Police and Crime Commissioner for Lancashire

Treasury Management Strategy 2019/20

Background

Treasury management is defined as "The management of the authority's 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 Police and Crime Commissioner adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the approval of a treasury management strategy before the start of each financial year. The PCC also adheres to investment guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG). In 2018 the MHCLG issued new guidance which widens the definition of investments. For treasury management investments the guidance requires authorities to prioritise security, liquidity and yield in that order of importance. This is consistent with previous guidance. In addition, the guidance definition includes financial and non-financial assets which are held primarily or partially to generate a profit.

Where an authority holds non treasury investments it is required to produce a separate investment strategy. Although the definition is wide ranging covering loans to third parties, the holding of property to make a profit it is not considered that the PCC hold any such assets and it does not propose to engage in any such investments in 2019/20.

The strategy also has regard to other CIPFA treasury management publications such as risk management in 'Treasury Risk Toolkit for Local Authorities' (2012) and the use of derivatives in 'Using Financial Instruments to Manage Risk' (2013.)

This strategy supports the Commissioner's medium term financial strategy along with the capital strategy and the reserves strategy.

Statutory requirements

The Local Government Act 2003 (the Act) and supporting Regulations requires the Commissioner to "have regard to" the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Commissioner's capital investment plans are affordable, prudent and sustainable. The PCC has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

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

CIPFA requirements

The primary requirements of the CIPFA Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Commissioner's treasury management activities, the current version is shown at Annex A.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Commissioner will seek to achieve those policies and objectives.

3. The production 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.
4. Delegation by the Commissioner of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

Treasury Management Strategy for 2019/20

This Strategy Statement has been prepared in accordance with the Code of Practice. In accordance with the code, the Treasury Management Strategy will be approved by the Commissioner. In addition to this the Commissioner will also receive a mid-year report and a final year-end outturn report. In addition there will be monitoring and review reports provided in the event of any changes to Treasury Management policies or practices. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

The following reporting arrangements will be adopted in accordance with the requirements of the revised Code:

Area of Responsibility	**Committee/ Officer**	**Frequency**
Treasury Management Policy Statement	Police and Crime Commissioner	Annually.
Treasury Management Strategy / Annual Investment Strategy / MRP policy – scrutiny and approval	Police and Crime Commissioner	Annually
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid-year report, scrutiny of performance	Police and Crime Commissioner	Mid-year – 6 months
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Police and Crime Commissioner	As required
Annual Treasury Management Outturn Report	Police and Crime Commissioner	Annually
Treasury Management Monitoring Reports	Chief Finance Officer	Quarterly
Treasury Management Practices	Chief Finance Officer	Annually

In setting the Treasury Management Strategy, the following factors have been taken into account; economic forecasts, the level of the approved Capital Programme and the current structure of the Commissioner’s debt portfolio. It covers the following aspects of the Treasury Management function:-

- Prudential Indicators which will provide a controlling framework for treasury management activities.
- Long-term debt outstanding;
- Prospects for interest rates;
- The Borrowing Strategy;
- The Investment Strategy;
- Policy on borrowing in advance of need.

Economic Context

Economic Forecast

The UK economic outlook is still subject to uncertainty arising from the negotiations on the exit from the European Union (EU) and its future trading arrangements. Despite the uncertainty the economy has continued to grow, albeit at relatively low levels. The Q3 GDP growth figures show a year on year growth of 1.5%. However, the first estimate for Q4 has shown the year on year growth reducing to 1.3%. It is anticipated that the growth will continue with the Bank of England, in its November Inflation Report, expecting GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

The Bank of England remit includes a 2% inflation (CPI) target. Inflation is slightly above this level at 2.1% in December 2018. The Monetary Policy Committee of the Bank of England in its February inflation report considered, that given their assumptions on the economy, then inflation will settles at a rate a little above the target without some change to monetary policy.

Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.

