Office of the Police and Crime Commissioner Devon and Cornwall

DRAFT

POLICE AND CRIME COMMISSIONER FOR DEVON AND CORNWALL

DRAFT 2019/20 TREASURY MANAGEMNT AND INVESTMENT STRATEGY

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1.0 Introduction

1.1 This Treasury Management Strategy Statement is for the Office of the Police and Crime Commissioner for Devon and Cornwall.

1.2 The Office of the Police and Crime Commissioner (OPCC) has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the OPCC to approve a Treasury Management Strategy before the start of each financial year.

1.3 In addition, this strategy also covers elements of the Local Government Act 2003, the CIPFA Prudential Code, the Ministry of Housing, Communities and Local Government (MHCLG) MRP Guidance and MHCLG Investment Guidance.

1.4 This report fulfils the OPCC's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the MHCLG Guidance.

1.5 Treasury Management is the management of the OPCC's cash flows, borrowing and investments, and the associated risks. The OPCC funds are exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates as well as ensuring that revenue cash flow is adequately planned and funding is available to meet capital expenditure plans. The successful identification, monitoring and control of financial risk are therefore central to the OPCC's prudent financial management.

1.6 In accordance with the MHCLG Guidance, the OPCC will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the OPCC's capital programme or in the level of its investment balance.

1.7 The Treasury Management Strategy is integral to the Medium Term Financial Strategy (MTFS) and this document should be read in conjunction with the report on the MTFS for 2019/20 to 2022/23.

1.8 This Strategy includes the Borrowing Strategy, the Investment Strategy and Prudential Indicators.

2.0 Treasury Management Strategy

2.1 On 31st March 2018 the OPCC held £45.526mm of investments and £30.277m of external borrowing.

2.2 This is set out in further detail in Appendix 1 Table 1. Forecast changes in these sums are shown in the balance sheet analysis for each Force in Appendix 1 Table 2.

2.3 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The OPCC's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

2.4 The OPCC has an increasing CFR due to the capital programme and will therefore be required to borrow externally by £26m over the forecast period.

2.5 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the OPCC's total debt should be lower than its highest forecast CFR over the next three years. Appendix 1 Table 2 shows that the OPCC expects to comply with this recommendation during 2019/20.

2.6 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 5.

2.7 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.80%, and that new long-term loans will be borrowed at an average rate of 2.85%. Long-term loans will be required to support the Devon and Cornwall capital programme.

2.8 **Liability benchmark**: To compare the OPCC's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing at Appendix 1 Table 3. This assumes the same forecasts as Appendix 1 Table 2, but that cash and investment balances are kept to a minimum level of £3m at each year-end to maintain sufficient liquidity but minimise credit risk.

2.9 Following on from the medium-term forecasts in Appendix 1 Table 3, the long-term liability benchmark assumes capital expenditure funded by borrowing of £22m over 4 years, minimum revenue provision on new capital expenditure based on various years depending on the type of asset.

3.0 <u>Borrowing Strategy</u>

3.1 The OPCC held £30.277m of PWLB loans as at the 31 March 2018.

3.2 The balance sheet forecast shown in Appendix 1 Table 2 shows that the OPCC will need to borrow externally in 2019/20. The OPCC may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £56m.

3.3 **Objectives:** The OPCC chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the OPCC's long-term plans change is a secondary objective.

3.4 **Strategy:** Given the significant cuts in funding, the OPCC borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the OPCC is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or short term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the OPCC with this 'cost of carry' and breakeven analysis. Its output may determine whether the OPCC borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the OPCC may arrange forward starting loans during 2019/20, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the OPCC may borrow short-term loans to cover unplanned cash flow shortages.

3.5 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Police Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

The OPCC has previously raised all of its long term borrowing from PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

3.6 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to the Police and Crime Commissioner.

3.7 **Short-term and variable rate loans**: These loans leave the OPCC exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

3.8 **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The OPCC may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

4.0 Investment Strategy

4.1 The OPCC holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the first 6 months of the year, the OPCC's investment balance has ranged between £4.7m and £74m. Similar levels are expected to be maintained by the OPCC in the forthcoming year.

4.2 **Objectives:** The CIPFA Code and the MHCLG Guidance requires the OPCC to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The OPCC's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the OPCC will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

4.3 **Negative interest rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short term investments options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

4.4 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the OPCC aims to diversify into more secure and/or higher yielding asset classes during 2019/20. The majority of the OPCC's surplus cash is currently invested in short-term unsecured bank deposits, and money market funds.

