NOT PROTECTIVELY MARKED – for public release **Agenda Item No.**

JOINT INDEPENDENT AUDIT COMMITTEE
22 February 2023

09

SUBJECT	**TREASURY MANAGEMENT STRATEGY STATEMENT 2022/23**
REPORT BY	**CHIEF FINANCE OFFICER OPCC AND FORCE CHIEF FINANCE OFFICER**
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SUMMARY AND PURPOSE OF REPORT The report details the strategy for Treasury Management, including the Minimum Revenue Provision Policy Statement and the Annual Investment Strategy.	
RECOMMENDATION	***That the Committee reviews the Treasury Management Strategy Statement 2023/24.***

A. SUPPORTING INFORMATION

1. The Treasury Management Strategy Statement is approved annually which covers:

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

2. The draft Treasury Management Strategy Statement 2023/24 is attached at Appendix A.

3. A mid-year treasury management report gives an update on the capital position, amending prudential indicators as necessary, and whether any policies require revision. There is also an annual treasury report that reviews actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy. These reports are scrutinised by the Police and Crime Strategy Board, the Joint Independent Audit Committee and the Police and Crime Commissioner.

B. FINANCIAL CONSIDERATIONS

There are no additional financial considerations to those included in the report itself.

C. LEGAL AND HUMAN RIGHTS CONSIDERATIONS

There are no specific issues arising from this report.

D. PERSONNEL, EQUAL OPPORTUNITIES AND DIVERSITY ISSUES

(including any impact or issues relating to Children and Young People)

There are no specific issues arising from this report.

E. REVIEW ARRANGEMENTS

The committee will receive annual Treasury Management Reports as stated in this report.

F. RISK MANAGEMENT

Risks are detailed as appropriate within this report.

G. PUBLIC ACCESS TO INFORMATION

Information in this report along with any supporting material is subject to the Freedom of Information Act 2000 and other legislation.

Appendix A

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Treasury Management Strategy Statement 2022/23

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Police and Crime Commissioner for Lincolnshire

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1. INTRODUCTION

CIPFA published the revised codes on 20th December 2021 and has stated that implementation of the Prudential Code is not required until the 2023/24 financial year. There is no implementation date specified for the Treasury Management Code. The Police and Crime Commissioner (PCC) has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy.

The revised Treasury Management Code requires all investments and investment income to be attributed to one of the following three purposes: -

Treasury management
Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

Service delivery
Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".

Commercial return
Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to a council's financial capacity – i.e., that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. An authority must not borrow to invest primarily for financial return.

The revised Treasury Management code will require an authority to implement the following:

- adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a minimum of ten years, with material differences between the liability benchmark and actual loans to be explained;

- long term treasury investments, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case;

- pooled funds are to be included in the indicator for principal sums maturing in years beyond the initial budget year;

- amendment to the knowledge and skills register for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;

- reporting to members is to be done quarterly, to include prudential indicators.

- enviromental, social and governance (ESG) issues to be addressed within an authority's treasury management policies and practices (TMP1). (*This area is under further development by CIPFA.)*

The main requirements of the Prudential Code relating to service and commercial investments are:

- The risks associated with service and commercial investments should be proportionate to their financial capacity – ie that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services.

- An authority must not borrow to invest for the primary purpose of commercial return.

- It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.

- An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt.

- A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream.

- Create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).

The authority's capital strategy or investment strategy should include:

- investments for service or commercial purposes:

- the authority's approach to investments for service or commercial purposes (together referred to as non-treasury investments), including defining the authority's objectives, risk appetite and risk management in respect of these investments, and processes ensuring effective due diligence

- an assessment of affordability, prudence and proportionality in respect of the authority's overall financial capacity (ie whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services)

- details of financial and other risks of undertaking investments for service or commercial purposes and how these are managed

- limits on total investments for service purposes and for commercial purposes respectively (consistent with any limits required by other statutory guidance on investments)

- requirements for independent and expert advice and scrutiny arrangements (while business cases may provide some of this material, the information contained in them will need to be periodically re-evaluated to inform the authority's overall strategy)

- state compliance with paragraph 51 of the Prudential Code in relation to investments for commercial purposes, in particular the requirement that an authority must not borrow to invest primarily for financial return.

Members will be updated on how all these changes will impact our current approach and any changes required will be incorporated into, and formally adopted, within the 2023/24 TMSS/AIS report.

