1. Background

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. Treasury management is defined in the CIPFA treasury management in the public services code of practice (the CIPFA Code) 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 CIPFA Code includes the recommendation that authorities adopt the following:

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 Appendix 1.
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. This is delegated to the Chief Finance Officer.
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.

The PCC has adopted the Code and 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 2020/21.

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

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.

2. Reporting requirements

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 before the start of the financial year.
Treasury Management Strategy / Annual Investment Strategy / MRP policy	Police and Crime Commissioner	Annually before the start of the financial year
Mid-year review, 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 by 30 September
Treasury Management Monitoring Reports	Chief Finance Officer	Quarterly
Treasury Management Practices	Chief Finance Officer	Annually

3. Treasury Management Strategy for 2020/21

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.*

3.1. Economic Context

3.1.1. Economic Forecast

The UK economy has been affected by concerns over the world economy, in particular the trade war between the USA and China, and the uncertainty arising from the UK's exit from the European Union. Gross Domestic Product growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. The Bank of England sets its monetary policy to achieve the government's target of keeping inflation at 2%. The latest inflation rate as measured by the Consumer Prices Index is 1.8%. In the short term, the Bank of England has to balance the target of low inflation with supporting economic growth and jobs. As a result, the base rate has remained at 0.75% throughout 2019.

The Bank of England monetary policy committee met on 19 December 2019 with the committee's latest projections for activity and inflation being set out in the November Monetary Policy Report and assumed an orderly transition to a free trade agreement between the United Kingdom and the European Union. UK Gross Domestic Product growth was projected to pick up, supported by the reduction of Brexit-related uncertainties, an easing of fiscal policy and a modest recovery in global growth. With demand growth outstripping the subdued pace of supply growth, excess demand and domestic inflationary pressures were expected to build gradually. Consumer Prices Index inflation was projected to rise slightly above the 2% target towards the end of the forecast period.

However, the spread of coronavirus has resulted in a deteriorating global economic outlook with the OECD warning that coronavirus could halve global economic growth in 2020; GDP growth of 1.5% compared to its previous 2.9% forecast. Central banks in the United States, Canada and Australia have cut rates and on the 11th March, the Bank of England followed by cutting the Bank Rate by 0.5% to 0.25%.This was followed by a further cut on the 19th March to bring the Bank Rate to 0.1%.

3.1.2. Interest Rate Forecast and Prospects for Market Liquidity

Interest rate forecasts are made in the context of the overall economic position as outlined above. Until recently, the forecast provided by Arlingclose Ltd was that the base rate would remain constant for the foreseeable future but if there was a move, it was most likely to see a reduction. However, the impact of the coronavirus has resulted in updated forecasts, which includes a forecast of two 0.25% reductions, which would take the base rate from 0.75% to 0.25%.

Details of the latest forecast provided by Arlingclose Ltd is shown in the table below. However, this forecast was produced before the Bank of England reduced the Base Rate by 0.5% and therefore the March figures are lower than indicated in the table.

	Bank Rate %	3 month money market %	12 month money market %	5 year gilt yield %	10 year gilt yield %	20 year gilt yield %	50 year gilt yield %
March 20	0.50	0.50	0.65	0.30	0.50	0.75	0.75
June 20	0.25	0.25	0.40	0.20	0.40	0.70	0.70
September 20	0.25	0.25	0.45	0.25	0.45	0.75	0.75
December 20	0.25	0.25	0.60	0.35	0.60	0.80	0.80
March 21	0.50	0.50	0.70	0.60	0.65	0.85	0.85
June 21	0.50	0.50	0.70	0.60	0.70	0.85	0.85
September 21	0.50	0.50	0.70	0.60	0.70	0.90	0.90
December 21	0.50	0.50	0.70	0.65	0.75	0.90	0.90
March 22	0.50	0.50	0.70	0.65	0.75	0.95	0.95
June 22	0.50	0.50	0.70	0.70	0.80	0.95	0.95
September 22	0.50	0.50	0.70	0.70	0.80	1.00	1.00
December 22	0.50	0.50	0.70	0.70	0.85	1.00	1.00
March 23	0.50	0.50	0.70	0.70	0.85	1.05	1.05

PWLB borrowing rates are based on 'Gilt Yield' and so this is a forecast of long-term interest rates. The Commissioner can borrow at 1.8% above the gilt yield, so for example a fixed interest rate to borrow PWLB money for 10 years would be 2.30%0.50% plus 1.8%.

