers, are removed from the Capita Asset Services list the threshold for new deposits will be reduced to £250,000 to allow the current account to operate in the short term. When using durational bands set out above the PCC will also apply credit limits as set out in table 10 below. For overnight deposits reference will be made to credit ratings if a counter party moves into the no colour band. The proposed counter party list is set out in Appendix 7.

Table 10

Counterparty Limits Investment Fund and Short Term cash Deposits

Counterparty type	**Minimum Credit Criteria/ Colour Band**			**Credit Limit**
Banks				
Term Deposits with UK and Foreign Banks	Green			
	Fitch	Moodys	Standard and Poors	£12m
Overnight deposits UK and Foreign Banks	A	A2	A	
Building Societies				
UK Building Societies	Green			£4m
Public Bodies				
Central Government				
Debt Management Office (credit criteria relates to UK sovereign rating)	AA+			No limit
Local Government				
All Local Authorities, Fire Authorities and Police and Crime Commissioners	N/A			£5m
Money Market Funds including enhanced money market funds	AAA			£10m

6.17 The approved list of counterparties is formally reviewed at least weekly. Notification of credit rating downgrades (or other market intelligence) is acted upon immediately, resulting in any further lending being suspended.

6.18 All additions, to the approved counterparty list will be approved by the Treasurer.

6.19 The DCLG classifies investments as either specified or non-specified. Specified investments are lower risk whereas non-specified investments are higher risk. To be a specified investment an investment must be:

- Sterling denominated
- For less than 365 days
- Be of high credit quality
- not deemed to be capital expenditure

6.20 Appendix 3 sets out the PCC's investments and classifies them according to whether they are specified or non-specified investments. No more £20m or 50% of the overall portfolio whichever is the lower will be invested in non-specified investments.

Investment Return Expectations

6.21 Capita Asset Services have provided a detailed forecast for Bank of England (BoE) bank rate and market rates which is provided in Appendix 4. The BoE bank rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015. BoE bank rate forecasts for financial year ends (March) are:

- 2014-15 0.50%
- 2015-16 0.75%
- 2016-17 1.75%

6.22 The rates used to calculate the interest receipts budget are as contained in table 11 below.

Table 11

Forecast Rates for Budget Purposes (Interest receipts)	**Average %**			
	14-15	**15-16**	**16-17**	**17-18**
Short Term Cash	0.5	0.5	0.9	1.2
Devon and Cornwall Police Investment Fund	0.7	0.7	1.2	1.5

6.23 The economic data and commentary that underpins these forecasts is provided in Appendix 8. If the economy were to recover more quickly than Capita Asset Services' forecast then the investment returns would be higher than included in the Medium Term Financial Strategy. Conversely if the pace of economic recovery is slower than forecast then returns, particularly in the later years of the Medium Term Financial Strategy, will be lower than forecast.

Gilt Holding

6.24 As described in paragraph 6.6 above, UK gilts with a nominal value of £1.8m and a maturity date of 22/07/2018 were transferred to the PCC's Investment Fund on the closure of the externally managed fund. As of the date of this report an unrealised capital loss of approximately £34,000 has been incurred on this holding which is a net loss of £20,000 after taking into account accrued interest. The options for this investment are:

I. to sell the holding thus incurring a net loss
II. to hold the investment to maturity – this option yields 1.25% per annum until July 2018 and this is above the Capita market forecasts until September 2016
III. or set a target sale price that would produce a net return in line with the return acheived using the PCC's current investment strategy.

A significant increase in the gilt price would be required before the target sale price is achieved. It is proposed that the PCC continue to hold the gilt and the price is monitored so that if the target sale price is achieved the Treasurer can make the decision as to whether the gilt should be sold.

Performance

6.25 The benchmark for performance on the Investment fund will be the 3 month LIBID (London Interbank Bid Rate); this is a more challenging target than that used in previous year (7 day LIBID).

Investment Treasury Indicator

6.26 **Upper limit for principal sums invested for period of over 364 days.**

This indicator sets a limit on the level of investments that are held for more than 364 days.

