POLICE AND CRIME COMMISSIONER FOR DEVON AND CORNWALL

TREASURY MANAGEMENT STRATEGY 2022/23

POLICE AND CRIME COMMISSIONER FOR DEVON AND CORNWALL
2022/23 TREASURY MANAGEMENT STRATEGY STATEMENT

1.0 Introduction

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

1.2 The Commissioner 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 Commissioner to approve a Treasury Management Strategy before the start of each financial year.

1.3 In addition, this strategy also complies with 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 Commissioner'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 Commissioner's cash flows, borrowing and investments, and the associated risks. **The Commissioner 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 Commissioner's prudent financial management.

1.6 In accordance with the MHCLG Guidance, the Commissioner 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 Commissioner's capital programme; or in the level of its investment balances.

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 2022/23 to 2025/26.

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

2.0 Treasury Management Strategy

2.1 On 31 March 2021 the Commissioner held treasury investments totalling £27.675m and £48.400m external debt.

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 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 Commissioner's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

2.4 Over the forecast period CFR will decrease by the amounts reflecting the reduction in the existing liabilities (e.g. minimum revenue provision) and will increase by any new unfinanced capital expenditure.

2.5 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the total debt should be lower than its highest forecast CFR over the next three years. Appendix 2 Table 8 shows that the Commissioner expects to comply with this recommendation during 2022/23.

2.6 The economic background, credit outlook and interest rate forecasts, provided by Arlingclose, is shown at Appendix 5.

2.7 Given that investment interest rates are currently negligible with little prospect of significant short term changes, a budget of £12.7k has been set for 2022/23. For new borrowing the rate range is 0.02% to 2.00% depending on the term and source of the loan.

2.8 **Liability benchmark**: To compare the Commissioner's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This benchmark is the minimum amount of debt that the Commissioner would hold if internal borrowing was used up to the maximum level possible (i.e. using all reserves and cashflow surpluses). The Commissioner's liability benchmark is shown 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 £10m 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 external and internal borrowing; and minimum revenue provision on new capital expenditure based on various years depending on the type of asset.

3.0 Borrowing Strategy

3.1 As at the 31 March 2021, the Commissioner held long term borrowing of £30.277m with PWLB, £18m short term borrowing with Local Authorities and finance leases of £0.123m. The Commissioner may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing which is shown in Appendix 2 Table 10.

3.2 **Objectives:** The 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 Commissioner's long-term plans change is a secondary objective.

3.3 **Strategy:** Given the significant cuts in funding, the Commissioner's 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 Commissioner 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 Commissioner Treasurer with this 'cost of carry' and breakeven analysis. Its output may determine whether the Commissioner borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Commissioner will consider PWLB as a source of borrowing as well as other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. The PWLB lending terms have been revised so that loans are no longer available to authorities that plan on buying investment assets primarily for yield. The Commissioner has no intention of undertaking this type of activity and so the access to PWLB loans is retained.

Alternatively, the Commissioner may arrange forward starting loans, 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 Commissioner may borrow short-term loans to cover temporary cash flow shortages.

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments
- 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 Devon and Cornwall 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 Commissioner will only borrow from organisations that have signed up to the Modern Slavery Statement.

3.5 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a 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 Commissioner.

3.6 **Short-term and variable rate loans**: These loans leave the Commissioner 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. Financial derivatives may be used to manage this interest rate risk.

3.7 **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 Commissioner 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 Commissioner holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the first 7 months of 2021/22, the Commissioner's investment balance has ranged between £18.688m and £69.112m. These levels may reduce in the forthcoming year.

4.2 **Objectives:** The CIPFA Code and the MHCLG Guidance requires the Commissioner to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Commissioner'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 Commissioner 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:** The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. 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 Commissioner aims to diversify into more secure and/or higher yielding asset classes during 2022/23. This aim may however become secondary if the advice from Arlingclose differs as we have seen in previous years.

4.5 **Business Model:** Under the IFRS 9 Financial Instruments standard, the accounting for certain investments depends on the Commissioner's approach to managing them. The Commissioner aims to realise value from its internally managed treasury investments and uses two business models to achieve this. One collects contractual cashflows e.g. a bank notice account and the other covers non-contractual investments such as pooled funds which include money market funds. The accounting treatment is different for each model with an unusable reserve used to recognise fair value gains and losses for the latter model.