3.1.3. Current Position

Current Treasury Portfolio Position

The current value of the Commissioner's Treasury Portfolio at 29.2.2020 is:

DEBT	**Principal £m**
Fixed rate loans from PWLB	46.354
Fixed term loans from other local authorities	1.500
Total debt	**47.854**
INVESTMENTS	
Variable rate investments in the County Council's General County Fund	8.437
Total investments	**8.437**

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.

3.2. 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 this method.

The CFR has been calculated adopting a policy that the Commissioner has set aside revenue reserves and contributions 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. The Commissioner's strategy increases the revenue budget each year in respect of the contribution made to finance the capital programme. This approach reflects the reduction in earmarked reserves available for funding the capital programme and represents a prudent strategy for the funding of short life assets. This approach is taken because the cost of borrowing over shorter terms is more expensive than for longer periods and the use of revenue contributions and reserves to minimise such shorter life borrowing represents better value for money.

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

	31/3/2020 £m	**31/3/2021 £m**	**31/3/2022 £m**	**31/3/2023 £m**
Capital Financing Requirement	65.334	95.311	123.798	131.328

Less external borrowing	47.854	42.479	41.454	40.575
Borrowing requirement	17.480	52.832	82.344	90.753
Reserves and working capital	10.331	2.932	2.782	2.532
Borrowing/(investment) need	7.149	49.900	79.562	88.221

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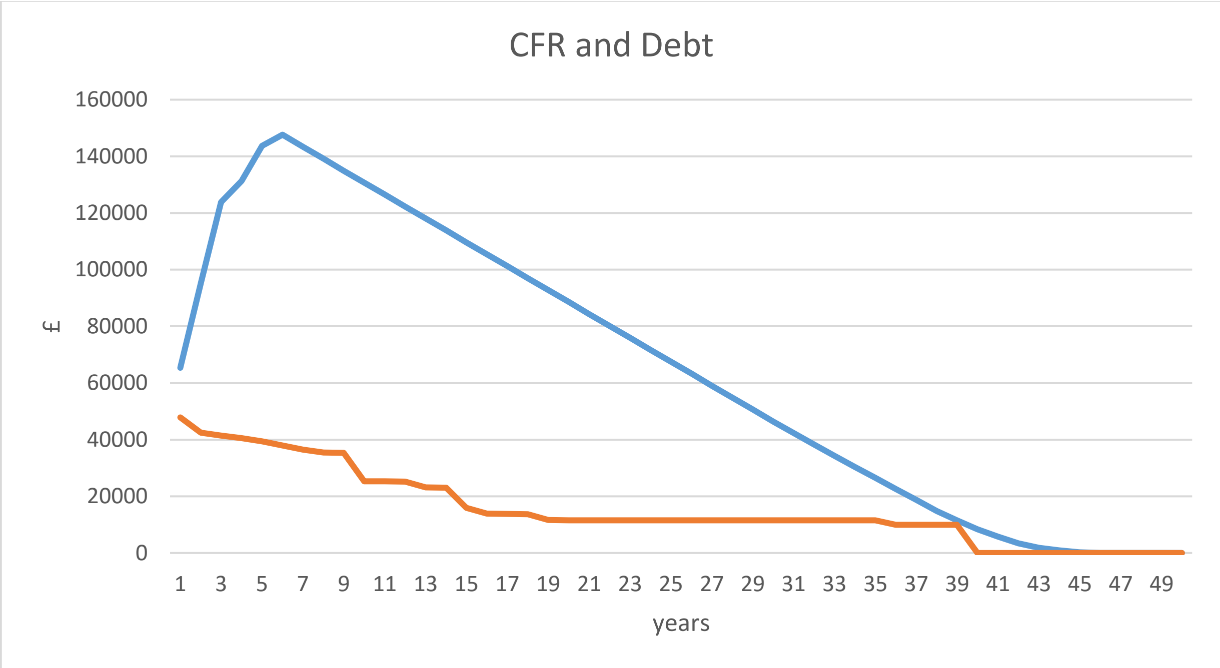
The underlying need to borrow is greater than the actual borrowing as shown by the comparison of the CFR and actual debt in the graph below.