1.1. Background

The PCC is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the PCC's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the PCC's capital plans. These capital plans provide a guide to the borrowing need of the PCC, essentially the longer-term cash flow planning, to ensure that the PCC can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet PCC risk or cost objectives.

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

CIPFA defines treasury management as:

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

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

1.2. Reporting requirements

1.2.1. Capital Strategy

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

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

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

1.2.2. Treasury Management reporting

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

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

The first and most important report is forward looking and covers:

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

b) A mid-year treasury management report

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

c) An annual treasury report

This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports require adequate scrutiny before recommendation to the PCC. This role is fulfilled by the Joint Independent Audit Committee and the attendees of the Police and Crime Strategy Board.

1.3. Treasury Management Strategy for 2022/23

The strategy for 2022/23 covers two main areas:

a) Capital issues

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

b) Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the PCC;

- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, DLUHC Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

1.4. Training

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

1.5. Treasury management consultants

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

The PCC recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regard to all available information, including, but not solely, our treasury advisers.

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

2. THE CAPITAL PRUDENTIAL INDICATORS 2022/23 – 2025/26

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

2.1. Capital expenditure and financing

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

Capital Expenditure	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
£000	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
Building Schemes	2,888	1,658	1,165	1,000	1,000	1,000
Command & Control	150	817	2,004	-	-	-
Bluelight Innovation	75	43	-	-	-	-
ICT Projects	469	1,978	2,258	250	250	250
Airwaves Refresh	-	1,000	-	-	-	-
Vehicles	1,964	427	2,102	1,200	1,200	1,200
ESMCP	171	150	423	4,176	-	-
Horizons: Intelligence Tool	296	768	-	-	-	-
Equipment Replacement/Telephony	410	690	250	250	250	250
Total	**6,423**	**7,531**	**8,202**	**6,876**	**2,700**	**2,700**

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

Capital Expenditure	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
£000	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
Total	**6,423**	**7,531**	**8,202**	**6,876**	**2,700**	**2,700**
Financed by:						
Grants	483	100	-	-	-	-
Capital Receipts	313	63	60	60	60	60
Partner Funding (re Bluelight)	663	120	-	-	-	-
Earmarked Reserves	-	287	-	-	-	-
Revenue Funding	1,400	-	-	-	-	-
Net financing need for the year	**3,564**	**6,961**	**8,142**	**6,816**	**2,640**	**2,640**

Note that correspondence from the Home Office has advised that the capital grant will no longer be specifically allocated to capital as from the end of 21/22.

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

The second prudential indicator is the PCC's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the PCC's indebtedness and so the underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

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

The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the PCC borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the PCC is not required to separately borrow for these schemes. The PCC currently has £4m of such schemes within the forecasted CFR.

The PCC is asked to approve the CFR projections below:

Capital Financing Requirement	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**
£000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
CFR Opening Balance	43,582	42,017	46,388	51,124	53,516	51,202
Movement in CFR	- 1,565	4,371	4,736	2,392	- 2,315	- 2,277
Total CFR	**42,017**	**46,388**	**51,124**	**53,516**	**51,202**	**48,924**

Movement in CFR represented by:						
Net financing need for the year (above)	3,564	6,961	8,142	6,816	2,640	2,640
Less MRP and other financing movements	5,129	2,590	3,406	4,424	4,955	4,917
Movement in CFR	**- 1,565**	**4,371**	**4,736**	**2,392**	**- 2,315**	**- 2,277**

2.3. Core funds and expected investment balances

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

Year-end Resources	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**
£000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Fund balances/Reserves	20,362	14,520	12,898	12,091	11,756	11,756
Provisions	1,389	1,389	1,389	1,389	1,389	1,389
Annual Cash Flow Adj		7,000	-	-	-	-
Total Core Funds	**21,751**	**22,909**	**14,287**	**13,480**	**13,145**	**13,145**
Working Capital*	(3,520)	(3,520)	(3,520)	(3,520)	(3,520)	(3,520)
Under Borrowing	(9,321)	(17,996)	(9,635)	(8,910)	(7,446)	(5,962)
Expected investments	**8,910**	**1,393**	**1,132**	**1,050**	**2,179**	**3,663**

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

Please note that actual figures for 2020/21 for all tables include Regional figures and are therefore as stated in the Financial Statements for 2020/21.

An adjustment has been included in respect of surplus cash flow that allows the forecasted borrowing figure to be flexed – see section 3.1 below. Note that this surplus is only available in the short term; it is assumed that from 2022/23 the PCC will undertake the required borrowing to support the forecasted capital programme.