4.6 **Approved counterparties:** The Commissioner may invest its surplus funds with any of the counterparty types shown in Appendix 1 Table 4, subject to the cash and time limits. The Commissioner will invest with counterparties recommended by Arlingclose and those that meet the required criteria outlined in this strategy.

4.7 **Minimum credit rating:** Treasury investments in the sectors marked with an asterisk in Table 4 will only be made with entities whose lowest published long-term credit rating is no lower than A-. 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.

For entities without published credit ratings, investments may be made only where external advice indicates the entity to be of similar credit quality.

4.8 **Banks and building societies (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 **Secured investments:** Investments secured on the borrower’s assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies 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. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

4.10 **Government:** Loans to, 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 Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

4.11 **Registered providers (unsecured):** Loans to, and bonds issued or guaranteed by, registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are 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.

4.12 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Commissioner will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

4.13 **Strategic pooled funds:** Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. These allow the Commissioner 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 Commissioner's investment objectives will be monitored regularly. Any such investment would require the explicit approval of the Commissioner.

4.14 **Operational bank accounts:** The Commissioner 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, therefore where the credit rating falls below A- balances will be kept below £1.250m, otherwise the standard counterparty limit will apply, except for:

(i) When the only investment option available incurs a negative interest rate then excess funds will be left in the bank account unless:

- The total amount remaining in the bank exceeds £6m in line with the cash limit for investment to a single organisation,
- Or the bank account interest rate falls below 0% or the investment rate pertaining to the investment.

(ii) Where unscheduled income is received after the counterparty investment cut off times, the balance may exceed £1.250m. The Treasury team will advise the Treasurer accordingly and ensure that the balance is brought back down to below £1.250m the next working day.

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 Commissioner maintaining operational continuity.

4.15 **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Commissioner's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. 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 "negative watch") 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 Commissioner 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 Commissioner'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 above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Commissioner 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 Commissioner's cash balances, then the surplus will be deposited with the UK Government or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

4.17 **Investment limits**: The Commissioner's revenue reserves available to cover investment losses are forecast to be £45.218m on 31 March 2022. The maximum that will be lent to any one organisation (other than the UK Government) is set out in Appendix 1 Table 4. A group of entities 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 and foreign countries. 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 1 Table 5.

4.18 **Liquidity management**: The Commissioner uses a 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 Commissioner being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Commissioner's medium term financial plan and cash flow forecast.

The Commissioner will spread its liquid cash to ensure that access to cash is maintained in the event of operational difficulties of any one provider.

5.0 2018 MHCLG Investment Guidance

5.1 The contribution that Treasury Management Investments make to the objectives of the Commissioner 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:

- To support local public services by lending to or buying shares in other organisations (service investments), and
- To earn investment income (known as commercial investments where this is the main purpose)

5.3 The Commissioner 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.

5.4 Financial guarantees are not strictly counted as investments, since no money has exchanged hands yet, but they do carry risks. The Commissioner provides two financial guarantees: one for the Police ICT company amounting to £124k and another to the APCC pension fund held by Merseyside LGPS amounting to £21k. This would be covered within the General Fund Balance reserve.

6.0 Prudential Code Indicators

6.1 The Local Government Act 2003 requires the Commissioner to have regard to the CIPFA 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 Commissioner are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Commissioner 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 Commissioner's planned capital expenditure and financing is shown in Table 6 in Appendix 2 as well as the **estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) (Table 7 in Appendix 2) measures the Commissioner's underlying need to borrow for a capital purpose.

(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 Commissioner 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 2 Table 8.

(iii) **Operational Boundary for External Debt:** The operational boundary shown in Appendix 2 Table 9 is based on the Commissioner's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Commissioner's estimates of capital expenditure, the capital financing requirement, finance leases and cash flow requirements, and is a key management tool for in-year monitoring.

(iv) **Authorised Limit for External Debt:** The authorised limit shown in Appendix 2 Table 10 is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Commissioner 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. This is shown in Appendix 2 Table 11.

7.0 Treasury Management Code Prudential Indicators

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

7.2 **Security:** The Commissioner 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.