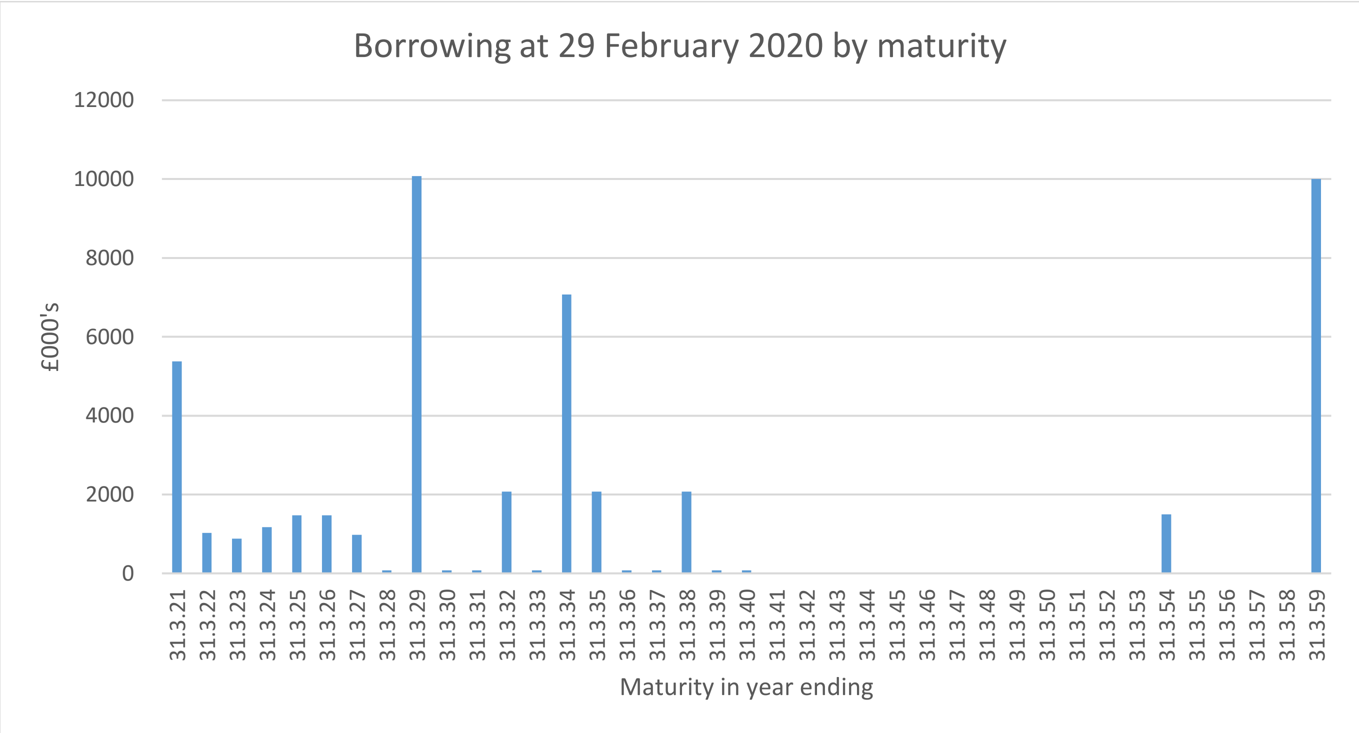
The table shows that there will be a need for borrowing even after the use of internal resources.