World economic factors will also have an impact on the UK. There are signs that there will be a slowing of world economic growth in 2019. There is a continued risk of a developing trade war between US and China while the German economy grew by 1.5 per cent in 2018, the weakest rate since 2013. The World Bank forecast global economic growth would slow to 2.9 per cent with falls in the US, China and the Eurozone.

Interest Rate Forecast and Prospects for Market Liquidity

Interest rate forecasts are made in the context of the overall economic position outlined above. The Bank of England last changed rates in August 2018 and it has maintained expectations for slow and steady rate rises however with the high level of uncertainty there is the possibility for the next change in interest rates will be a reduction.

The latest forecast provided by Arlingclose Ltd is shown in the table below:

	Bank Rate %	3 month LIBID %	12 month LIBID %	5 year gilt yield %	10 year gilt yield %	20 year gilt yield %	50 year gilt yield %
March 19	0.75	0.90	1.20	0.95	1.30	1.70	1.65
June 19	0.75	0.90	1.20	0.95	1.35	1.75	1.70
September 19	0.75	0.95	1.25	1.00	1.40	1.80	1.75

December 19	1.00	1.20	1.50	1.25	1.65	2.00	1.95
March 20	1.00	1.25	1.60	1.30	1.75	2.05	2.00
June 20	1.25	1.35	1.75	1.45	1.90	2.20	2.15
September 20	1.25	1.40	1.75	1.45	1.85	2.20	2.15
December 20	1.25	1.40	1.70	1.40	1.85	2.20	2.15
March 21	1.25	1.40	1.70	1.40	1.85	2.20	2.15
June 21	1.25	1.40	1.70	1.40	1.85	2.20	2.15
September 21	1.25	1.40	1.70	1.40	1.85	2.20	2.15
December 21	1.25	1.40	1.70	1.40	1.85	2.20	2.15
March 22	1.25	1.40	1.70	1.40	1.85	2.20	2.15

In the above table 'bank rate' refers to the policy rate of the Bank of England. 'LIBID' is the London Interbank bid rate and can be used as a proxy for short term market interest rates. PWLB borrowing rates are based on 'Gilt Yield' and so this is a forecast of long term interest rates. The Commissioner can borrow at 80 basis points above the gilt yield, so for example a fixed interest rate to borrow PWLB money for 10 years would be 2.45%, 1.65% plus 0.80%.

Current Position

The current value of the Commissioner's treasury portfolio at 28/2/2019 is:

	Principal	
	£m	**%**
DEBT		
Fixed rate loans from PWLB	15.954	38
Fixed term loans from other local authorities	26.000	62
Total Debt	**41.954**	
INVESTMENTS		
Variable rate investments with Lancashire County Council	15.067	100
Total investments	**15.067**	

The level of investments represents the Commissioner's cumulative surplus on the General Fund, the balances on other cash-backed earmarked reserves and a cash-flow balance generated by a surplus of creditors over debtors and by grant receipts in advance of payments.

Borrowing Requirement

In the medium term the PCC borrows for capital purposes only. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The table below compares the estimated CFR to the debt which currently exists. This gives an indication of the borrowing required. It also shows the estimated resources available for investment. An option is to use these balances to finance the expenditure rather than investing, often referred to as internal borrowing, so the table gives an indication of the minimum borrowing requirement through these method.

The CFR forecast includes the impact of the latest forecast of the funding of the Capital Programme.

	31/3/2019	**31/3/2020**	**31/3/2021**	**31/3/2022**
	£m	**£m**	**£m**	**£m**
Capital Financing Requirement	62.846	76.671	92.829	108.263

Less external borrowing	41.954	14.854	14.554	13.604
Borrowing requirement	20.892	61.817	78.275	94.659
Reserves and working capital	-30.622	-23.390	-18.912	-17.459
Borrowing/(investment) need	-9.730	38.427	59.363	77.200

The Commissioner has not borrowed long term for capital purposes since 2007, preferring instead to fund capital expenditure and maturing borrowing from internal resources; hence the borrowing requirement identified in the table above. However, it is anticipated that with the proposed borrowing requirement in the Capital Programme and the falling level of reserves this will not be sustainable in the medium term. The position will continue to be reviewed by the Chief Finance Officer and borrowing either long term or short term will be taken as necessary.