Credit risk indicator	**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:

Liquidity risk indicator	**Target**
Minimum limit at less than 31 days duration	£6m

7.4 **Interest rate exposures**: This indicator is set to control the Commissioner’s exposure to interest rate risk. The upper limits on the one year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	**Limit**
Upper limit on 1 year revenue impact of a 1% rise in interest rates	(£420k)
Upper limit on 1 year revenue impact of a 1% fall in interest rates	£420k

The impact of a change to the variable interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates.

It should be noted that all loan arrangements in place and those forecast have fixed interest rates and have been excluded from the calculations.

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

Refinancing rate risk indicator	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and within 24 months	55%	0%
24 months and within 5 years	65%	0%
5 years and within 10 years	80%	0%
10 years and above	100%	0%

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 Commissioner'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:

Long term treasury management investments indicator	2022/23	2023/24	2024/25	2025/26
Counterparty Limit on principal invested beyond year end	£6m	£5.5m	£5m	£4.5m

8.0 <u>Other Items</u>

8.1 The CIPFA Code requires the Commissioner 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 Commissioner 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 Commissioner'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 Commissioner 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 Commissioner 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 Commissioner 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 Commissioner's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit. The maximum period between borrowing and expenditure is expected to be two years, although the Commissioner 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 Commissioner 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 2022/23 is £12.7k, based on an average investment portfolio of £25m at an average interest rate of 0.05%. The budget for debt interest payable in 2022/23 is £1.341m. 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 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 considered 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 are set out in Appendix 6.

Appendices

Appendix 1: Investment Strategy
Appendix 2: Prudential Indicators
Appendix 3: Budget
Appendix 4: Minimum Revenue Provision Statement
Appendix 5: Economic Context
Appendix 6: Governance
Appendix 7: Glossary

INVESTMENT STRATEGY **Appendix 1**

Table 1: Existing Investment and Debt Portfolio Position

Actual Portfolio as at 31/03/2021	
	£'000
External Borrowing:	
Short-term borrowing	(18,000)
Long-term borrowing	(30,277)
Total External Borrowing	(48,277)
Finance Leases	
Finance lease liabilities	(123)
Total Finance Leases	(123)
Total Gross External Debt	**(48,400)**
Treasury Investments:	
Short-term investments	18,157
Cash and cash equivalents	9,518
Total Treasury Investments	**27,675**
Net Debt	**(20,725)**

Table 2: Balance Sheet Summary and Forecast

	31/03/2021	31/03/2022	31/03/2023	31/03/2024	31/03/2025	31/03/2026
	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000	£'000
Total Capital Financing Requirement	**67,477**	**68,575**	**76,728**	**81,193**	**86,113**	**82,770**
Less: External Borrowing	(30,277)	(33,616)	(44,042)	(50,800)	(58,650)	(58,784)
Less: Finance Leases	(123)	(56)	0	(207)	(135)	(63)
Internal Borrowing	**37,077**	**34,903**	**32,686**	**30,186**	**27,328**	**23,923**
Less: Balance Sheet Resources						
Usable Reserves	(46,089)	(46,178)	(39,683)	(33,282)	(25,923)	(25,041)
Working Capital	(18,664)	(18,664)	(18,664)	(18,664)	(18,664)	(18,664)
Total Funds	**(64,753)**	**(64,842)**	**(58,347)**	**(51,946)**	**(44,587)**	**(43,705)**
New borrowing or (Treasury investments)	**(27,676)**	**(29,939)**	**(25,661)**	**(21,760)**	**(17,259)**	**(19,782)**

INVESTMENT STRATEGY **Appendix 1**

Table 3: Liability Benchmark

	31/03/2021	31/03/2022	31/03/2023	31/03/2024	31/03/2025	31/03/2026
	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000	£'000
Total Capital Financing Requirement	**67,477**	**68,575**	**76,728**	**81,193**	**86,113**	**82,770**
Less: Finance Leases	(123)	(56)	0	(207)	(135)	(63)
Less: Balance Sheet Resources						
Usable Reserves	(46,089)	(46,178)	(39,683)	(33,282)	(25,923)	(25,041)
Working Capital	(18,664)	(18,664)	(18,664)	(18,664)	(18,664)	(18,664)
Plus: Liquidity Allowance	10,000	10,000	10,000	10,000	10,000	10,000
Liability Benchmark	**12,601**	**13,677**	**28,381**	**39,040**	**51,391**	**49,002**