3.2.1. Borrowing Strategy

The Commissioner's borrowing strategy will be based upon the long-term need for borrowing, the ability to use internal resources and the interest rate forecasts. The borrowing requirement section has shown that there is a long-term borrowing requirement. It is expected that internal resources will continue to be used to minimize the borrowing as the investment return lost is expected to be lower than the cost of borrowing. However, the use of internal resources will result in the need for short-term borrowing to meet cash-flow requirements. The latest cash-flow forecasts are shown below:

It is anticipated that a mixture of long and short-term borrowing will meet the borrowing need. Short-term borrowing is generally cheaper in year but there is the risk that future replacement loans will be more expensive. Therefore, consideration will be given to the latest interest rate forecasts to assess whether long or short-term borrowing is taken. The interest rates forecasts shown earlier in the report show rates are expected to remain at low levels. If there was an expectation that long-term rates were due to increase then it is likely that more long-term loans would be taken.

In taking long-term debt, the need to borrow will be the key factor but the re-financing risk will also be taken into account. The chart below shows the current maturity profile of the Commissioner's debt.



The interest rate on the loans ranges from 1.05% to 4.875%.

In undertaking borrowing, 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

It is proposed that the approved sources of borrowing will remain as set out above.

Previously all long-term borrowing has been taken from the Public Works Loan Board, but the PCC continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at rates that are more favourable.

This is especially the case as in October the PWLB announced that its loan rates would be increased to be 1.8% above the rate of Gilts rather than the then 0.8%. However, in the Chancellor of the Exchequers Budget a consultation on PWLB borrowing was launched which may affect future rates and availability.

3.2.2. 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 now. 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.

3.2.3. 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 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.

3.2.4. 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.

3.2.5. Current Investments

At 29th February 2020, the Commissioner held £8.437m invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2019/20, the Commissioner's investment balance has averaged at £38.052m, with the highest balance being £86.807m. 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 0.10%). 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 29 February 2020 is £0.262m.at an annualised rate of 0.75%. This compares favourably with the benchmark 7 day LIBID that averages 0.57% over the same period.

3.2.6. Investment Counter-parties

With the security and liquidity, being key drivers of the investment strategy it is expected that the LCC call account will remain a key part of the investments. However, 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*

Whilst the investment strategy allows 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 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 either made at 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.

3.3. Revenue Budget

Based on the Strategy outlined above the forecast budget requirement for capital financing is:

	2020/21 £m	2021/22 £m	2022/23 £m	2023/24 £m
MRP	1.224	2.004	2.820	3.637
Interest payable	1.835	2.789	3.210	3.449
Interest receivable	-0.092	-0.184	-0.184	-0.184
Net budget	**2.967**	**4.609**	**5.846**	**6.902**

3.4. Prudential Indicators for 2020/21 to 2022/23 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.

Prudential Indicators:

	2019/20 (Revised)	**2020/21**	**2021/22**	**2022/23**
	£000	**£000**	**£000**	**£000**
1. Adoption of the Revised CIPFA Code of Practice on Treasury Management	Adopted for all years			
2. Estimated capital expenditure	14,197	41,772	36,014	19,170
3. Authorised limit for external debt	A prudent estimate of external debt, which includes sufficient headroom for unusual cash movements.			
Borrowing	91,000	125,000	150,000	160,000
Other long-term liabilities	5,000	5,000	5,000	5,000
TOTAL	**96,000**	**130,000**	**155,000**	**165,000**
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	95,000	120,000	130,000
Other long-term liabilities	500	500	500	500
TOTAL	**75,500**	**95,500**	**120,500**	**130,500**

	2019/20 (Revised)	2020/21	2021/22	2022/23
5. Gross Debt / Capital Financing Requirement Indicator				
Capital financing requirement (CFR)	£65.334M	£95.311M	£123.798m	£131.328m
Estimated gross debt	£56.354M	£95.000M	£120.000m	£130.000m
Debt to CFR (%)	86	99	97	99
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	£5M	£5M	£5m	
8. **Upper limit for total principal sums invested for over 364 days** (per maturity date as a percentage of total investments.)				
	£300M	£300M	300M	300M
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	
10. **Ratio of financing costs to revenue stream**				
	0.80	0.98	1.51	1.90

Annex A

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.