Treasury Management Strategy Statement 2023/24

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Police and Crime Commissioner for Lincolnshire

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1. INTRODUCTION

The 2021 revised CIPFA Treasury Management Code and Prudential Code documented changes which will impact on future TMSS/AIS reports and the risk management framework.

CIPFA published the revised codes on 20th December 2021 and has stated that revisions need to be included in the reporting framework from the 2023/24 financial year. 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 and also related reports during the financial year.

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, specifically, the Chief Finance Officer (CFO) is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The CFO is expected to establish a measurement and reporting process that highlights significant actual or forecast deviations from the approved indicators. However, monitoring of prudential indicators, including forecast debt and investments, is not required to be taken to full council and should be reported as part of the authority's integrated revenue, capital and balance sheet monitoring;

- enviromental, social and governance (ESG) issues to be addressed within an authority's treasury management policies and practices (TMP1).

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 2021 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 (JIAC) and the attendees of the Police and Crime Strategy Board (PCSB).

Quarterly reports

In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June/end of December) is also required. However, these additional reports do not have to be reported to JIAC but do require to be adequately scrutinised. This role is undertaken by the PCSB. (The reports, specifically, should comprise updated Treasury/Prudential Indicators.)

1.3. Treasury Management Strategy for 2023/24

The strategy for 2023/24 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. This especially applies to members responsible for scrutiny.

Furthermore, pages 47 and 48 of the Code state that they expect "all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making.

The scale and nature of this will depend on the size and complexity of the organisation's treasury management needs. Organisations should consider how to assess whether treasury management staff and board/ council members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

As a minimum, authorities should carry out the following to monitor and review knowledge and skills:

- Record attendance at training and ensure action is taken where poor attendance is identified.
- Prepare tailored learning plans for treasury management officers and board/council members.
- Require treasury management officers and board members to undertake self-assessment against the required competencies (as set out in the schedule that may be adopted by the organisation).
- Have regular communication with officers and board members, encouraging them to highlight training needs on an ongoing basis."

In further support of the revised training requirements, CIPFA's Better Governance Forum and Treasury Management Network have produced a 'self-assessment by members responsible for the scrutiny of treasury management', which is available from the CIPFA website to download.

The training needs of treasury management officers are periodically reviewed.

A formal record of the training received by officers central to the Treasury function will be maintained by the Head of Finance. Similarly, a formal record of the treasury management/capital finance training received by members will also be maintained by the Head of Finance.

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 2023/24 – 2026/27

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	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
£000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Building Schemes	1,324	1,348	2,006	1,600	1,600	1,600
Command & Control	580	2,128	815	-	-	-
Bluelight Innovation	15	-	-	-	-	-
Digital Data and Technology	1,777	1,333	5,967	1,601	1,019	1,550
Airwaves Refresh	1,310	-	-	-	-	-
Vehicles	606	2,282	1,800	2,100	1,600	1,400
ESMCP	110	203		-	4,176	-
Horizons: Intelligence Tool	736	35	-	-	-	-
Equipment Replacement	339	408	250	250	250	250
Other		283				
Total	**6,797**	**8,020**	**10,838**	**5,551**	**8,645**	**4,800**

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	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
£000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Grants	1,353	-	225		170	
Capital receipts	132	75	3,310	60	60	60
Partner Funding (re Bluelight)	3	100	-	-	-	-
Ear marked reserves/DRF		-	-	-	-	-
Revenue funding	473	70	-	-	-	
Internal Borrowing	4,836	7,775	7,303	- 5,509	1,915	4,740
External Borrowing				11,000	6,500	
Total	**6,797**	**8,020**	**10,838**	**5,551**	**8,645**	**4,800**

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 doesn't have any such schemes within the forecasted CFR.