Table 4: Treasury Investment Counterparties and Limits

Sector	Time Limit	Counterparty Limit	Sector Limit
The UK Government	50 years	Unlimited	n/a
Local Authorities and Other Government Entities	25 years	£6m	Unlimited
Secured Investments*	25 years	£6m	Unlimited
Banks (unsecured) *	13 months	£3m	Unlimited
Building Societies (unsecured) *	13 months	£3m	£6m
Registered Providers (unsecured) *	5 years	£3m	£6m
Money Market Funds (including Cash Plus Funds)*	n/a	£6m	Unlimited
Strategic Pooled Funds**	n/a	£6m	£11m

*Please refer to the section on minimum credit rating.

**This sector limit is in line with the minimum level of reserves.

Table 5: Additional Investment Limits

	Cash Limit
Any group of Strategic Pooled Funds under the same management	£6m per manager
Negotiable instruments held in a broker's nominee account	£15m per broker
Foreign countries	£6m per country

PRUDENTIAL INDICATORS **Appendix 2**

Table 6: Estimates of Capital Expenditure

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000	£'000
Total Expenditure	**17,469**	**14,230**	**23,160**	**17,682**	**21,120**	**8,017**
Capital Grants	1,416	864	671	163	54	0
Capital Receipts	173	0	0	853	107	0
Earmarked Reserves	6,922	5,768	7,232	4,866	7,004	750
Revenue Contribution to Capital	4,287	4,259	4,831	5,042	6,105	7,133
Borrowing	4,671	3,339	10,426	6,758	7,850	134
Total Financing	**17,469**	**14,230**	**23,160**	**17,682**	**21,120**	**8,017**

Table 7: Estimates of Capital Financing Requirement

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Actual	Forecast	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000	£'000
Opening CFR	**64,532**	**67,477**	**68,575**	**76,728**	**81,193**	**86,113**
Capital expenditure to be funded by borrowing	4,671	3,339	10,426	6,758	7,850	134
Finance Leases	0	0	0	279	0	0
Less: Minimum Revenue Provision	(1,683)	(2,174)	(2,217)	(2,500)	(2,858)	(3,405)
Less: Finance Leases Repayment	(43)	(67)	(56)	(72)	(72)	(72)
Closing CFR	**67,477**	**68,575**	**76,728**	**81,193**	**86,113**	**82,770**

PRUDENTIAL INDICATORS **Appendix 2**

Table 8: Gross Debt and the Capital Financing Requirement

Debt	2020/21 Actual £'000	2021/22 Forecast £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
External Borrowing	30,277	33,616	44,042	50,800	58,650	58,784
Finance Leases	123	56	0	207	135	63
Internal Borrowing	37,077	34,903	32,686	30,186	27,328	23,923
Total Debt	**67,477**	**68,575**	**76,728**	**81,193**	**86,113**	**82,770**

Table 9: Operational Boundary for External Debt

Operational Boundary	2020/21 Actual £'000	2021/22 Forecast £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
External Borrowing	30,277	33,616	44,042	50,800	58,650	58,784
Finance Leases	123	56	0	207	135	63
Maximum forecast cashflow deficit arising from revenue budget operations	10,000	20,000	25,000	25,000	25,000	25,000
Total Operational Boundary	**40,400**	**53,672**	**69,042**	**76,007**	**83,785**	**83,847**

Table 10: Authorised Limit for External Debt

Authorised Limit	2020/21 Actual £'000	2021/22 Forecast £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Total Operational Boundary Debt	40,400	53,672	69,042	76,007	83,785	83,847
Additional margin for unforeseen circumstances/capital receipt	10,000	10,000	10,000	10,000	10,000	10,000
Total Authorised Limit	**50,400**	**63,672**	**79,042**	**86,007**	**93,785**	**93,847**

Table 11: Ratio of Financing Costs to Net Revenue Stream

	2020/21 Actual	2021/22 Forecast	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Ratio of Financing Costs to Net Revenue Stream	**0.39%**	**0.37%**	**0.36%**	**0.40%**	**0.42%**	**0.43%**

BUDGET **Appendix 3**

Table 12: Budget

	2022/23
	Budget
	£'000
Interest Income	(13)
Interest Payments	1,341

MINIMUM REVENUE PROVISION **Appendix 4**

Annual Minimum Revenue Provision Statement 2022/23

Where the Commissioner 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 Commissioner to have regard to the former Ministry of Housing, Communities and Local Government's (MHCLG) Guidance on Minimum Revenue Provision most recently issued in 2018. The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is either commensurate with that over which the capital expenditure provides benefits.