Capital Funding Strategy

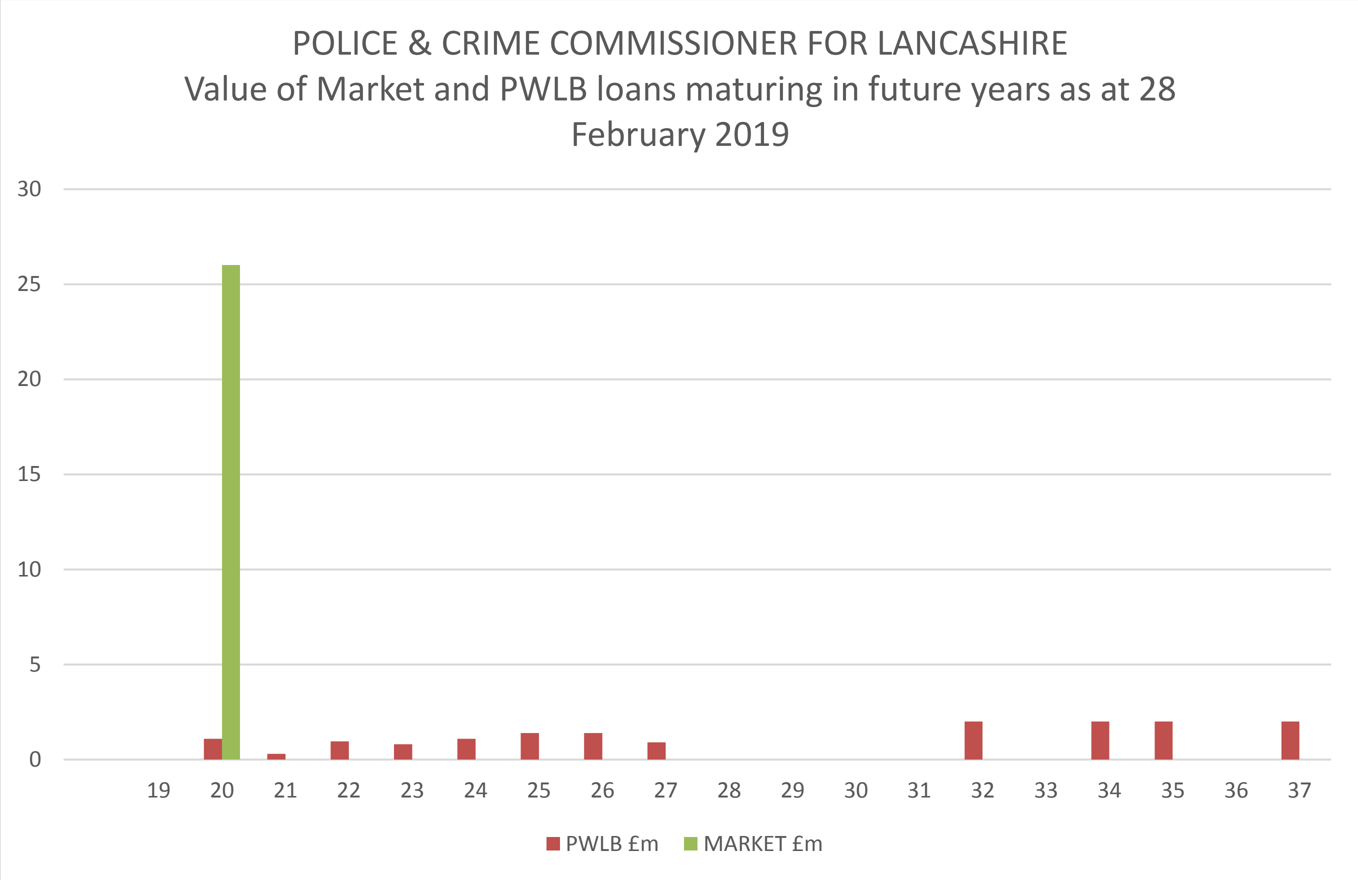
The Commissioner has set aside funding in ear-marked revenue reserves to contribute to the delivery of the investment included in the Capital Programme. This resource will be used, in the first instance, to provide finance for short life assets such as IT systems and equipment in order to avoid the use of borrowing where possible for this type of asset. This approach represents a prudent strategy for the funding of short life assets as the cost of borrowing over shorter terms is more expensive than for longer periods and the use of reserves to minimise such shorter life borrowing represents better value for money.