The PCC is asked to approve the CFR projections below:

Capital Financing Requirement	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
£000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
CFR Opening Balance	42,017	40,941	45,657	47,601	48,338	51,553
Movement in CFR	- 1,076	4,716	1,943	737	3,216	- 1,413
Total CFR	**40,941**	**45,657**	**47,601**	**48,338**	**51,553**	**50,140**

Movement in CFR represented by:						
Net financing need for the year (above)	4,836	7,775	7,303	5,491	8,415	4,740
Less MRP and other financing movements	5,912	3,059	5,360	4,754	5,199	6,153
Movement in CFR	**- 1,076**	**4,716**	**1,943**	**737**	**3,216**	**- 1,413**

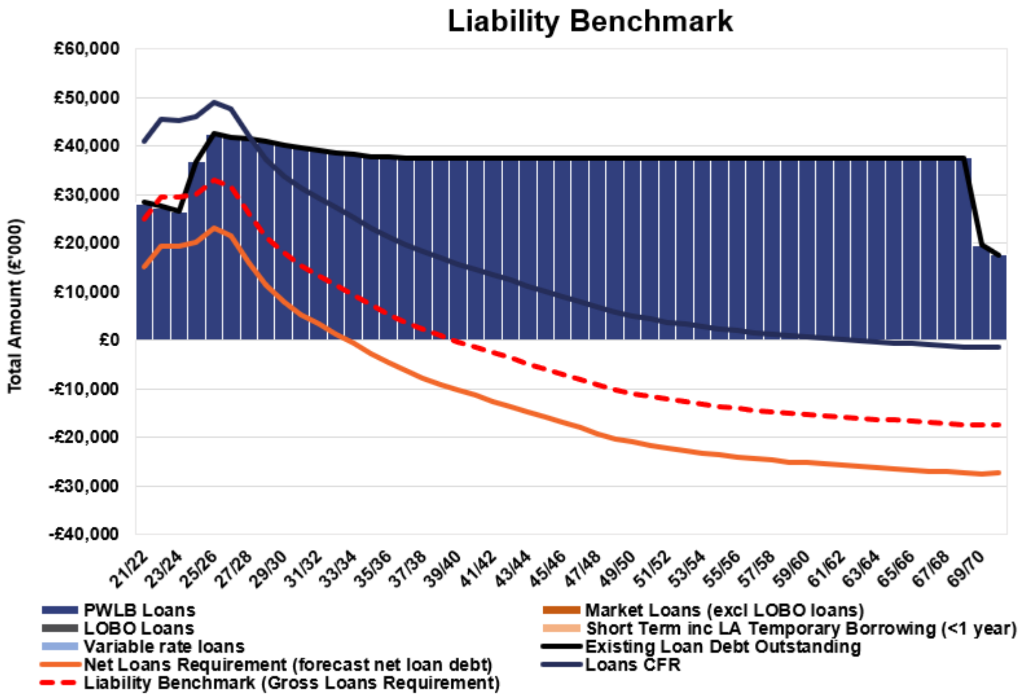
2.3. Liability Benchmark

A third and new prudential indicator for 2023/24 is the Liability Benchmark (LB). The PCC is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum.

There are four components to the LB: -

1. **Existing loan debt outstanding**: the PCC's existing loans that are still outstanding in future years.
2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.

   It should be noted that only planned prudential borrowing for approval is included hence why the loans CFR peaks after four years. All other inputs are projected forward to cover the full debt maturity profile.
3. **Net loans requirement**: this will show the PCC's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
4. **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.



Any years where actual loans are less than the benchmark indicate a future borrowing requirement whereas any years where actual loans outstanding exceed the benchmark represent an overborrowed position resulting in excess cash for investment. See section 4 below.

2.4. 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 PCC's current financial plans and following the strategy in this document.

Year-end Resources	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
£000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Fund balances/Reserves	29,877	29,877	23,288	11,833	11,833	11,833
Provisions	822	822	822	822	822	822
Annual Cash Flow Adj			3,000	5,000	2,000	1,000
Total Core Funds	**30,699**	**30,699**	**27,110**	**17,655**	**14,655**	**13,655**
Working Capital*	(3,929)	(3,929)	(3,929)	(3,929)	(3,929)	(3,929)
Under Borrowing	(12,556)	(18,175)	(21,001)	(11,590)	(9,098)	(8,402)
Expected investments	**14,214**	**8,595**	**2,180**	**2,136**	**1,628**	**1,324**

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

Please note that actual figures for 2021/22 for all tables include regional figures and are therefore as stated in the Financial Statements for 2021/22.

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 2024/25 the PCC will undertake some borrowing to support the forecasted capital programme in conjunction with the surplus.