4.5 **Business Model:** Under the new IFRS 9 standard, the accounting for certain investments depends on the OPCC's "business model" for managing them. The OPCC aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

4.6 **Approved counterparties:** The OPCC may invest its surplus funds with any of the counterparty types shown in Appendix 2 Table 4, subject to the cash limits (per counterparty) and the time limits shown. Appendix 2 Table 5 and 6 contains more detailed information on specific counterparties and limits.

4.7 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

4.8 **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

4.9 **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

4.10 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

4.11 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely and only following an external credit assessment.

4.12 **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department of Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

4.13 **Pooled funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the OPCC to diversify into asset classes other than cash without the need to own and manage the underlying investments. As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the OPCC's investment objectives will be monitored regularly. Any such investment would require the explicit approval of the Police and Crime Commissioner.

4.14 **Operational bank accounts:** The OPCCs' operational bank account is held with Barclays. The OPCC may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1.25m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the OPCC's maintaining operational continuity.

4.15 **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the OPCC's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

4.16 **Other information on the security of investments**: The OPCC understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press and analysis and advice from the OPCC's treasury management advisor. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the OPCC will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the OPCC's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

4.17 **Specified investments**: The MHCLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - o the UK Government,
  - o a UK local authority, parish council or community council, or
  - o a body or investment scheme of "high credit quality".

The OPCC defines "high credit quality" organisations and securities as those having a credit rating of [A-] or higher that are domiciled in the UK or a foreign country with a sovereign rating of [AA+] or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of [A-] or higher.

4.18 **Non-specified investments**: Any investment not meeting the definition of a specified investment is classed as non-specified. The OPCC does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in Appendix 2 Table 7.

4.19 **Investment limits**: The OPCC's revenue reserves available to cover investment losses are forecast to be £35.4mm on 31st March 2019. In order that no more than 17% of available reserves for will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £6m for unsecured funds. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries. Investment limits are shown in Appendix 2 Table 8.

4.20 **Liquidity management**: The OPCC uses purpose-built cash flow forecasting spreadsheet to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the OPCC being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the OPCC's medium term financial plan and cash flow forecast.

5.0 2018 MHCLG Investment Guidance

5.1 The contribution that Treasury Management Investments make to the objectives of the OPCC is to support effective treasury management activities.

5.2 The statutory guidance issued by MHCLG in January 2018 requires authorities to report also on their investment strategy with regard to the following purposes:

5.2.1 To support local public services by lending to or buying shares in other organisations (service investments), and

5.2.2 To earn investment income (known as commercial investments where this is the main purpose)

5.3 The OPCC does not have any current plans for such investments. Should these plans change in the future a full assessment will be made and an appropriate Investment Strategy Report will be prepared.

5.2 Financial guarantees are not strictly counted as investments, since no money has exchanged hands yet, but they do carry risks. The OPCC is being asked, along with all other OPCCs, to provide a financial guarantee for the Police ICT company amounting to c. £124,000 for Devon and Cornwall. This would be covered within the General Fund Balance reserve.

6.0 Prudential Indicators

6.1 The Local Government Act 2003 requires the OPCC to have regard to the CIPFA Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of the OPCC are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the OPCC has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

i) Estimates of Capital Expenditure: The OPCC's planned capital expenditure and financing is shown in Table 9 in Appendix 3 as well as the **estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) (Table 10 in Appendix 3) measures the OPCC's underlying need to borrow for a capital purpose.

Devon and Cornwall CFR is forecast to increase in line with the requirements of the capital programme.

ii) Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the OPCC should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence which is shown in Appendix 3 Table 11.

Total debt for the OPCC is expected to remain below the CFR during the forecast period.

iii) Operational Boundary for External Debt: The operational boundary shown in Table 12 is based on the OPCC's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the OPCC's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the OPCC's debt.

iv) Authorised Limit for External Debt: The authorised limit shown in Table 13 is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the OPCC can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

v) Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income. This is shown in Table 14.

