APPENDIX B

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-Year Review Report 2023/24

Police & Crime Commissioner for Lincolnshire

1. Background

1.1 Capital Strategy

In December 2021, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following: -

- a high-level 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

1.2 Treasury management

The Police and Crime Commissioner for Lincolnshire (PCC) operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising 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 the PCC can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet PCC risk or cost objectives.

Accordingly, treasury management is defined 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."

2. Introduction

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2021).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the PCC's treasury management activities;

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the PCC will seek to achieve those policies and objectives;

3. Receipt by the PCC of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy, for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year. (Quarterly reports are also required for the periods ending April to June and October to December but may be assigned to a designated committee or panel as deemed appropriate to meet the Treasury Management governance and scrutiny aspects of the PCC);

4. Delegation by the PCC of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions;

5. Delegation by the PCC of the role of scrutiny of treasury management strategy and policies to a specific named body. For the PCC the delegated body is the Joint Independent Audit Committee (JIAC).

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2023/24 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The PCC's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the PCC's investment portfolio for 2023/24;
- A review of the PCC's borrowing strategy for 2023/24;
- A review of any debt rescheduling undertaken during 2023/24;
- A review of compliance with Treasury and Prudential Limits for 2023/24.

Changes to the capital programme and capital financing requirement have been addressed in the capital and revenue monitoring reports. This review is to report on the treasury activity for the first half of 2023/24.

Performance Overview

- £29.4m of investments were held on 30 September 2023
- Actual interest yield for the 6 months to 30 September 2023 was £0.501m
- Average Investment Rate of Return of 5.45% was achieved for the 6 months to 30 September against SONIA* of 4.732% and average BoE rate of 4.802% for the same period.

  *LIBOR has transitioned within the financial environment to SONIA. LIBOR gives the cost of borrowing for a range of different periods (1 month, 3 months etc). SONIA is a single rate that measures the cost of overnight borrowing. For the purpose of this report, we calculate an average over the relevant period.

Recommendations

Please note (section 4) that there is a need to revise upwards the Capital Financing Requirement of £47.601m previously approved, by £0.938m to £48.539m due to the timing delay of expected capital receipts during the year.

The JIAC are asked to note the contents of this report, the treasury activity and recommend approval of the changes to the prudential indicators. They are also asked to note that that there has been compliance with the Treasury Management Strategy.

3. Economics and interest rates

3.1 Economics update

- The first half of 2023/24 saw:
  - Interest rates rise by a further 100bps, tracking the Bank of England Rate from 4.25% to 5.25% on 3 August 2023. On 21 September the MPC kept the base rate at 5.25%.
  - Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
  - A 0.5% m/m decline in real GDP in July, mainly due to more strikes.
  - CPI inflation falling from 8.7% in April to 6.7% in August, its lowest rate since February 2022, but still the highest in the G7.
  - Core CPI inflation declining to 6.2% in August from 7.1% in April and May, a then 31 years high.
  - A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose to 7.8% in August, excluding bonuses).
- The 0.5% m/m fall in GDP in July suggests that underlying growth has lost momentum since earlier in the year. Some of the weakness in July was due to there being almost twice as many working days lost to strikes in July (281,000) than in June (160,000). But with output falling in 10 out of the 17 sectors, there is an air of underlying weakness.
- The fall in the composite Purchasing Managers Index from 48.6 in August to 46.8 in September left it at its lowest level since COVID-19 lockdowns reduced activity in January 2021. At face value, it is consistent with the 0.2% q/q rise in real GDP in the period April to June, being followed by a contraction of up to 1% in the second half of 2023.
- The 0.4% m/m rebound in retail sales volumes in August is not as good as it looks as it partly reflected a pickup in sales after the unusually wet weather in July. Sales volumes in August were 0.2% below their level in May, suggesting much of the resilience in retail activity in the first half of the year has faded.
- As the growing drag from higher interest rates intensifies over the next six months, we think the economy will continue to lose momentum and soon fall into a mild recession. Strong labour demand, fast wage growth and government handouts have all supported household incomes over the past year. And with CPI inflation past its peak and expected to decline further, the economy has got through the cost-of- living crisis without recession. But even though the worst of the falls in real household disposable incomes are behind us, the phasing out of financial support packages provided by the government during the energy crisis means real incomes are unlikely to grow strongly. Higher interest rates will soon bite harder too. We expect the Bank of England to keep interest rates at the probable peak of 5.25% until the second half of 2024. Mortgage rates are likely to stay above 5.0% for around a year.
- The tightness of the labour market continued to ease, with employment in the three months to July falling by 207,000. The further decline in the number of job vacancies from 1.017m in July to 0.989m in August suggests that the labour market has loosened a bit further since July. That is the first time it has fallen below 1m since July 2021. At 3.0% in July, and likely to have fallen to 2.9% in August, the job vacancy rate is getting closer to 2.5%, which would be consistent with slower wage growth. Meanwhile, the 48,000 decline in the supply of workers in the three months to July offset some of the loosening in the tightness of the labour market. That was due to a 63,000 increase in inactivity in the three months to July as more people left the labour market due to long term sickness or to enter education. The supply of labour is still 0.3% below its pre-pandemic February 2020 level.
- But the cooling in labour market conditions still has not fed through to an easing in wage growth. While the monthly rate of earnings growth eased sharply from an upwardly revised +2.2% in June to -0.9% in July, a lot of that was due to the one-off bonus payments for NHS staff in June not being