Borrowing Strategy

In view of the above interest rate forecast the Commissioner's borrowing strategy will be based upon the following information:

- Official UK interest rates are not anticipated to rise significantly in 2019/20. Gilt yields are projected to be fairly flat in the short term with some increase towards the end of the year. This will continued to be reviewed with the result that:
- If it were felt that there was a significant risk of a sharp fall in long and short term rates, e.g. due to a marked increase of risks around relapse into recession, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- If it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

The chart below shows the current maturity profile of the Commissioner's long term debt.



The interest rate on the loans ranges from 4.1% to 4.875%.

The cheapest borrowing at present is internal borrowing facilitated by running down cash balances and foregoing interest earned on investments at historically low rates - this is the policy the Commissioner has been pursuing for a number of years, funding capital expenditure and paying down debt maturities from existing balances. Although this policy has been beneficial the significant capital expenditure funded from borrowing and the anticipated reduction in the level of reserves will result in a need for new borrowing. However, borrowing may be minimised by the use of internal borrowing

The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Continuing the policy of using internal balances is likely to increase the need for the Commissioner to incur short term loans to cover cash flow shortages.

The approved sources of long-term and short-term borrowing currently are:

- Public Works Loan Board
- UK local authorities
- any institution approved for investments
- any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
- UK public and private sector pension funds

In the past the Commissioner has raised all long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

Debt Restructuring

The Chief Finance Officer, together with the County Council's treasury management team reviews options for debt restructuring on a regular basis. A recent review found that given the relatively favourable interest rates at which these have been taken out (below 5%) and the penalties associated with any early repayment, restructure is not considered financially viable at the present time. A better option for the immediate future is to continue to utilise reserves to minimise the future borrowing requirement rather than repay debt.

Frequent discussions will continue to take place between the Chief Finance Officer and the Treasury Management Team to monitor this situation and any future decisions on debt financing will be put through the same rigorous cost and prudence analysis that external borrowing has traditionally gone through and will be reported to the Commissioner in due course.

Policy on Borrowing in Advance of Need

The Commissioner will not borrow more than or in advance of need purely in order to profit from the investment of the extra sums borrowed. However advance borrowing may be taken if it is considered that current rates are more favourable than future rates and that this advantage outweighs the cost of carrying advance borrowing. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Commissioner can ensure the security of such funds and relationships.

In determining whether borrowing will be undertaken in advance of need the Commissioner will:

- Ensure that there is a clear link between the capital programme and the maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
- Consider the merits and demerits of alternative forms of funding.
- Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

Treasury Management Investment Strategy

The Commissioner will have regard to the MHCLG's Guidance on Local Government Investments and the revised CIPFA Treasury Management in Public Services Code of Practice and Guidance Notes ("the CIPFA TM Code"). The Commissioner's investment priorities are:

(a) The security of capital and

(b) The liquidity of its investments.

The Commissioner will also aim to achieve the optimum return on his investments commensurate with proper levels of security and liquidity. The risk appetite of the Commissioner is low in order to give priority to security of its investments.