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.

2.5. Minimum revenue provision (MRP) policy statement

Under Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, where the PCC has financed capital expenditure by borrowing it is required to make a provision each year through a revenue charge (MRP).

The PCC is required to calculate a prudent provision of MRP which ensures that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. The MRP Guidance (2018) gives four ready-made options for calculating MRP, but the PCC can use any other reasonable basis that it can justify as prudent.

The MRP policy statement requires full approval in advance of each financial year.

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.

Capital expenditure incurred during 2022/23 will not be subject to an MRP charge until 2023/24, or the year after the asset becomes operational.

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 2022 and for the position as at 31 Dec 2022 are shown below for both borrowing and investments:

Treasury Portfolio	**2021/22**	**2021/22**	**2022/23**	**2022/23**
£000	**Actual**	**Actual as %**	**Current**	**Current as %**
Banks	-	-	10,500	53%
DMAF	8,350	62%	2,500	13%
Money Market Funds	5,075	38%	6,670	34%
Total treasury investments (managed in house)	**13,425**	**100%**	**19,670**	**100%**
PWLB	28,064	99%	27,296	99%
SALIX	321	1%	246	1%
Total external borrowing	**28,385**	**100%**	**27,542**	**100%**
Net treasury investments / (borrowing)	**(14,960)**		**(7,872)**	

There is a greater temporary cash surplus at December 2022 compared with March 2022.

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	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
£000	**Actual**	**Estimate**	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Debt at 1 April	29,305	28,385	27,482	26,600	36,748	42,455
New Loans		-	-	11,000	6,500	-
Repayments	920	903	882	852	793	717
Actual Gross Debt at 31 March exc Finance Lease	**28,385**	**27,482**	**26,600**	**36,748**	**42,455**	**41,738**
Finance Lease Liability	-	-	-	-	-	-
Actual Gross Debt at 31 March	**28,385**	**27,482**	**26,600**	**36,748**	**42,455**	**41,738**
The Capital Financing Requirement	40,941	45,657	47,601	48,338	51,553	50,140
Under / (Over borrowing)	12,556	18,175	21,001	11,590	9,098	8,402

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 2023/24 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	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Debt	46	48	49	52	51

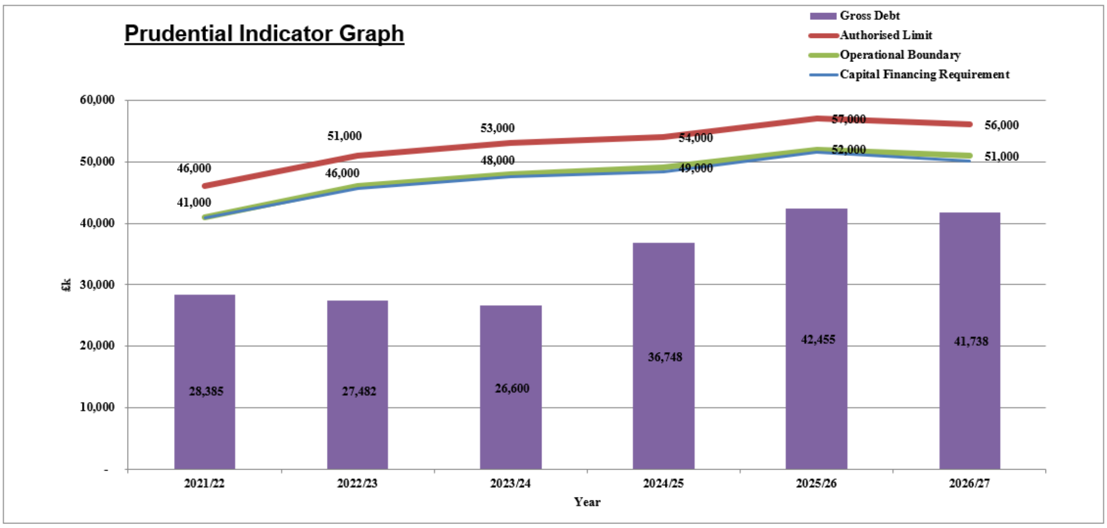
The authorised limit for external debt

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	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Debt	51	53	54	57	56