repeated in July. The headline 3myy rate rose from 8.4% (revised up from 8.2%) to 8.5%, which meant UK wage growth remains much faster than in the US and in the Euro-zone. Moreover, while the Bank of England's closely watched measure of regular private sector wage growth eased a touch in July, from 8.2% 3myy in June to 8.1% 3myy, it is still well above the Bank of England's prediction for it to fall to 6.9% in September.

- CPI inflation declined from 6.8% in July to 6.7% in August, the lowest rate since February 2022. The biggest positive surprise was the drop in core CPI inflation, which declined from 6.9% to 6.2%. That reverses all the rise since March and means the gap between the UK and elsewhere has shrunk (US core inflation is 4.4% and in the Euro-zone it is 5.3%). Core goods inflation fell from 5.9% to 5.2% and the further easing in core goods producer price inflation, from 2.2% in July to a 29-month low of 1.5% in August, suggests it will eventually fall close to zero. But the really positive development was the fall in services inflation from 7.4% to 6.8%. That also reverses most of the rise since March and takes it below the forecast of 7.2% the Bank of England published in early August.
- In its latest monetary policy meeting on 20 September, the Bank of England left interest rates unchanged at 5.25%. The weak August CPI inflation release, the recent loosening in the labour market and the downbeat activity surveys appear to have convinced the Bank of England that it has already raised rates far enough. The minutes show the decision was "finely balanced". Five MPC members (Bailey, Broadbent, Dhingra, Pill and Ramsden) voted for no change and the other four (Cunliffe, Greene, Haskel and Mann) voted for a 25bps hike.
- Like the US Fed, the Bank of England wants the markets to believe in the higher for longer narrative. The statement did not say that rates have peaked and once again said if there was evidence of more persistent inflation pressures "further tightening in policy would be required". Governor Bailey stated, "we'll be watching closely to see if further increases are needed". The Bank also retained the hawkish guidance that rates will stay "sufficiently restrictive for sufficiently long".
- This narrative makes sense as the Bank of England does not want the markets to decide that a peak in rates will be soon followed by rate cuts, which would loosen financial conditions and undermine its attempts to quash inflation. The language also gives the Bank of England the flexibility to respond to new developments. A rebound in services inflation, another surge in wage growth and/or a further leap in oil prices could conceivably force it to raise rates at the next meeting on 2nd November, or even pause in November and raise rates in December.
- The yield on 10-year Gilts fell from a peak of 4.74% on 17th August to 4.44% on 29th September, mainly on the back of investors revising down their interest rate expectations. But even after their recent pullback, the rise in Gilt yields has exceeded the rise in most other Developed Market government yields since the start of the year. Looking forward, once inflation falls back, Gilt yields are set to reduce further. A (mild) recession over the next couple of quarters will support this outlook if it helps to loosen the labour market (higher unemployment/lower wage increases).
- The pound weakened from its cycle high of $1.30 in the middle of July to $1.21 in late September. In the first half of the year, the pound bounced back strongly from the Truss debacle last autumn. That rebound was in large part driven by the substantial shift up in UK interest rate expectations. However, over the past couple of months, interest rate expectations have dropped sharply as inflation started to come down, growth faltered, and the Bank of England called an end to its hiking cycle.
- The FTSE 100 has gained more than 2% since the end of August, from around 7,440 on 31st August to 7,608 on 29th September. The rebound has been primarily driven by higher energy prices which boosted the valuations of energy companies. The FTSE 100's relatively high concentration of energy companies helps to explain why UK equities outperformed both US and Euro-zone equities in September. Nonetheless, as recently as 21st April the FTSE 100 stood at 7,914.

3.2 Interest rate forecasts

The PCC has appointed Link Group as treasury advisors and part of their service is to assist the PCC to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012.

The latest forecast on 25th September sets out a view that both short and long-dated interest rates will be elevated for some little while, as the Bank of England seeks to squeeze inflation out of the economy.

Our PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps, calculated as gilts plus 80bps) which has been accessible to most authorities since 1st November 2012.