The majority of significant funding streams are received on a monthly basis, with the exception of the Home Office pension top up grant which is received annually in July.

2.4. Minimum revenue provision (MRP) policy statement

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

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

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

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

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

- **Asset life method.** MRP will be based on the estimated life of the assets, in accordance with the regulations, however it does not need to reflect the same asset life as the asset policy recommends as long as the decision to vary this is prudent.

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

Repayments included in finance leases are applied as MRP.

3. BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the PCC. The treasury management function ensures that the PCC's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the PCC's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1. Current portfolio position

The overall treasury management portfolio as at 31 March 2021 and for the position as at 31 Dec 2021 are shown below for both borrowing and investments:

Treasury Portfolio £000	**2020/21 Actual**	**2020/21 Actual**	**Dec-21 Current**	**Dec-21 Current as %**
Banks	-	-	10,000	42%
6 Month Fixed Term Deposits	-	-	7,500	32%
Money Market Funds	8,870	100%	6,050	26%
Total treasury investments (managed in house)	**8,870**	**100%**	**23,550**	**100%**
PWLB	28,886	99%	28,284	99%
SALIX	419	1%	345	1%
Total external borrowing	**29,305**	**100%**	**28,629**	**100%**
Net treasury investments / (borrowing)	**(20,435)**		**(5,079)**	

There is a greater temporary cash surplus at December 2021 compared with March 2021.

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

Borrowing £000	**2020/21 Actual**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**
Debt at 1 April	29,942	29,305	28,392	41,489	44,607	43,755
New Loans	245	-	14,000	4,000	-	-
Repayments	882	913	903	882	852	793
Actual Gross Debt at 31 March exc Finance Lease	**29,305**	**28,392**	**41,489**	**44,607**	**43,755**	**42,962**
Finance Lease Liability	3,391	-	-	-	-	-
Actual Gross Debt at 31 March	**32,696**	**28,392**	**41,489**	**44,607**	**43,755**	**42,962**
The Capital Financing Requirement	42,017	46,388	51,124	53,516	51,202	48,924
Under / (Over borrowing)	9,321	17,996	9,635	8,910	7,446	5,962

Within the range of prudential indicators there are a number of key indicators to ensure that the PCC's activities operate within well-defined limits. One of these is that the PCC needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and the following three financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Chief Finance Officer reports that the PCC complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2. Treasury Indicators: limits to borrowing activity

The operational boundary

This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational Boundary £m	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt	47	52	54	52	49

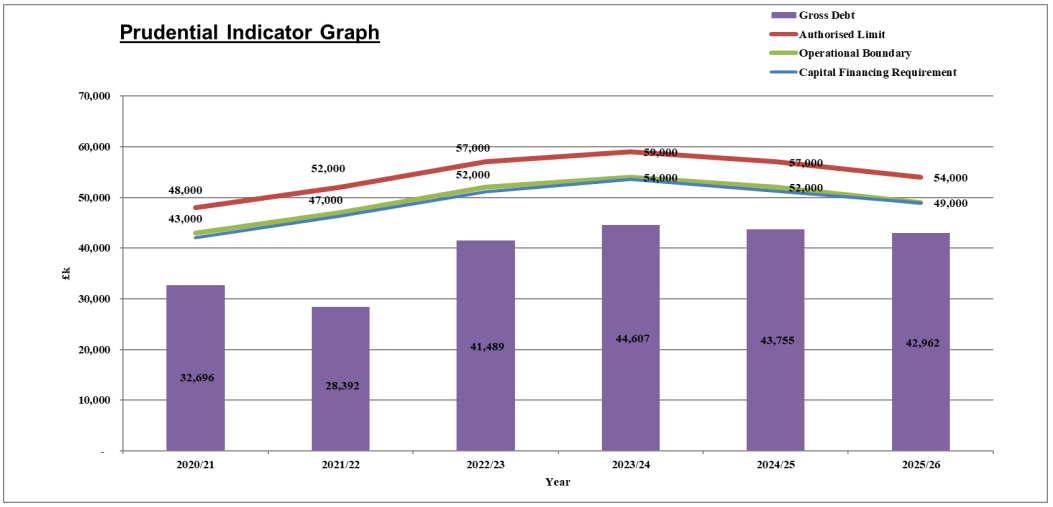
The authorised limit for external debt

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

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

Authorised Limit £m	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt	52	57	59	57	54

Graph to show projections of CFR and borrowing:



3.3. Prospects for interest rates

The PCC has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 7th February 2022. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View 7.2.22	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
3 month av. earnings	0.80	1.00	1.00	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
6 month av. earnings	1.00	1.10	1.20	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
12 month av. earnings	1.40	1.50	1.60	1.70	1.70	1.60	1.60	1.50	1.40	1.40	1.40	1.40	1.40
5 yr PWLB	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
10 yr PWLB	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
25 yr PWLB	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
50 yr PWLB	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40

Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021 and then to 0.50% at its meeting of 4th February 2022.