The Treasury Management Strategy imposes the following controls on sums invested for more than 364 days:

> Police and Crime Commissioner's Investment Fund - no more than the lesser of £20m or 50% of the Investment Fund may be invested for more than 364 days

The total for forecast investments as at 31 March 2014 is £40m

Limits on investments to mature beyond:
31 March 2015 £20.0m
31 March 2016 £10.0m
31 March 2017 £1.8m

7.0 Monitoring & Benchmarking

7.1 Income and expenditure will be monitored monthly to ascertain performance against the budget. Performance and changes in borrowing and lending will be reported regularly to the Commissioner’s Management Team.

7.2 During 2014-15 the PCC will participate in the Capita Asset Services benchmarking club. The aim of this benchmarking will be to determine, whether, given the risk appetite of the PCC the rate of return on internally managed funds has been maximised.

8 Governance Structure

8.1 The governance arrangements for the Treasury Management Strategy are set out in Appendix 8. This strategy will be considered by the Joint Audit Committee before it is presented to the Commissioner’s Management Team for approval.

9 Banking Arrangements

9.1 The Commissioner’s bankers are Barclays PLC. In December 2013 Commissioner’s Management Team approved an extension of the current contract for one year until 31 March 2015.

10 Treasury Management Consultants

10.1 The PCC uses Capita Asset Services as its external treasury management advisors.

10.2 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 external service providers. The PCC 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.

11.0 Conclusion

11.1 The continuation of the low bank rate of 0.5% and the operation of the Bank of England’s “Funding for Lending Scheme” means that forecast interest returns from investments for 2014-15 are lower than for 2013-14. Returns on investments are expected to continue at this low level in 2015-16 and start to rise in 2016-17. The nature of the PCC’s debt means that no rescheduling or repayment is possible. During the year relative interest rates will be monitoring and modelling will be undertaken to determine the most advantageous strategy for the PCC in terms of external borrowing.

11.2 The Treasury Management Strategy has been reviewed by the treasury management advisers, Capita Asset Services, and their view is; that it complies with all the legislative requirements and is sound in terms of the current and forecast interest rates.

11.3 This Strategy is compliant with all the relevant statutory and regulatory requirements including; the CIPFA Code of Practice on Treasury Management, the CIPFA Prudential Code, the Local Government Act 2003 and the Department for Communities and Local Government investment guidance.

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Treasurer

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Appendices

1 MRP Policy
2 Objectives of the PCC's Investment Fund
3 Interest Rate Forecasts
4 Alternative Investment Strategies
5 Countries Approved for Investment
6 Police and Crime Commsiioner for Devon and Cornwall - Approved List of Borrowers
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9 External Borrowing

Minimum Revenue Provision Policy Statement 2013-14

DCLG Regulations have been issued which require The Police and Crime Commissioner to approve **an MRP Statement** in advance of each year.. The Commissioner is recommended to approve the following MRP Statement

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

- **Existing practice** - MRP will follow the existing practice outlined in former CLG Regulations (Option 1);

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

1. For expenditure incurred after 1 April 2008 the MRP policy will be:

- **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (Option 3);

This option provides for a reduction in the borrowing need over approximately the asset's life.

Devon and Cornwall PCC's Investment Fund

Purpose

To invest cash balances to achieve best value in terms of return whilst giving primacy to the effective management and control of risk. This means that the security of the principal sums invested and the liquidity of funds will be given priority over yield.

Investment Strategy

1. Funds may be invested in:
   - fixed interest deposits with UK and Overseas banks and UK building societies;
   - the Debt Management Account Deposit Facility provided by central government;
   - pooled money market funds with either a constant net asset value or a variable net asset value;
   - certificates of deposit

   A more detailed definition of approved investment is provided in Annex 3.

2. All investment to be with countries with a sovereign rating of AA- or above. Banks with a UK banking licence will be deemed to be rated according to the UK sovereign rating.