7.0 Treasury Management Indicators

7.1 The OPCC measures and manages its exposures to treasury management risks using the following indicators.

7.2 **Security:** The OPCC has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit rating	A+

7.3 **Liquidity:** Minimum limits are set for short term cash in order that sufficient liquidity is available to meet unexpected variation in the cash flow:

	Target
Minimum limit at less than 31 days duration	£9m
Minimum limit overnight	£3m

7.4 **Interest rate exposures**: This indicator is set to control the OPCC's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net interest payable will be:

	2019/20
	Limit
Upper limit on 1 year revenue impact of a 1% rise in interest rates	£13k
Upper limit on 1 year revenue impact of a 1% fall in interest rates	£13k

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

7.5 **Maturity structure of borrowing:** This indicator is set to control the OPCC's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	**Lower**
Under 12 months	10%	0%
12 months and within 24 months	15%	0%

24 months and within 5 years	25%	0%
5 years and within 10 years	40%	0%
10 years and above	100%	60%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

7.6 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the OPCC's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2019/20	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£10m	£5m	£0m	£0m

8.0 Other Items

8.1 The CIPFA Code and MHCLG requires the OPCC to include the following in its Treasury Management Strategy.

8.2 **Financial derivatives:** In the absence of any explicit legal power to do so, the OPCC will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

8.3 **Investment training:** The needs of the OPCC's treasury management staff for training in investment management are assessed on an ongoing basis and as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff attend internal training courses and/or training courses, seminars and conferences provided by Arlingclose and CIPFA.

8.4 **Investment advisers:** The OPCC has appointed Arlingclose Limited as treasury management advisers and receive specific advice on investment, debt and capital finance issues.

8.5 **Investment of money borrowed in advance of need**: The OPCC may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the OPCC is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the OPCCs overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £47m. The maximum period between borrowing and expenditure is expected to be two years, although the OPCC is not required to link particular loans with particular items of expenditure.

8.6 The Minimum Revenue Provision (MRP) Policy Statement is shown in Appendix 4. MRP is an amount charged to the revenue budget for the repayment of debt. The Local Government Act 2003 requires the OPCC to have regard to the MHCLG Guidance on Minimum Revenue Provision most recently issued in 2018.

9.0 Financial Implications

9.1 The budget for investment income in 2019/20 is £0.149m, based on an average investment portfolio of £18.6m at an interest rate of 0.80%. The budget for debt interest payable in 2019/20 is £1.4m for. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

10.0 Other Options Considered

10.1 The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Treasurer, having consulted the Police and Crime Commissioner believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising

		investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

11.0 Governance Arrangements

11.1 The Treasury Management governance arrangements for both Forces is set out in Appendix 6.

INVESTMENTS **Appendix 1**

Table 1
Existing Investment and Debt Portfolio Position

	31.03.18 Actual Portfolio £'000
External Borrowing: Finance Leases	(30,277) (113)
Total Gross External Debt	**(30,390)**
Treasury Investments: Short Term Investments Cash and Cash Equivalents	 33,707 11,819
Total Treasury Investments	**45,526**
Net Investments	**15,136**

Table 2
Balance Sheet Summary and Forecast

	31.3.18	**31.3.19**	**31.3.20**	**31.3.21**	**31.3.22**	**31.3.23**
	Actual	**Estimate**	**Forecast**	**Forecast**	**Forecast**	**Forecast**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Total Capital Financing Requirement	**38,915**	**45,245**	**60,406**	**63,685**	**61,527**	**59,039**
Less: External Borrowing	(30,277)	(30,277)	(42,277)	(49,277)	(54,277)	(56,277)
Less: Other Long Term Liabilities	(113)	(890)	(718)	(539)	(351)	(153)
Internal Borrowing	**8,525**	**14,079**	**17,411**	**13,869**	**6,899**	**2,609**
Usable Reserves	53,783	35,482	32,897	29,461	26,308	24,314
Working Capital	268	215	215	215	215	215
Total Funds	**54,051**	**35,697**	**33,112**	**29,676**	**26,523**	**24,529**
Investments (Funds less internal borrowing)	**45,526**	**21,619**	**15,701**	**15,807**	**19,624**	**21,921**

INVESTMENTS **Appendix 1**

Table 3
Liability Benchmark

	31.3.19	31.3.20	31.3.21	31.3.22	31.3.23
	Estimate	Forecast	Forecast	Forecast	Forecast
	£'000	£'000	£'000	£'000	£'000
Total Capital Financing Requirement	**45,245**	**60,406**	**63,685**	**61,527**	**59,039**
Less: Usable Reserves	(35,482)	(32,897)	(29,461)	(26,308)	(24,314)
Less: Working Capital	(215)	(215)	(215)	(215)	(215)
Plus: Minimum Investments	3,000	3,000	3,000	3,000	3,000
Liability Benchmark	**12,547**	**30,294**	**37,008**	**38,003**	**37,509**