The MHCLG Guidance requires the Commissioner 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 Commissioner 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 Commissioner has opted for the equal instalment method. This method will be reviewed to ensure its continued suitability. 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.

Where former operating leases have been brought onto the balance sheet on 1 April 2022 due to the adoption of the IFRS 16 Leases accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.

The Commissioner 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 Commissioner's latest estimate of its Capital Financing Requirement on 31 March 2022, the budget for MRP has been set as follows:

	2022/23 Estimated CFR	2022/23 Estimated MRP
	£'000	£'000
Unsupported capital expenditure after 31.03.2008	76,728	2,273

ECONOMIC CONTEXT **Appendix 5**

Arlingclose Economic Context as of 17 December 2021

Economic background: Economic background: The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022/23.

The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously but notes that Omicron could weaken the demand for labour.

UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% q/q rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP readings suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fifth successive month of inflation. Core CPI inflation was 2.6% y/y in November, the fourth month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 2.1% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

Credit outlook: Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Authority's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around

Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.

Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.

Arlingclose Economic and Interest Rate Forecast – December 2021

Underlying assumptions:

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.

- Despite relatively buoyant activity survey data, official GDP data indicates that growth was weakening into Q4 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, PMIs increased, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.

- The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.

- These factors prompted the MPC to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.

- The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Q4 and Q1 activity could be weak at best.

- Longer-term government bond yields remain relatively low despite the more hawkish signals from the BoE and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.

- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

Forecast:

- The MPC will want to build on the strong message it delivered this month by tightening policy despite Omicron uncertainty.
- Arlingclose therefore expects Bank Rate to rise to 0.50% in Q1 2022, but then remain there. Risks to the forecast are initially weighted to the upside, but becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.
- Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.
- Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.
- The risks around the gilt yield forecasts vary. The risk for short and medium term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

ECONOMIC CONTEXT **Appendix 5**

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month money market ra													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
10yr gilt yield													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
20yr gilt yield													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
50yr gilt yield													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45

PWLB certainty rate = relevant gilt yield + 0.80%

GOVERNANCE **Appendix 6**

Treasury Management Governance Arrangements

The Commissioner 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 Commissioner.

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.

GLOSSARY **Appendix 7**

Annuity	A method of repaying a loan where the cash payment remains constant over the life of the loan, but the proportion of interest reduces and the proportion of principal repayment increases over time. Repayment mortgages and personal loans tend to be repaid by the annuity method.
Authorised limit	The maximum amount of *debt* that a local authority may legally hold, set annually in advance by the authority itself. One of the *Prudential Indicators*.
Bail-in	A method of rescuing a failing *financial institution* by cancelling some of its *deposits* and *bonds*. Investors may suffer a *haircut* but may be given *shares* in the bank as part compensation.
Bank	Regulated firm that provides financial services to customers. But see also *Bank of England*.
Bank of England	The *central bank* of the UK, based in London, sometimes just called "the Bank". See also *Monetary Policy Committee.*
Bank Rate	The official interest rate set by the *Monetary Policy Committee*, and the rate of interest paid by the *Bank of England* on commercial bank deposits. Colloquially termed the "base rate".
Bid	A bid to buy a *security* at a certain price (the bid price), or a bid to borrow money at a certain interest rate (the bid rate).
Bill	A certificate of *short-term* debt issued by a company, government, or other institution, which is tradable on financial markets
Bond	A certificate of *long-term* debt issued by a company, government, or other institution, which is tradable on financial markets.
Borrowing	Usually refers to the stock of outstanding loans owed and *bonds* issued.
Broker	Regulated firm that matches either borrowers and lenders (a money broker) or buyers and sellers of *securities* (a stockbroker) with each other in order to facilitate transactions.
Building society	A mutual organisation that performs similar functions to a *retail bank* but is owned by its customers.
Capital	**(1)** Long-term, as in *capital expenditure* and *capital receipt.* **(2)** Principal, as in *capital gain* and capital value. **(3)** Investments in *financial institutions* that will absorb losses before *senior unsecured creditors.*
Capital expenditure	Expenditure on the acquisition, creation or enhancement of fixed assets that are expected to provide value for longer than one year, such as property and equipment, plus expenditure defined as capital in legislation such as the purchase of certain investments.
Capital finance	Arranging and managing the cash required to finance *capital expenditure*, and the associated accounting.
Capital financing requirement (CFR)	A local authority's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed. The CFR increases with *capital expenditure* and decreases with *capital finance* and *MRP*.
Capital markets	The markets for long-term finance, including *bonds* and *shares*. See also *money markets*.

