Police and Crime Commissioner for Lancashire

Treasury Management Strategy

2023/24

Police and Crime Commissioner for Lancashire

Treasury Management Strategy 2023/24

1. Background

1.1. 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 Codes as "The management of the organisation’s borrowing, investments and cash flows, including 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."

1.2. The CIPFA Code includes the recommendation that authorities adopt the following:

- 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.
- 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.
- 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.
- 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.

1.3. The PCC has adopted the Code and also adheres to investment guidance issued by the then 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.

1.4. 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 2023/24.

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

1.6. 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

2.1. 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 2023/24

3.1. 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

4. Economic background:

4.1. Key factors to consider in assessing the impact on the Strategy are the expectation for economic growth, inflation and the possible impact on interest rates.

4.2. The overall picture for next year is the expectation that growth will be weak with the Bank of England's quarterly Monetary Policy Report (MPR) for November forecasting a prolonged but shallow recession in the UK. The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the Bank of England forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024. The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%

4.3. CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR. With any forecast there is uncertainty and the Bank of England state that the risks are to the upside.

4.4. The picture is similar in other economies with interest rates rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%.

5. Arlingclose Forecast

5.1. The Bank of England (BoE) increased the Bank Rate to 4% in February 2023. This has been part of a cycle of increases that has seen the base rate increase from 0.25% in December 2021.

5.2. The Authority's treasury management adviser Arlingclose forecasts that there will be one further rise to 4.25% as the Bank of England continues to attempt to subdue inflation which is significantly above its 2% target. It is then expected that the rate will remain constant until early 2024 when rates will begin to fall in response to a poorly performing economy.

5.3. Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.1%, 3.2%, and 3.85% respectively over the 3-year period to December 2025.

5.4. The latest forecast is shown in the table below:

	Bank Rate %	3-month money market rate%	5-year gilt yield %	10-year gilt yield %	20-year gilt yield %	50-year gilt yield %
Current rate	4.00	4.20	3.06	3.19	3.71	3.43
Mar-23	4.25	4.40	3.20	3.30	3.85	3.60
Jun-23	4.25	4.40	3.20	3.30	3.85	3.60
Sep-23	4.25	4.40	3.20	3.30	3.85	3.60
Dec-23	4.25	4.35	3.20	3.30	3.85	3.60
Mar-24	4.00	4.15	3.10	3.20	3.85	3.60
Jun-24	3.75	4.10	3.10	3.20	3.85	3.60
Sep-24	3.50	4.00	3.10	3.20	3.85	3.60
Dec-24	3.25	3.75	3.00	3.20	3.85	3.60
Mar-25	3.00	3.50	3.00	3.20	3.85	3.60
Jun-25	3.00	3.40	3.00	3.20	3.85	3.60
Sep-25	3.00	3.40	3.00	3.20	3.85	3.60
Dec-25	3.00	3.40	3.10	3.20	3.85	3.60

5.5. In the above table 'bank rate' refers to the policy rate of the Bank of England. PWLB borrowing rates are based on 'Gilt Yield' and so this is a forecast of long-term interest rates. The Authority 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 3.99%, 3.19% plus 0.80%.

Current Position

6. Current Treasury Portfolio Position

6.1. The current value of the Commissioner's Treasury Portfolio at 31.12.2022 is:

	Principal £m
DEBT	
Fixed rate loans from PWLB	43.575
Fixed term loans from other local authorities	60.000
Total debt	**103.575**
INVESTMENTS	
Fixed rate investments with other local authorities	5.000
Variable rate investments in the County Council	56.767
General County Fund	
Total investments	**61.767**
Net (debt)/Investments	**(41.808)**

6.2. 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.

7. Borrowing Requirement

7.1. 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.

7.2. 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 annual cost of borrowing over shorter terms is more expensive than for longer periods due to the higher MRP repayment and the use of revenue contributions and reserves to minimise such shorter life borrowing represents better value for money.