As shown in the forecast table above, the forecast for Bank Rate now includes a further three increases of 0.25% in March, May and November 2022 to end at 1.25%.

Significant risks to the forecasts

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity.

- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns. 25% of the population not being vaccinated is also a significant risk to the NHS being overwhelmed and lockdowns being the only remaining option.

- **The Monetary Policy Committee** acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- **The Monetary Policy Committee** tightens monetary policy too late to ward off building inflationary pressures.

- **The Government** acts too quickly to cut expenditure to balance the national budget.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Longer term US treasury yields** rise strongly and pull gilt yields up higher than forecast.

- **Major stock markets** e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.

- **Geopolitical risks,** for example in Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

Forecasts for Bank Rate

The Monetary Policy Committee is now very concerned at the way that forecasts for inflation have had to be repeatedly increased within a matter of just a few months. Combating this rising tide of inflation is now its number one priority and the 5-4 vote marginally approving only a 0.25% increase on 4th February rather than a 0.50% increase, indicates it is now determined to push up Bank Rate quickly. A further increase of 0.25% is therefore probable for March, and again in May, followed possibly by a final one in November. However, data between now and November could shift these timings or add to or subtract from the number of increases.

However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- We do not know whether there will be further mutations of Covid and how severe they may be, nor how rapidly scientific advances may be made in combating them.

- The economy was running out of steam during the second half of 2021 and Omicron will mean that economic growth in quarter 1 of 2022 is likely to be flat, though on the rise towards the end of the quarter as the economy recovers. However, 54% energy cap cost increases from April, together with 1.25% extra employee national insurance, food inflation around 5% and council tax likely to rise in the region of 5% too - these increases are going to hit lower income families hard despite some limited assistance from the Chancellor to postpone the full impact of rising energy costs.

- Consumers are estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above increases. But most of those holdings are held by more affluent people whereas poorer people already spend nearly all their income before these increases hit and have few financial reserves.

- These increases are already highly disinflationary; inflation will also be on a gradual path down after April so that raises a question as to whether the MPC may shift into protecting economic growth by November, i.e., it is more debatable as to whether they will deliver another increase then.

- The BIG ISSUE – will the current spike in inflation lead to a second-round effect in terms of labour demanding higher wages, (and/or lots of people getting higher wages by changing job)?

- If the labour market remains very tight during 2022, then wage inflation poses a greater threat to overall inflation being higher for longer, and the MPC may then feel it needs to take more action.

- If the UK were to invoke article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this would have the potential to end up in a no-deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.

Forecasts for PWLB rates and gilt and treasury yields

Gilt yields. Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. Our forecasts show little overall increase in gilt yields during the forecast period to March 2025 but there will doubtless be a lot of unpredictable volatility during this forecast period.

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on gilt yields. **As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for medium to longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.**

US treasury yields. During the first part of 2021, US President Biden's, and the Democratic party's, determination to push through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. This was in addition to the $900bn support package previously passed in December 2020. Financial markets were alarmed that all this stimulus was happening at a time when: -

1. A fast vaccination programme roll-out had enabled a rapid opening up of the economy during 2021.
2. The economy was growing strongly during the first half of 2021 although it has weakened during the second half.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.
4. And the Fed was still providing substantial stimulus through monthly QE purchases during 2021.

It was not much of a surprise that a combination of these factors would eventually cause an excess of demand in the economy which generated strong inflationary pressures. This has eventually been recognised by the Fed at its recent December meeting with an aggressive response to damp inflation down during 2022 and 2023.

- **At its 3rd November Fed meeting**, the Fed decided to make a start on tapering its $120bn per month of QE purchases so that they ended next June. However,

at its **15th December meeting** it doubled the pace of tapering so that they will end all purchases in February. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that treasury yields will rise over the taper period, all other things being equal.