GLOSSARY **Appendix 7**

Capital receipt	Cash obtained from the sale of an item whose purchase would be *capital expenditure*. The law only allows local authorities to spend capital receipts on certain items, such as new capital expenditure. They are therefore held in a capital receipts reserve until spent.
Cash plus fund	A *pooled fund is* similar to a *money market fund* but with a *WAM* up to around six months.
Central bank	A government agency responsible for setting interest rates, regulating banks and maintaining financial stability.
Certificate of deposit (CD)	A short-term *debt* instrument, similar to a *deposit*, but that is tradable on the *money markets*.
CIPFA	The Chartered Institute of Public Finance and Accountancy - the professional body for accountants working in the public sector. CIPFA also sets various standards for local government.
Commercial investment	An investment whose main purpose is generating income, such as *investment property*.
Cost of carry	When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim.
Counterparty	The other party to a loan, investment or other contract.
Counterparty limit	The maximum amount an investor is willing to lend to a *counterparty*, in order to manage *credit risk*.
Covered bond	*Bond* issued by a *financial institution* that is secured on that institution's assets, usually residential mortgages, and is therefore lower risk than unsecured bonds. Covered bonds are exempt from *bail-in*.
CPI	Consumer Price Index - the measure of inflation targeted by the *Monetary Policy Committee*, measured on a harmonised basis across the European Union.
Credit default swap (CDS)	*Derivative* for swapping *credit risk* on a particular issuer, similar to an insurance policy where the buyer pays a *premium* against the risk of default. Also used as an indicator of credit risk: the higher the premium, the higher the perceived risk.
Credit rating	Formal opinion by a *credit rating agency* of a *counterparty*'s future ability to meet its financial obligations. As it is only an opinion, there is no guarantee that a highly rated organisation will not default.
Credit rating agency	An organisation that publishes *credit ratings*. The three largest agencies are Fitch, Moody's and Standard & Poor's but there are many smaller ones.
Credit risk	The risk that a *counterparty* will *default* on its financial obligations.
Debt	**(1)** A contract where one party owes money to another party, such as a *loan*, *deposit* or *bond*. Contrast with *equity*. **(2)** In the *Prudential Code*, the total outstanding *borrowing* plus *other long-term liabilities.*
Default	Failure to meet an obligation under a debt contract, including the repayment of cash or compliance with a *covenant*, usually as a result of being in financial difficulty (rather than an administrative oversight).