INVESTMENT STRATEGY **Appendix 2**

Table 4
Counterparty Types

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£6m 5 years	£12m 20 years	£12m 50 years	£3.5m 20 years	£6m 20 years
AA+	£6m 5 years	£12m 10 years	£12m 25 years	£3.5m 10 years	£6m 10 years
AA	£6m 4 years	£3m 5 years	£3m 15 years	£3.5m 5 years	£6m 10 years
AA-	£6m 3 years	£3m 4 years	£3m 10 years	£3.5m 3 years	£6m 10 years
A+	£6m 2 years	£3m 3 years	£6m 5 years	£3.5m 3 years	£6m 5 years
A	£6m 13 months	£3m 2 years	£6m 5 years	£3.5m 2 years	£6m 5 years
A-	£6m 6 months	£3m 13 months	£6m 5 years	£1.5m 13 months	£1.5m 5 years
None	£1.5m 6 months	n/a	£6m 25 years	£1.5m 5 years	£6m 5 years
Pooled funds	£6m per fund				

INVESTMENT STRATEGY **Appendix 2**

Table 5
Counterparties and Limits

Approved List of Counterparties to Invest with:

	UK	Unsecured £m	Secured £m	Group Unsecured £m	Group Secured £m	Duration Unsecured
Lloyd Banking Group:				6	12	
Bank of Scotland	Yes	6	12			6 months
Lloyds Bank PLC	Yes	6	12			6 months
HSBC Bank	Yes	6	12			6 months
Bank of Montreal		6	12			6 months
Bank of Nova Scotia		6	12			6 months
Canadian Imperial Bank of Commerce		6	12			6 months
Royal Bank of Canada		6	12			6 months
Toronto Dominion Bank		6	12			6 months
Cooperatieve Rabobank		6	12			13 months
DBS Bank LTD		6	12			13 months
Oversea-Chinese Banking Corporation		6	12			13 months
United Oversea Bank		6	12			13 months
Nordea Bank AB		6	12			13 months
Svenska Handlebanken		6	12			6 months
Close Brother Limited		6	12			6 months
Santander UK PLC	Yes	6	12			6 months
Australia and New Zealand Banking Group		6	12			6 months
Commonwealth Bank of Australia		6	12			6 months
National Australia Bank		6	12			6 months
Westpac Banking Group		6	12			6 months
Landesbank Hessen-Thuringen (Helaba)		6	12			6 months
Nationwide Building Society	Yes	6	12			6 months
Coventry Building Society	Yes	6	12			6 months
Standard Chartered	Yes	6	12			6 months
Op Corporate		6	12			6 months
Bayerische Landesbank		6	12			6 months
DZ Bank		6	12			6 months
Landesbank Baden Wuerttemberg		6	12			6 months
Danske Bank		6	12			100 days
ING Bank		6	12			100 days
Barclays Bank	Yes	6	12			100 days
Goldman Sachs International Bank	Yes	6	12			100 days
Leeds Building Society	Yes	6	12			100 days
Credit Suisse		6	12			100 days
Darlington BS	Yes	6	12			100 days
Furness BS	Yes	6	12			100 days

Harpenden BS	Yes	6	12			100 days
Hinckley & Rugby BS	Yes	6	12			100 days
Leek United BS	Yes	6	12			100 days
				Group		
	UK	**Unsecured £m**	**Secured £m**	**Unsecured £m**	**Secured £m**	**Duration Unsecured**
Mansfield BS	Yes	6	12			100 days
Marsden BS	Yes	6	12			100 days
Melton Mowbray BS	Yes	6	12			100 days
National Counties BS	Yes	6	12			100 days
Newbury BS	Yes	6	12			100 days
Scottish BS	Yes	6	12			100 days
Tipton & Coseley BS	Yes	6	12			100 days
RBS Banking Group				6	12	
National Westminster Bank PLC	Yes	6	12			100 days
Royal Bank of Scotland	Yes	6	12			100 days

The table has been updated with additional counterparties recommended by Arlingclose.