- It also forecast that it expected there would be three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024. This would take rates back above 2% to a neutral level for monetary policy. It also gave up on calling the sharp rise in inflation as being 'transitory'.

- At its **26th January meeting**, the Fed became even more hawkish following inflation rising sharply even further. It indicated that rates would begin to rise very soon, i.e., it implied at its March meeting it would increase rates and start to run down its holdings of QE purchases. It also appears likely that the Fed could take action to force longer term treasury yields up by prioritising selling holdings of its longer bonds as yields at this end have been stubbornly low despite rising inflation risks. The low level of longer dated yields is a particular concern for the Fed because it is a key channel through which tighter monetary policy is meant to transmit to broader financial conditions, particularly in the US where long rates are a key driver of household and corporate borrowing costs.

There are also possible **DOWNSIDE RISKS** from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to monitor.

There is likely to be **exceptional volatility and unpredictability in respect of gilt yields and PWLB rates** due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields (see below). As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising higher in the US than in the UK; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two yields.
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong and enduring will inflationary pressures turn out to be in both the US and the UK, and so impact treasury and gilt yields?
- **Will the major western central banks implement their previously stated new average or sustainable level inflation monetary policies when inflation has now burst through all previous forecasts and far exceeded their target levels? Or are they going to effectively revert to their previous**

approach of prioritising focusing on pushing inflation back down and accepting that economic growth will be very much a secondary priority - until inflation is back down to target levels or below?

- How well will central banks manage the running down of their stock of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?
- If Russia were to invade Ukraine, this would be likely to cause short term volatility in financial markets, but it would not be expected to have a significant impact beyond that.

The balance of risks to medium to long term PWLB rates: -

- There is a balance of upside risks to forecasts for medium to long term PWLB rates.

A new era – a fundamental shift in central bank monetary policy

One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US, before consideration would be given to increasing rates.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' before starting on raising Bank Rate and the ECB now has a similar policy.
- ***For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.***
- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

Investment and borrowing rates

- **Investment returns** are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.

- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.
- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The current margins over gilt yields are as follows: -.
  - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)

- **Borrowing for capital expenditure.** The long-term (beyond 10 years), forecast for Bank Rate is 2.00%. As some PWLB certainty rates are currently below 2.00%, there remains value in considering long-term borrowing from the PWLB where appropriate. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio. In addition, there are also some cheap alternative sources of long-term borrowing if an authority is seeking to avoid a "cost of carry" but also wishes to mitigate future re-financing risk.
- While the PCC will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.4. Borrowing strategy

The PCC is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the PCC's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it were felt that there is a significant risk of a sharp FALL in borrowing rates, then fixed rate borrowing will be postponed.
- if it were felt that there is a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding of longer term would be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the PCC at the next available opportunity although the current forecast up to 2025/26 indicates no additional borrowing.

3.5. Policy on borrowing in advance of need

The PCC will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the PCC can ensure the security of such funds.

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

3.6. Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates, even though the general margin of PWLB rates over gilt yields was reduced by 100 bps in November 2020.

3.7. New financial institutions as a source of borrowing

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

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

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

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

4. ANNUAL INVESTMENT STRATEGY

4.1. Investment policy – management of risk

The Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government (MHCLG)) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team).

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

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

The PCC's investment priorities will firstly be security, secondly portfolio liquidity and then yield (return). The PCC will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the PCC's risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the PCC will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.

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

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

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

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

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

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year;

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

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

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

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

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

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

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

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

l) As a result of the change in accounting standards for 2022/23 under **IFRS 9**, the PCC will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years **ending 31.3.23**.)

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

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

4.2. Creditworthiness policy

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

- credit watches and credit outlooks from credit rating agencies;

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

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

Yellow	*5 years*
Dark pink	*5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25*
Light pink	*5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5*
Purple	*2 years*
Blue	*1 year (only applies to nationalised or semi nationalised UK Banks)*
Orange	*1 year*
Red	*6 months*
Green	*100 days*
No colour	*Not to be used*

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

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

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

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

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

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

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

* Whichever is the higher

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

Creditworthiness
Significant levels of downgrades to Short- and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

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

4.3. Country limits

The PCC has determined that it will use any UK counterparties irrespective of rating and approved counterparties from non-UK countries with a minimum sovereign credit rating of

AAA from Fitch. The list of countries that qualify using this credit criteria are provided by Link and is regularly reviewed. Changes will be notified to us should ratings change in accordance with this policy.