GLOSSARY **Appendix 7**

Deflation	Negative inflation, which central banks are keen to avoid since households tend to delay spending waiting for prices to fall further, leading to further deflation.
Deposit	A regulated placing of cash with a *financial institution*. Deposits are not tradable on financial markets.
Derivative	Financial instrument whose value is derived from an underlying instrument or index, such as a *swap*, *option* or *future*. Derivatives can be used to gain exposure to, or to help protect against, changes in the value of the underlying.
Discount	**(1)** The amount that the early repayment cost of a loan is below its principal, or the price of a bond is below its nominal value. **(2)** To calculate the *present value* of an investment taking account of the time value of money.
Diversification	The spreading of risk across a variety of exposures in order to reduce the risk. For example, investing in a range of *counterparties* to limit *credit risk* or borrowing to a range of *maturity* dates to limit *refinancing risk*.
Duration	In relation to a *bond* or *bond fund*, the weighted average time of the future cash flows from today, usually expressed in years. The longer the duration, the more the price moves for a given change in interest rates.
ECB	European Central Bank – the *central bank* of the Eurozone, based in Frankfurt, Germany.
Embedded derivative	A *derivative* that is combined into another financial instrument, such as the *options* embedded in a *LOBO*.
Equity	**(1)** The residual value of an entity's assets after deducting its liabilities. **(2)** An investment in the residual value of an entity, for example ordinary shares.
Fair value	*IFRS* term for the price that would be obtained by selling an investment, or paid to transfer debt, in a market transaction.
Federal Reserve	The *central bank* of the USA, often just called "the Fed".
Financial instrument	*IFRS* term for investments, borrowing and other cash payable and receivable.
Financing costs	In the *Prudential Code*, interest payable on *debt* less investment income plus *premiums* less *discounts* plus *MRP*.
Future	A *derivative* whose payments depend on the future value of a variable.
Fund manager	Regulated firm that manages *pooled funds*.
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
General Fund	A local authority reserve that holds the accumulated surplus or deficit on revenue income and expenditure, except on council housing.
Gilt	Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on.
Gilt yield	*Yield* on *gilts*. Commonly used as a measure of risk-free long-term interest rates in the UK.
Guarantee	An arrangement where a third party agrees to pay the contractual payments on a *loan* to the lender if the borrower *defaults*.

GLOSSARY **Appendix 7**

IFRS	International Financial Reporting Standards, the set of accounting rules in use by UK local authorities since 2010.
Impairment	A reduction in the value of an investment caused by the *counterparty* being in financial difficulty.
Interest	Compensation for the use of cash paid by borrowers to lenders on *debt* instruments.
Interest rate risk	The risk that unexpected changes in interest rates cause an unplanned loss, for example by increased payments on borrowing or lower income on investments.
Internal borrowing	A local government term for when actual "external" *debt* is below the *capital financing requirement*, indicating that difference has been borrowed from internal resources instead; in reality this is not a form of borrowing.
Investment guidance	Statutory guidance issued by MHCLG and the devolved governments on local government investments. Local authorities are required by law to have regard to the relevant investment guidance.
Investment strategy	A document required by *investment guidance* that sets out a local authority's investment plans and parameters for the coming year. Sometimes forms part of the authority's *treasury management strategy*.
Lease	A contract where one party permits another to make use of an asset in return for a series of payments. It is economically similar to buying the asset and borrowing a loan, and therefore leases are often counted as a type of *debt*.
Liability benchmark	Term in CIPFA's Risk Management Toolkit which refers to the minimum amount of borrowing required to keep investments at a minimum liquidity level. Used to compare against the actual and forecast level of borrowing.
Loan	Contract where the lender provides a sum of money (the *principal*) to a borrower, who agrees to repay it in the future together with *interest*. Loans are not normally tradable on financial markets. There are specific definitions in government *investment guidance*.
Long-term	Usually means longer than one year.
Maturity	**(1)** The date when an investment or borrowing is scheduled to be repaid. **(2)** A type of loan where the principal is only repaid on the maturity date.
MHCLG	Ministry of Housing, Communities and Local Government – the central government department that oversees local authorities in England.
Monetary policy	Measures taken by *central banks* to boost or slow the economy, usually via changes in interest rates. Monetary easing refers to cuts in interest rates, making it cheaper for households and businesses to borrow and hence spend more, boosting the economy, while monetary tightening refers to the opposite.
Monetary Policy Committee (MPC)	Committee of the *Bank of England* responsible for implementing *monetary policy* in the UK by changing *Bank Rate* and *quantitative easing* with the aim of keeping *CPI* inflation at around 2%.
Money market fund (MMF)	A *pooled fund* which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to *CNAV* and *LVNAV* funds with a *WAM* under 60 days which offer instant access, but the European Union definition extends to include *cash plus funds*.
Money markets	The markets for short-term finance, including *deposits* and *T-bills*.