Current Investments

At 28th February 2019 the Commissioner held £15.067m invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2018/19 the Commissioner's investment balance has averaged at £31.344m, with the highest balance being £74.792m. Levels for 2019/20 will be dependent upon the use of reserves and the level of internal borrowing used to fund capital expenditure In line with the treasury management strategy, the Commissioner will only use very high quality counterparties for investments. All of the Commissioner's investments are currently with LCC.

The Commissioner currently has access to a call (instant access) account with LCC. This currently pays bank rate, (currently 0.75%). Each working day the balance on the Commissioner's Current Account is invested in this to ensure that the interest received on surplus balances is maximised.

The interest earned on as at 28 February 2019 is £0.194m.at an annualised rate of 0. 68%. The current interest rate is 0.75%.This compares favourably with the benchmark 7 day LIBID which averages 0.50% over the same period.

The economy is currently in a low yield environment but both the CIPFA Code and the MHCLG Guidance require the Commissioner to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Commissioner's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The Commissioner can invest with other local authorities. Arlingclose, the County Council's Treasury Management advisor, state they are "comfortable with clients making loans to UK local authorities for periods up to two years, subject to this meeting their approved strategy. For periods longer than two years we recommend that additional due diligence is undertaken prior to a loan being made." On this basis it is proposed that the investments to local authorities are limited as follows:

	Maximum individual investment (£m)	Maximum total investment (£m)	Maximum period
Up to 2 years	10	250	2 years
Over 2 years	10	50	10 years

The investment in LCC as part of the call account arrangement is excluded from the above limits. The balance on this account is dependent upon short term cash flows and therefore does not have a limit.

The Commissioner may invest surplus funds with any of the counterparties in the table below, subject to the cash and time limits shown.

Counterparty		**Cash limit**	**Time limit †**
Secured Bank Deposits, Reverse repurchase Agreements	AAA	£5m each	5 years*
	AA+		3 years*
	AA		2 years*
	AA-		2 years*

Call Accounts with banks and other organisations with minimum AA- credit rating	£10m	next day
UK Central Government (irrespective of credit rating)	unlimited	50 years**
UK Local Authorities (irrespective of credit rating)	£10m	10 years
Call Account with Lancashire County Council	unlimited	Next day
Secured Bond Funds AA rating and WAL not more than 3 years	£5m each	n/a
Secured Bond Funds AAA rated and WAL not more than 5 years	£5m each	n/a

** but no longer than 2 years in fixed-term deposits and other illiquid instruments*
*** but no longer than 5 years in fixed-term deposits and other illiquid instruments*

Legislative Context

Whilst the investment strategy has been amended to allow greater flexibility with investments any decision as to whether to utilise this facility will be made based on an assessment of risk and reward undertaken jointly between the Chief Finance Officer and LCC Treasury Management Team, and consideration of this forms part of the on-going meetings that take place throughout the year.

The legislative and regulatory background to treasury management activities has previously required the Commissioner to set out the use of “specified” and “non-specified” investments.

Specified Investments: The MHCLG Guidance defines specified investments as those:

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

The Commissioner defines “high credit quality” organisations as those having a credit rating of A+ or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

Non-Specified Investments are any investment that does not meet the definition of a specified investment. The Commissioner does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition of specified credit quality.

The Commissioner may lend or invest money using any of the following instruments:-

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits where the Commissioner may demand repayment at any time (with or without notice),
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments, and
- shares in bond funds

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

On behalf of the Commissioner the county council's treasury management section prepares daily cash flow forecasts to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Commissioner's medium term financial plan and cash flow forecast.

The performance target on investments will remain as being above the average rate for 7 day notice money.

Revenue Budget

Based on the Strategy outlined above then the proposed budget for capital financing are:

	2019/20	2020/21	2021/22	2022/23
	£m	£m	£m	£m
MRP	1.140	1.514	1.956	2.443
Interest payable	1.416	1.415	1.862	2.189
Interest receivable	-0.257	-0.361	-0.361	-0.361
Transferred debt	0.010			
Net budget	2.309	2.568	3.457	4.271

Prudential Indicators for 2019/20 to 2021/22 in respect of the Police and Crime Commissioner's Treasury Management Activities.