3. Funds to be invested only with counterparties on the approved list.

4. The fund will not invest directly in government bonds, foreign currency or international bonds. The exception to this being the investment in UK government gilts transferred to the Devon and Cornwall Investment Fund following the winding up of segregated fund managed by the external investment manager.

6. Investments for more than one year are classified as non-specified investments. A limit of £20m or 50% of the overall portfolio will be placed on the amount of the fund that can be invested for a period of more than 1 year.

7. The benchmark for performance will be the 3 months LIBID (London Inter Bank Bid Rate).

8. Investment decisions within the policy will be taken by the Treasurer.

Specified and Non Specfied Investments

Specified Investments	Non Specified Investments
Term deposits with banks and building socities for 365 days or less duration – minimum credit criteria green	Term deposits with banks and building socities for more than 365 days duration – minimum credit criteria green
Certficates of deposit for 365 days or less duration – minimum credit criteria green	
Term deposits with other local authorities for 365 days or less duration	Term deposits with other local authorities for 365 days or more duration
Money Market Funds – with a credit rating of AAA	
Enhanced money market funds – with a credit rating of AAA	
UK government gilts	

Appendix 4

Capita Asset Services Interest Rate Forecasts

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2014	0.50	2. 60	4.40	4.40
Jun 2014	0.50	2.60	4.40	4.50
Sep 2014	0.50	2.70	4.50	4.50
Dec 2014	0.50	2.80	4.60	4.60
Mar 2015	0.50	2.90	4.70	4.70
Jun 2015	0.50	2.90	4.70	4.80
Sep 2015	0.50	3.00	4.80	4.90
Dec 2015	0.75	3.10	4.90	5.00
Mar 2016	0.75	3.20	5.00	5.10
Jun 2016	1.00	3.20	5.00	5.10
Sep 2016	1.25	3.30	5.10	5.10
Dec 2016	1.50	3.40	5.10	5.20
Mar 2017	1.75	3.50	5.10	5.20

Appendix 5

Alternative Investments

Type of Investment	Comments
Cash Fund Managers	Managers with cash/gilt mandates similar to the previous external fund manager find it difficult to provide good returns in the current market environment and for this reason it is not appropriate to seek an alternative cash fund manager.
Enhanced Cash Funds – these are similar to money market fund but the underlying deposits have a longer duration. As a result the value of the investment is more likely to vary as compared to money market funds but under certain conditions the returns can be higher than money market funds	These funds were approved for use in 2013-14 however market conditions have not been favourable and they have not been used. They have been included on the list of approved instrument and may be used in future if market conditions improve.
Exchange Traded Funds – are investment funds traded on stock exchanges, much like equities.	The value of these investments can go up or down dependent on market conditions. For this reason they are not appropriate for short term investments due to the level of risk. As the PCC's cash position cannot be forecast with certainty over the medium to long term and therefore these are not appropriate investments.
Equities	As exchange traded funds above.
Property funds	The value of property fund investments can can go up or down dependent on market conditions. In addition there can be high entrance and exit costs. For this reason thay must be seen as a medium to long term investment.
Corporate Bonds – longer dated instruments issued by financials and non-financial corporate bodies	These instruments can have higher returns than other investments, however the value of bonds can go up and down. The level of risk inherent in investing in individual corporate bonds does not match the PCC's investment strategy of putting security and liquidity before yield.
Corporate Bond Funds – invest in corporate bonds but diversify the risk by investing in a wide range of corporate bonds.	Corporate bond funds may be an appropriate investment for the PCC however more investigation is required particularly in terms of whether the funds meet legislative requirements in terms of use of derivatives.