Link Group Interest Rate View	25.09.23												
	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26
BANK RATE	5.25	5.25	5.25	5.00	4.50	4.00	3.50	3.00	2.75	2.75	2.75	2.75	2.75
3 month ave earnings	5.30	5.30	5.30	5.00	4.50	4.00	3.50	3.00	2.80	2.80	2.80	2.80	2.80
6 month ave earnings	5.60	5.50	5.40	5.10	4.60	4.10	3.60	3.10	2.90	2.90	2.90	2.90	2.90
12 month ave earnings	5.80	5.70	5.50	5.20	4.70	4.20	3.70	3.20	3.00	3.00	3.00	3.00	3.00
5 yr PWLB	5.10	5.00	4.90	4.70	4.40	4.20	4.00	3.90	3.70	3.70	3.60	3.60	3.50
10 yr PWLB	5.00	4.90	4.80	4.60	4.40	4.20	4.00	3.80	3.70	3.60	3.60	3.50	3.50
25 yr PWLB	5.40	5.20	5.10	4.90	4.70	4.40	4.30	4.10	4.00	3.90	3.80	3.80	3.80
50 yr PWLB	5.20	5.00	4.90	4.70	4.50	4.20	4.10	3.90	3.80	3.70	3.60	3.60	3.60

4. Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2023/24 was approved by the PCC in April 2023.

The underlying TMSS approved previously requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out below-

Prudential Indicator	2023/24 Original Indicator £m	2023/24 Revised Indicator £m
Authorised Limit	53	54
Operational Boundary	48	49
Capital Financing Requirement	48	49

5. The PCC's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The PCC's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

This table below shows the revised estimates for capital expenditure, which includes the proposed changes since the capital programme was agreed.

Capital Expenditure	2023/24 Original Estimate £'000s	2023/24 Revised Estimate £'000s
Building Schemes	2,006	1,706
Command & Control	815	596
DDaT	5,967	4,238
Vehicles	1,800	2,123
Other	250	899
Total	**10,838**	**9,562**

The capital expenditure is forecast to decrease by £1,276 from the original estimate. This is largely due to slippage in the capital programme for 2023/24.

5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the PCC by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2023/24 Original Estimate £'000s	2023/24 Revised Estimate £'000s
Total capital expenditure	**10,838**	**9,562**
Financed by:		
Capital grants and contributions	225	130
Revenue/Reserves	-	413
Capital Receipts	3,310	60
Total financing	**3,535**	**603**
Borrowing requirement	**7,303**	**8,959**

Capital receipts have decreased by £3.250m. This is due to the delay in the sale of a former Police Station which was originally expected to complete in 2023/24. This has meant that the expected receipt will now not be received until 2024/25. This has also added to the borrowing requirement increase of £1.656m.

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

The revised forecast Capital Financing Requirement is £938k higher than the original forecast amount due to the reprofiling of the capital receipt explained above.

Prudential Indicator – the Operational Boundary for external debt

	2023/24 Original Estimate £'000s	2023/24 Revised Estimate £'000s
Prudential Indicator – Capital Financing Requirement		
Capital Finance Requirement	47,601	48,539
Net movement in CFR	**1,943**	**5,367**
Prudential Indicator – the Operational Boundary for external debt		
Borrowing	26,600	26,591
Total debt (year end position)	**26,600**	**26,591**

Total debt remains within the operational boundary.

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and next two financial years. This allows some flexibility for limited early borrowing for future years. The PCC has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2023/24 Original Estimate £'000s	2023/24 Revised Estimate £'000s
Borrowing	26,600	26,591
Total debt	**26,600**	**26,591**
CFR (year end position)	**47,601**	**48,539**

The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by the PCC. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Prudential Indicator	2023/24 Original Indicator £m	2023/24 Revised Indicator £m
Operational Boundary	48	49
Authorised Limit for External Debt	53	54

6. Borrowing

The PCC's capital financing requirement (CFR) for 2023/24 is £48.5m. The CFR denotes the PCC's underlying need to borrow for capital purposes. If the CFR is positive the PCC may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The PCC currently has borrowings of £26.6m from the PWLB and has utilised £21.2m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate but will require ongoing monitoring in the event that upside risk to gilt yields prevails.

No new external borrowing has been undertaken so far in 2023/24 and it is not anticipated that any further borrowing will be undertaken during the year. The capital programme is being kept under regular review due to the effects of inflationary pressures, shortages of materials and labour. In the short term, capital spend will be financed through internal borrowing. Our borrowing strategy will, therefore, also be regularly reviewed and then revised, if necessary, in order to achieve optimum value and risk exposure in the long-term.