Table 6
Counterparties and Limits

High Quality Bond Issuers			
Country	**Counterparty**	**Max Duration**	**Max Amount**
Supra	Council of Europe Development Bank	15 years	£5m
Supra	European Bank for Reconstruction & Development	25 years	£5m
Supra	European Coal & Steel Community	25 years	£5m
Supra	European Investment Bank	25 years	£5m
Supra	Inter-American Development Bank	25 years	£5m
Supra	International Bank for Reconstruction & Development Bank	25 years	£5m
Supra	International Finance Corp	25 years	£5m
Supra	Nordic Investment Bank	25 years	£5m
Australia	New South Wales Treasury Corporation	25 years	£5m
Canada	Export Development Canada	25 years	£5m
Denmark	Kommunekredit	15 years	£5m
Finland	Finnish Government	15 years	£5m
Finland	Municipality Finance plc	15 years	£5m
Germany	FMS Wertmanagement	25 years	£5m
Germany	KfW	25 years	£5m
Germany	Landeskreditbank Baden-Württemberg - Förderbank	25 years	£5m
Germany	Landwirtschaftliche Rentenbank	25 years	£5m
Germany	State of Saxony-Anhalt	15 years	£5m
Netherlands	Bank Nederlandse Gemeenten	5 years	£3m
Netherlands	Nederlandse Waterschapsbank NV	5 years	£3m
Norway	Kommunalbanken AS	5 years	£3m
Singapore	Temasek Financial (I) Ltd	10 years	£3m
Sweden	Svensk Exportkredit AB	5 years	£3m
UK	LCR Finance plc	15 years	£5m
UK	Network Rail Infrastructure Finance plc	15 years	£5m
UK	Transport for London	10 years	£5m
UK	Wellcome Trust Finance plc	20 years	£3m

INVESTMENT STRATEGY **Appendix 2**

Table 7
Non-Specified Investment Limits

	Cash limit
Total long-term investments	£20m
Total investments without credit ratings or rated below [A-] (except UK Government and local authorities)	£6.0m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below [AA+]	£6.0m
Total non-specified investments	£32.0m

Table 8
Investment Limits

	2019/20 **Cash Limit**
Any single organisation, except the UK Government	£12m each (£6m unsecured funds)
Any group of organisations under the same ownership	£12m per Group (£6m unsecured funds)
Any group of pooled funds under the same management	£6m per manager
Negotiable instruments held in a broker's nominee account	£24m per Broker
Limit per non-UK country	£12m per country
Registered providers	£20m in Total
Unsecured investments with building societies	£12m in Total
Money Market Funds	£32m in Total
Bank Account	£1.25m

PRUDENTIAL INDICATORS **Appendix 3**

Table 9
Estimates of Capital Expenditure

	2018/19	2019/20	2020/2021	2021/22	2022/23
	Forecast	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Total Expenditure	**27,367**	**36,432**	**21,938**	**7,865**	**9,204**
Capital Receipts	3,983	4,677	11,177	2,341	2,200
Government Grants	3,542	1,104	1,468	1,468	1,468
Reserves	9,299	10,063	1,000	2,256	2,636
Revenue	3,343	3,605	3,293	1,800	2,900
Borrowing	7,200	16,983	5,000	0	0
Total Financing	**27,367**	**36,432**	**21,938**	**7,865**	**9,204**

Table 10
Estimates of Capital Financing Requirement

	2018/19	2019/20	2020/2021	2021/22	2022/23
	Forecast	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Opening CFR	**38,915**	**45,245**	**60,406**	**63,685**	**61,527**
Capital expenditure to be funded by borrowing	7,200	16,983	5,000	0	0
Finance Leases	900	0	0	0	0
Less: Minimum Revenue Provision	(1,646)	(1,650)	(1,542)	(1,970)	(2,291)
Less: Finance Leases	(123)	(171)	(180)	(188)	(197)
Closing CFR	**45,245**	**60,406**	**63,685**	**61,527**	**59,039**

PRUDENTIAL INDICATORS **Appendix 3**

Table 11
Gross Debt and the Capital Financing Requirement

Debt	2018/19 Forecast £'000	2019/20 Estimate £'000	2020/2021 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
External Borrowing	30,277	42,277	49,277	54,277	56,277
Finance Leases	890	718	539	351	153
Internal Borrowing	14,079	17,411	13,869	6,899	2,609
Total Debt	**45,245**	**60,406**	**63,685**	**61,527**	**59,039**

Table 12
Operational Boundary for External Debt

Operational Boundary	2018/19 Forecast £'000	2019/20 Estimate £'000	2020/2021 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
External Borrowing	30,277	42,277	49,277	54,277	56,277
Finance Leases	890	718	539	351	153
Maximum forecast cashflow deficit arising from revenue budget operations	10,000	10,000	10,000	10,000	10,000
Total Operational Boundary	**41,166**	**52,995**	**59,815**	**64,627**	**66,430**