In accordance with its statutory duty and with the requirements of the Prudential Code for Capital Finance and the CIPFA Code for Treasury Management, every local authority produces each year a set of prudential indicators which regulate and control its treasury management activities.

The following table sets out the debt and investment-related indicators which provide the framework for the Commissioner's proposed borrowing and lending activities over the coming three years. These indicators will also be approved by members as part of the Capital Programme approval process along with other capital expenditure-related indicators, but need to be reaffirmed and approved as part of this Treasury Management Strategy.

Prudential Indicators	**2018/19 (Revised) £000**	**2019/20 £000**	**2020/21 £000**	**2021/22 £000**
1. Adoption of the Revised CIPFA Code of Practice on Treasury Management	Adopted for all years			
2. Estimated capital expenditure	18,675	25,966	25,900	24,531
3. Authorised limit for external debt - A prudent estimate of external debt, which includes sufficient headroom for unusual cash movements.				
Borrowing	78,000	91,000	107,000	123,000
Other long-term liabilities	1,000	1,000	1,000	1,000
TOTAL	79,000	92,000	108,000	124,000

4. Operational boundary for external debt - A prudent estimate of debt, but no provision for unusual cash movements. It represents the estimated maximum external debt arising as a consequence of the Commissioner's current plans.

Borrowing	75,000	77,000	93,000	108,000
Other long-term liabilities	500	500	500	500
TOTAL	75,500	77,500	93,500	108,500

5. Gross Debt / Capital Financing Requirement Indicator

	2018/19 (Rev) £m	2019/20 £m	2020/21 £m	2021/22 £m
Capital Financing Requirement	62.846	76.671	92.829	108.263
Estimated Gross Debt	22.075	65.900	87.829	103.263
Debt to CFR (%)	35.1	85.9	94.60	95.4

This is a measure of prudence.
The fact that gross debt is less than the capital financing requirement is taken as an indicator borrowing has only been made for capital purposes.

6. Upper limit for fixed interest rate exposure

Upper limit of borrowing at fixed rates	100%	100%	100%	100%
Upper limit of investments at fixed rates	100%	100%	100%	100%

7. Impact 1% rate rise limit	£1M	£1M	£1m	£1m
8. Upper limit for total principal sums invested for over 364 days (per maturity date as a percentage of total investments.**)**	50%	50%	50%	50%

9. Maturity structure of Debt	**Upper Limit %**	**Lower Limit %**
Under 12 months	90	-
12 months and within 24 months	80	-
24 months and within 5 years	85	-
5 years and within 10 years	85	-
10 years and above	95	5

	2018/19 (Rev)	2019/20	2020/21	2021/22
10. Ratio of financing costs to revenue stream	1.01%	0.85%	0.95%	*1.28%*

Treasury Management Policy Statement

The Police and Crime Commissioner's financial regulations require him to create and maintain a treasury management policy statement, stating the policies, objectives and approach to risk management of his treasury activities, as a cornerstone for effective treasury management.

Definition

The Police and Crime Commissioner defines his treasury management activities as: the management of the Commissioner's investments and cash flows, his 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.

Risk management

The Commissioner regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of his treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

Value for money

The Commissioner acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. He is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Borrowing policy

The Commissioner aims to fund its capital expenditure in a cost effective manner. This will involve using short term and variable rate loans when these are seen as being the most beneficial strategy. However consideration will be given to the long term funding needs and the stability to budgets that fixed interest loans provides. The Commissioner will also constantly evaluate debt restructuring opportunities of the existing portfolio.

The Commissioner will set an affordable borrowing limit each year in compliance with the *Local Government Act 2003*, and will have regard to the *CIPFA Prudential Code for Capital Finance in Local Authorities* when setting that limit. He will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy

The Commissioner's primary objectives for the investment of his surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of services is an important, but secondary, objective.

The Commissioner will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.