PWLB maturity certainty rates (gilts plus 180bps) year to date to 29th September 2023

Gilt yields and PWLB certainty rates were on a generally rising trend throughout the first half of 2023/24. At the beginning of April, the 5-year rate was the cheapest part of the curve and touched 4.14% whilst the 25-year rate was relatively expensive at 4.58%.

July saw short-dated rates peak at their most expensive. The 1-year rate spiked to 6.36% and the 5-year rate to 5.93%. Although, in due course, short-dated rate expectations fell, the medium dates shifted higher through August and the 10-year rate pushed higher to 5.51% and the 25-year rate to 5.73%. The 50-year rate was 4.27% on 5th April but rose to 5.45% on 28th September.

We forecast rates to fall back over the next two to three years as inflation dampens. The CPI measure of inflation is expected to fall below 2% in the second half of 2024, and we forecast 50-year rates to stand at 3.90% by the end of September 2025. However, there is considerable gilt issuance to be digested by the market over the next couple of years, as a minimum, so there is a high degree of uncertainty as to whether rates will fall that far.

PWLB RATES 01.04.23 - 29.09.23

HIGH/LOW/AVERAGE PWLB RATES FOR 01.04.23 – 29.09.23

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.14%	4.20%	4.58%	4.27%
Date	06/04/2023	06/04/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.51%	5.73%	5.45%
Date	06/07/2023	07/07/2023	22/08/2023	17/08/2023	28/09/2023
Average	5.62%	5.16%	5.01%	5.29%	5.00%
Spread	1.71%	1.79%	1.31%	1.15%	1.18%

- The current PWLB rates are set as margins over gilt yields as follows: -.
    - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB Certainty Rate (GF)** is gilt plus 80 basis points (G+80bps)
    - **PWLB Local Infrastructure Rate** is gilt plus 60 basis points (G+60bps)
    - **PWLB Certainty Rate (HRA)** is gilt plus 40bps (G+40bps)

7. Debt Rescheduling

Debt rescheduling opportunities have increased over the course of the past six months and will be considered if giving rise to long-term savings. However, no debt rescheduling has been undertaken to date in the current financial year.

8. Compliance with Treasury and Prudential Limits

It is a statutory duty for the PCC to determine and keep under review the affordable borrowing limits. During the half year ended 30th September 2023, the PCC has operated within the treasury and prudential indicators set out in the PCC's Treasury Management Strategy Statement for 2023/24. The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the PCC's Treasury Management Practices.

9. Annual investment strategy

The Treasury Management Strategy Statement (TMSS) for 2023/24, which includes the Annual Investment Strategy, was approved by the PCC in April 2023. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the PCC's investment priorities as being:

- Security of capital
- Liquidity
- Yield

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, but also to seek out value available in periods up to 12 months with high credit rated financial institutions, using the Link suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

Creditworthiness

Following the Government's fiscal event on 23rd September 2022, both S&P and Fitch have placed the UK sovereign debt rating on Negative Outlook, reflecting a downside bias to the current ratings in light of expectations of weaker finances and a challenging economic. Nothing further has evolved in the first half of 2023/24.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

CDS prices

It is noted that sentiment in the current economic climate can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

Investment balances

The average level of funds available for investment purposes during the half year was £26m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme. The PCC held £29.4m of investments as at 30th September 2023 (£9.5m at 31 March 2023 and £25.7m at 30 September 2022).

A full list of investments held as at 30 September 2023 is in Appendix 2.

Approved limits

The Chief Finance Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the period ended 30th September 2023.

APPENDIX 1: The CFR, Liability Benchmark and Borrowing

APPENDIX 2: Borrowing

Comparison of borrowing parameters to actual external borrowing

APPENDIX 3: Investment List as at 30 September 2023

Police And Crime Commissioner For Lincolnshire

Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest LT / Fund Rating	Historic Risk of Default
MMF Aberdeen Standard Investments	4,000,000	5.35%		MMF	AAAm	
MMF BlackRock	1,800,000	5.21%		MMF	AAAm	
Standard Chartered Bank	5,000,000	5.48%	04/07/2023	06/11/2023	A+	0.005%
DMO	4,750,000	5.31%	08/09/2023	16/11/2023	AA-	0.003%
DMO	8,800,000	5.33%	15/09/2023	16/11/2023	AA-	0.003%
Goldman Sachs International Bank	5,000,000	5.94%	04/07/2023	29/12/2023	A+	0.011%
Total Investments	**£29,350,000**	**5.45%**				**0.005%**

Note: An historic risk of default is only provided if a counterparty has a counterparty credit rating and is not provided for an MMF or USDBF, for which the rating agencies provide a fund rating. The portfolio's historic risk of default therefore measures the historic risk of default attached only to those investments for which a counterparty has a counterparty credit rating and also does not include investments which are not rated.

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