GLOSSARY **Appendix 7**

MRP	Minimum revenue provision **- a**n annual amount that local authorities are required to set aside and charge to revenue for the repayment of debt associated with capital expenditure. Local authorities are required by law to have regard to government guidance on MRP.
Municipal bond	*Bond* issued or guaranteed by local authorities.
Municipal bonds agency	Company that issues *bonds* in the *capital market* and lends the proceeds back to local authorities. The bonds are guaranteed by the local authorities.
Net borrowing	*Borrowing* minus *treasury investments*.
Net revenue stream	In the *Prudential Code*, income from general government grants, Council Tax and rates.
Notice account	A *deposit* account where the cash can be called back after a given notice period.
Other long-term liabilities	*Prudential Code* term for *credit arrangements*.
Operational boundary	A *prudential indicator* showing the most likely, prudent, estimated level of external *debt*, but not the worst-case scenario. Regular breaches of the operational boundary should prompt management action.
Option	A *derivative* where the holder pays a *premium* to have the right, but not the obligation, to buy or sell a security or enter into a defined transaction.
Outlook	A *credit rating agency's* expected direction of travel in the *long-term rating* over the next two years.
Pension Fund	Ringfenced account for the income, expenditure and investments of the local government pension scheme. Pension fund investments are not considered to be part of *treasury management*.
Pooled fund	Scheme in which multiple investors collectively hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
Premium	**(1)** The amount that the early repayment cost of a loan is above the principal, or the price of a bond is above its nominal value. **(2)** The initial payment made under a *derivative*.
Principal	The amount of money originally lent on a *debt* instrument.
Private Finance Initiative (PFI)	A government scheme where a private company designs, builds, finances and operates assets on behalf of the public sector, in exchange for a series of payments, typically over 30 years. Counts as a *credit arrangement* and *debt.*
Property fund	A *pooled fund* that mainly invests in property. Due to the costs of buying and selling property, including *stamp duty land tax*, there is usually a significant fee charged on initial investment, or a significant difference between the *bid* and *offer* price.
Prudential Code	Developed by CIPFA and introduced in April 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice. Local authorities are required by law to have regard to the Prudential Code.
Prudential indicators	Indicators required by the *Prudential Code* and determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable.

GLOSSARY **Appendix 7**

PWLB	Public Works Loans Board - a statutory body operating within the *DMO* that lends money from the National Loans Fund to local authorities and other prescribed bodies and collects the repayments. Not available in Northern Ireland.
Redemption	The process of withdrawing cash from a *pooled fund* and cancelling the units of shares. Redemptions can be suspended in certain circumstances detailed in the *prospectus*.
Refinancing risk	The risk that maturing loans cannot, be refinanced, or only at higher than expected interest rates leading to an unplanned loss. Managed by maintaining a smooth *maturity profile*.
Registered Provider of Social Housing (RP)	An organisation that is registered to provide social housing, such as a housing association. Also known as a registered social landlord or RSL.
Sector limit	The maximum amount an investor is willing to lend to all *counterparties* in a particular industry sector, in order to manage *credit risk*.
Security	**(1)** A *financial instrument* that can be traded on a *secondary market.* **(2)** The concept of low *credit risk.* **(3)** *Collateral.*
Secured investment	An investment that is backed by *collateral* and is therefore normally lower *credit risk* and lower yielding than an equivalent unsecured investment.
Service investments	Investments made to promote a local authority's public service objectives, for example a *loan* to a local charity or *shares* in a local company.
Share	An *equity* investment, which usually also confers ownership and voting rights.
Short-term	Usually means less than one year.
Swap	A *derivative* where the *counterparties* exchange cash flows, for example fixed rate interest and variable rate interest.
Total return	The overall return on an investment, including *interest*, *dividends*, *rent*, fees and *capital gains and losses*.
Treasury bill	Treasury bill - a *bill* issued by a government.
Treasury investments	Investments made for *treasury management* purposes, as opposed to *commercial investments* and *service investments*.
Usable reserves	Resources available to finance future *revenue* and/or *capital expenditure.* Some usable reserves are ringfenced by law for certain expenditure such as on schools or council housing.
Volatility	A measure of the variability of a price or index, usually expressed as the annualised standard deviation.
Working capital	The cash surplus or deficit arising from the timing differences between income/expenditure in accounting terms and receipts/payments in cash terms.
Yield	A measure of the return on an investment, especially a *bond*. The yield on a fixed rate bond moves inversely with its price.