PRUDENTIAL INDICATORS **Appendix 3**

Table 13
Authorised Limit for External Debt

Authorised Limit	2018/19 Forecast £'000	2019/20 Estimate £'000	2020/2021 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Total Operational Boundary Debt	**41,166**	**52,995**	**59,815**	**64,627**	**66,430**
Additional margin for unforeseen circumstances/capital receipt	3,000	10,000	10,000	10,000	10,000
Total Authorised Limit	**44,166**	**62,995**	**69,815**	**74,627**	**76,430**

Table 14
Ratio of Financing Costs to Net Revenue Stream

	2018/19 Revised %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %
Ratio of Financing Costs to Net Revenue Stream	0.45%	0.48%	0.55%	0.60%	0.62%

MINIMUM REVENUE PROVISION **Appendix 4**

Annual Minimum Revenue Provision Statement 2019/20

Where the OPCC finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the OPCC to have regard to the Ministry of Housing, Communities and Local Government's (MHCLG) Guidance on Minimum Revenue Provision. The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits.

The MHCLG Guidance requires the OPCC to approve an Annual MRP Statement each year, and provides four options for calculating an amount to put aside to revenue over time to cover the CFR i.e. the MRP. The OPCC has opted for option 3; the Asset Life Method. The Asset Life Method determines that MRP is calculated on the basis of charging the unfinanced capital expenditure over the expected useful life of the relevant assets based on either an equal instalment method or an annuity method. The OPCC has opted for the equal instalment method. This is applied from the year after the asset becomes operational. For assets acquired by finance leases, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

The OPCC can choose to make more MRP than considered the prudent minimum.

The maximum asset life used in MRP calculations is 50 years, unless a longer life is certified by an appropriately qualified professional adviser, or the asset has been acquired on a lease of longer than 50 years. For those assets purchased before 1st April 2018 that have an asset life of more than 50 years, the Code does not require a retrospective adjustment.

Based on the OPCC's latest estimate of its Capital Financing Requirement on 31st March 2019, the budget for MRP has been set as follows:

	2019/20 Estimated CFR £'000	**2019/20 Estimated MRP £'000**
Unsupported capital expenditure after 31.03.2008	60,406	1,822

ECONOMIC CONTEXT **Appendix 5**

Arlingclose Economic & Interest Rate Forecast October 2018

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20.
Following a weak reading in the first quarter of 2018 attributed to weather-related factors, UK GDP growth rebounded in the second quarter to 0.4%, but at an annual rate of only 1.2% this remains below trend. As economic growth had evolved broadly in line with its May Inflation Report forecast, the Bank of England's Monetary Policy Committee (MPC) voted unanimously for a rate rise of 0.25% in August, taking Bank Rate to 0.75%. In November 2018 the MPC maintained Bank Rate at 0.75% while the Inflation Report showed that compared to the August report further interest rate increases may be required to bring inflation down to the 2% target over the forecast horizon.

The headline rate of UK Consumer Price Inflation fell back to 2.4% year-on-year in September 2018 from 2.7% in August, as higher import and energy prices continued to hold inflation above the BoE target. Labour market data is positive. The ILO unemployment rate fell to 4%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.1% in August providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.7% and only likely to have a moderate impact on household spending.

While external inflationary pressures from energy costs and import prices are expected to subside, domestic pressures are projected to build over the forecast horizon with the balance of these effects likely to keep inflation above the Bank of England's target throughout most of their forecast horizon, meaning that strong real income growth is unlikely to materialise any time soon.
As the US economy has continued to perform well, the Federal Reserve maintained its monetary tightening stance and pushed up its target range for the Fed Funds Rate in September 2018 by 0.25% to 2% - 2.25%. One further rise is expected in 2018 and two more in 2019.

The fallout from the US-China trade war continues which, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity in 2019. Despite slower growth in the region, the European Central Bank has started conditioning markets for the end of quantitative easing as well as the timing of the first interest rate hike, currently expected in 2019, and the timing and magnitude of increases thereafter.

ECONOMIC CONTEXT **Appendix 5**

Credit outlook: The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ring-fenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ring-fenced banks generally being better rated than their non-ring-fenced counterparts.

European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

Interest rate forecast: Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. Whilst assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity. As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.5% and 2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

GOVERNANCE ARRANGEMENTS **Appendix 6**

Treasury Management Governance Arrangements

The PCC 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 Independent Audit Committee is responsible for:

- scrutinising the treasury management policy and procedures and making recommendations to the PCC.

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.