Appendix 6

Countries Approved for Investment

AAA

- Australia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Hong Kong
- Netherlands
- U.S.A.
- UK

AA

- Abu Dhabi (UAE)
- France
- Qatar

AA-

- Belgium
- Saudi Arabia

Appendix 7

DEVON AND CORNWALL POLICE
APPROVED LIST OF BORROWERS

		DCPA Lending Limits		
		Counterparty £ millions	**Group Limit**	**Capita Asset Services Classification**
1	CLEARING BANKS & SUBSIDIARIES (GROUP Limit £) (term deposits and certificate of deposits)			
	BARCLAYS BANK-			Overnight Deposits only
	FIBCA Account	12 *	12.25	
	Current Account	0.25	12.25	
	HSBC BANK	10	10	Orange
	LLOYDS BANKING GROUP	12	12	Blue
	ROYAL BANK OF SCOTLAND	12	12	Blue
	SANTANDER	12	12	Green
	STANDARD CHARTERED	10	10	Red
	NORDEA FINLAND	10	10	Red
	SVENSKA HANDELSBANKEN	12	12	Green
	TORONTO DOMINION BANK	12	12	Purple
	DEUTSCHE BANK	12	12	Green
	RABOBANK	12	12	Red
	NATIONAL AUSTRALIA BANK	12	12	Red
	GOLDMAN SACHS INTERNATIONAL BANK	12	12	Red
	* See Voluntary operational limits below			
2.	BUILDING SOCIETIES			
	NATIONWIDE	4	4	Green
3.	LOCAL AUTHORITIES	5	5	Yellow *
4.	DEBT MANAGEMENT ACCOUNT (CENTRAL GOVERNMENT)			
	DMA Deposit Facility (DMADF)	Unlimited		Yellow
	Treasury Bills	Unlimited		Yellow
5.	MONEY MARKET FUNDS			N/A
	IGNIS – Sterling Liquidity 2	10		N/A
	IGNIS – Short Duration Fund			Pink
	Prime Rate – Sterling Liquidity Share Class 4	10		N/A
	Prime Rate – Cash Plus Fund			Pink

Key to Sector Classification

Colour	Maximum Length of Deposit
Yellow	Up to 5 years
Purple	Up to 2 years
Blue	Up to 1 year
Orange	Up to 1 year
Red	Up to 6 months
Green	Up to 3 months
Pink	To be used after agreement from a TM meeting
* - Not classified by Capita Asset Services	Up to 1 year

Economic Background

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are also currently very positive in indicating that growth prospects are strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy is that wage inflation continues to remain significantly below CPI inflation so disposable income and living standards are under pressure, although income tax cuts have ameliorated this to some extent. This therefore means that labour productivity must improve significantly for this situation to be corrected by the warranting of increases in pay rates. The US, the main world economy, faces similar debt problems to the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth.

The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- As for the Eurozone, concerns have subsided considerably in 2013. However, sovereign debt difficulties have not gone away and major concerns could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;

- Investment returns are likely to remain relatively low during 2014/15 and beyond;

- Borrowing interest rates have risen significantly during 2013 and are on a rising trend. 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 even higher borrowing costs, which are now looming ever closer, where authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt, in the near future;

- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

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Appendix 9

Treasury Management Governance Arrangements

The Commissioner Management Team is responsible for:

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.
- approval of/amendments to the treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

The Joint Audit Committee is responsible for:

- scrutinising the treasury management policy and procedures and making recommendations to the PCC Senior Management Team

The Treasurer 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.

Police and Crime Commisioner for Devon and Cornwall - External Borrowing

Lender	Term	Maturity Date	Amount Borrowed	Period Outstanding as at 31/3/2014
	Years		£	Years
PWLB	5	03/05/2014	2,000,000	0.09
PWLB	8	02/11/2016	4,500,000	2.60
PWLB	15	01/10/2025	2,000,000	11.52
PWLB	26	03/05/2029	1,697,070	15.10
PWLB	26	03/05/2029	168,930	15.10
PWLB	26	03/05/2029	461,600	15.10
PWLB	26	03/11/2029	2,000,000	15.61
PWLB	20	01/10/2030	2,000,000	16.52
PWLB	26	23/11/2030	2,500,000	16.66
PWLB	25	16/12/2034	2,500,000	20.73
PWLB	31	03/05/2036	6,200,000	22.11
PWLB	31	23/11/2036	2,000,000	22.67
PWLB	30	03/05/2037	4,750,000	23.11
			32,777,600	