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 2023. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View	07.02.23												
	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.25	4.50	4.50	4.25	4.00	3.75	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.30	4.50	4.50	4.30	4.00	3.80	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.40	4.50	4.40	4.20	3.90	3.70	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.50	4.40	4.20	3.80	3.60	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.00	4.00	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.10	3.10	3.10
10 yr PWLB	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.60	4.40	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.40
50 yr PWLB	4.30	4.30	4.20	4.10	3.90	3.80	3.60	3.60	3.40	3.30	3.20	3.20	3.10

Additional notes by Link on this forecast table: -

Our central forecast for interest rates was updated on 19 December and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened but the Government's continued policy of emphasising fiscal rectitude will probably mean Bank Rate will not need to increase to further than 4.5%.

Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged. Our best judgment is that there will be scope for an early Christmas present for households with a December rate cut priced in, ahead of further reductions in 2024 and 2025.

The CPI measure of inflation looks to have peaked at 11.1% in Q4 2022 (currently 10.5%). Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started and will focus on the short, medium and longer end of the curve in equal measure.

In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)

On the positive side, consumers are still 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 challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

PWLB RATES

- The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.80%.
- The view is that the markets have built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is to the downside.

Downside risks to current forecasts for UK gilt yields and PWLB rates include: -

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).

- **The Bank of England** acts too quickly, or too far, over the next year to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- **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.

- **Geopolitical risks,** for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates: -

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project or even necessitates a further series of increases in Bank Rate.

- **The Government** acts too quickly to cut taxes and/or increases expenditure in light of the cost-of-living squeeze.

- **The pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

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

- Projected **gilt issuance, inclusive of natural maturities and QT,** could be too much for the markets to comfortably digest without higher yields consequently.

Borrowing for capital expenditure: The long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are currently above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023.

The Link Group's suggested budgeted earnings rates for investments up to about three months' duration in each financial year are rounded to the nearest 10bps as follows: -

Average earnings in each year	
2022/23 (remainder)	4.00%
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

The interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Forecasts will be updated as and when appropriate.

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 medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate increases over the remainder of 2022 and the first half of 2023.

Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 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, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

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 large difference between premature redemption rates and new borrowing rates.

3.7. New financial institutions as a source of borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points. 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.

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, more recently the UK sovereign debt rating has been placed on Negative Outlook by the three major rating agencies in the wake of the Truss/Kwarteng unfunded tax-cuts policy. Although the Sunak/Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded. Accordingly, when setting minimum sovereign debt ratings, the PCC will not set a minimum rating for the UK.

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. The current shape of the yield curve suggests that is the case at present, but there is the prospect of Bank Rate peaking in the first half of 2023 and possibly reducing as early as the latter part of 2023 so an agile investment strategy would be appropriate to optimise returns.

Accordingly, 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.

Investment returns expectations

The current forecast shown in paragraph 3.3, includes a forecast for Bank Rate to reach 4.5% in Q2 2023.

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	
2022/23 (remainder)	4.30%
2023/24	4.30%
2024/25	3.20%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

Against this view, for 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, in order to benefit from the compounding of interest.

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 – 2026/27

PRUDENTIAL INDICATOR TARGETS	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
External Debt						
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	46,000	51,000	53,000	54,000	57,000	56,000
Other long term liabilities	-	-	-	-	-	-
Total	46,000	51,000	53,000	54,000	57,000	56,000
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	40,941	45,657	47,601	48,338	51,553	50,140
Other long term liabilities	-	-	-	-	-	-
Total	40,941	45,657	47,601	48,338	51,553	50,140
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**
Upper limit for fixed interest rate exposure:						
Net principal re fixed rate borrowing less investments	14,171	18,887	24,420	34,612	40,827	40,414
Upper limit for variable rate exposure:						
Net principal re variable rate borrowing less investments	4,251	5,666	7,326	10,384	12,248	12,124
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						
Upper limit for net debt as percentage of gross debt:	100%	100%	100%	100%	100%	100%
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	2.44	2.34	2.65	3.39	3.99	4.73
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	40,941	45,657	47,601	48,338	51,553	50,140
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	2.94	3.62	4.02	3.93

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.*