4.4. Investment strategy

In-house funds

Where under-borrowing is not appropriate, the following investment strategy will be followed. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed:

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

Investment returns expectations

The current forecast shown in paragraph 3.3, includes a forecast for Bank Rate to reach 1.25% in November 2022.

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

Average earnings in each year	Now	Previously
2022/23	1.00%	0.50%
2023/24	1.25%	0.75%
2024/25	1.25%	1.00%
2025/26	1.25%	1.25%
Years 6 to 10	1.50%	-
Years 10+	2.00%	2.00%

Investment treasury indicator and limit

Total principal funds invested for greater than 365 days. These limits are set with regard to the PCC's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

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

Upper limit for principal sums invested for longer than 365 days			
£m	**2021/22**	**2022/23**	**2023/24**
Principal sums invested for longer than 365 days	£m Nil	£m Nil	£m Nil

For its cash flow generated balances, the PCC will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits, (overnight to 100 days) in order to benefit from the compounding of interest.

4.5. Investment performance / risk benchmarking

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

Security

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

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

Liquidity

In respect of this area the PCC seeks to maintain:

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

4.6. End of year investment report

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

5. APPENDICES

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

Appendix 1The Capital Prudential Treasury Indicators 2020/21 – 2025/26

PRUDENTIAL INDICATOR TARGETS	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
External Debt						
1 Authorised limit for external debt:						
The PCC will set for the forthcoming financial year and the following three years an authorised limit for its total external debt, gross of investments, separately identifying borrowing from other long term lliabilities						
Authorised limit for external debt:	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Borrowing	44,609	52,000	57,000	59,000	57,000	54,000
Other long term liabilities	3,391	-	-	-	-	-
Total	48,000	52,000	57,000	59,000	57,000	54,000
2 Operational boundary:						
The PCC will set for the forthcoming financial year and the following three years an operational boundary for its total external debt, gross of investments, separately identifying borrowing from other long term liabilities						
	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Operational boundary:						
Borrowing	38,626	46,388	51,124	53,516	51,202	48,924
Other long term liabilities	3,391	-	-	-	-	-
Total	42,017	46,388	51,124	53,516	51,202	48,924
Treasury Management Indicators						
Interest Rate Exposures						
The PCC will set for the forthcoming financial year and the following three years upper limits to its exposures to the effect of changes in interest rates						
	£000	**£000**	**£000**	**£000**	**£000**	**£000**
3 Upper limit for fixed interest rate exposure:						
Net principal re fixed rate borrowing less investments	23,786	26,999	40,357	43,556	41,577	39,299
4 Upper limit for variable rate exposure:						
Net principal re variable rate borrowing less investments	7,136	8,100	12,107	13,067	12,473	11,790
Gross and Net Debt						
The PCC will set for the forthcoming financial year and the following three years upper limits on the proportion of net debt compared to gross debt						
5 Upper limit for net debt as percentage of gross debt:	100%	100%	100%	100%	100%	100%
6 Ratio of financing costs to net revenue stream:						
The PCC will estimate for the forthcoming financial year and the following three years the ratio of financing costs to net revenue stream	2.56	2.45	2.99	3.81	4.15	4.06
7 Capital financing requirement:						
The PCC shall make reasonable estimates of the total of capital financing requirement at the end of the forthcoming financial year and the following three years	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Estimate of the capital financing requirement for the PCC	42,017	46,388	51,124	53,516	51,202	48,924
9 Maturity structure of new fixed rate borrowing:						
The PCC will set for the forthcoming financial year both upper and lower limits with respect to the maturity structure of borrowing						
	Upper Limit	Lower Limit				
Under 12 months	20%	0%				
12 months and within 24 months	30%	20%				
24 months and within 5 years	40%	30%				
5 years and within 10 years	50%	2%				
10 years and above	80%	10%				

Affordability prudential indicators

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

Ratio of financing costs to net revenue stream

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

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
Ratio of financing costs to net revenue stream %	2.56	2.45	2.99	3.81	4.15	4.06

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

Appendix 2

Treasury Management scheme of delegation including Section 151 Officer responsibilities

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

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

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

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

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

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

Appendix 3

The Treasury Management role of the Section 151 Officer

The S151 (responsible) officer is responsible for:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all investments and is in accordance with the risk appetite of the PCC.
- ensure that the PCC has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the PCC does not undertake a level of investing which exposes it to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by the PCC
- ensuring that the PCC has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following *(TM Code p54): -*
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

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