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

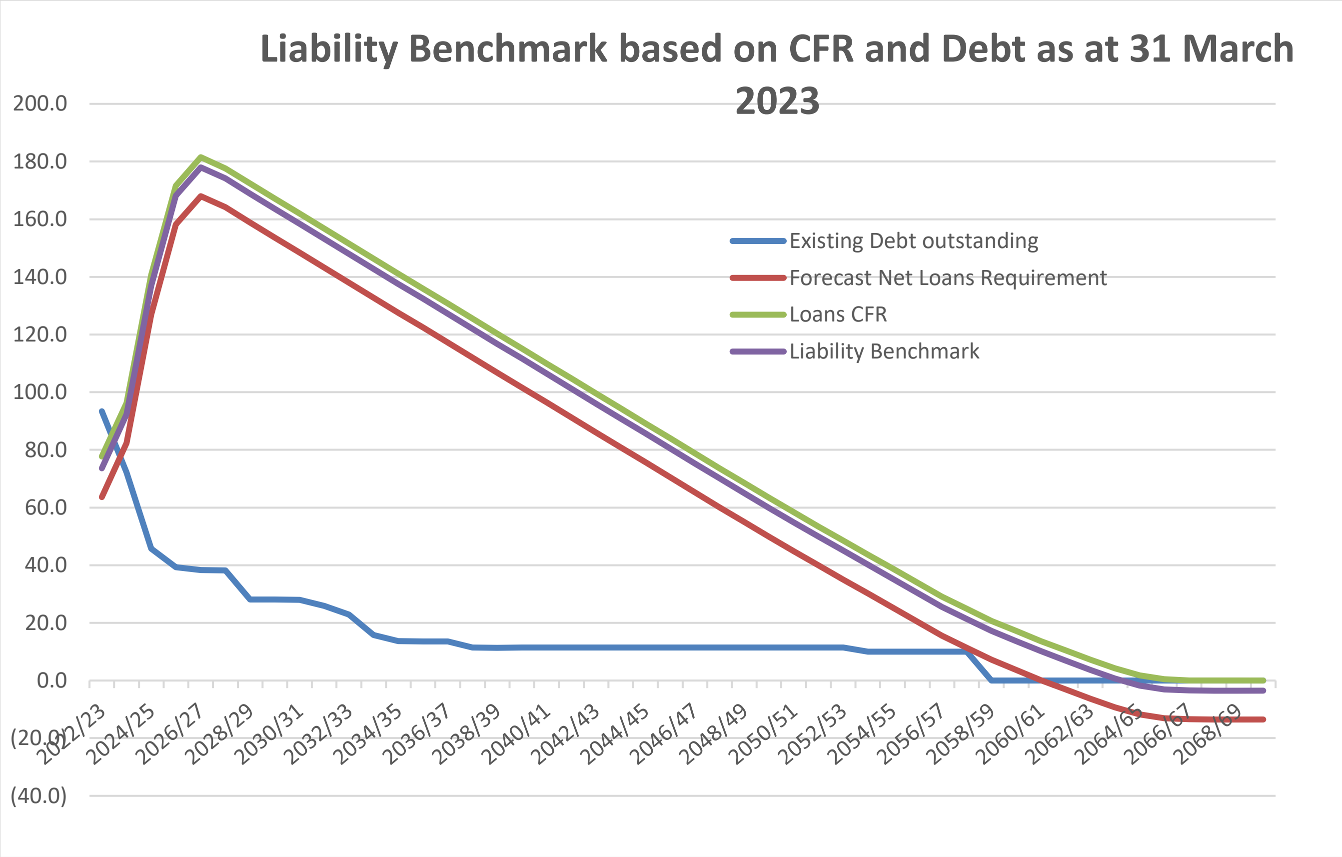
	31/3/2023	31/3/2024	31/3/2025	31/3/2026
	£m	£m	£m	£m
Capital Financing Requirement	77.751	96.262	140.652	171.654
Less external borrowing	93,388	72.213	45.738	39.263
Borrowing requirement	-15.637	24.049	94.914	132.391

Reserves and working capital	-14.169	-13.919	-13.769	-13.519
Borrowing/(investment) need	-29.806	10.130	81.145	118.872

7.4. The borrowing on 31 March 2023 is above the CFR as during the year there was slippage on the capital programme which has resulted in a reduction in the expected CFR. This is reflected in higher borrowing requirements in subsequent years and therefore the borrowing is within the Prudential Code requirements.

8. Liability benchmark

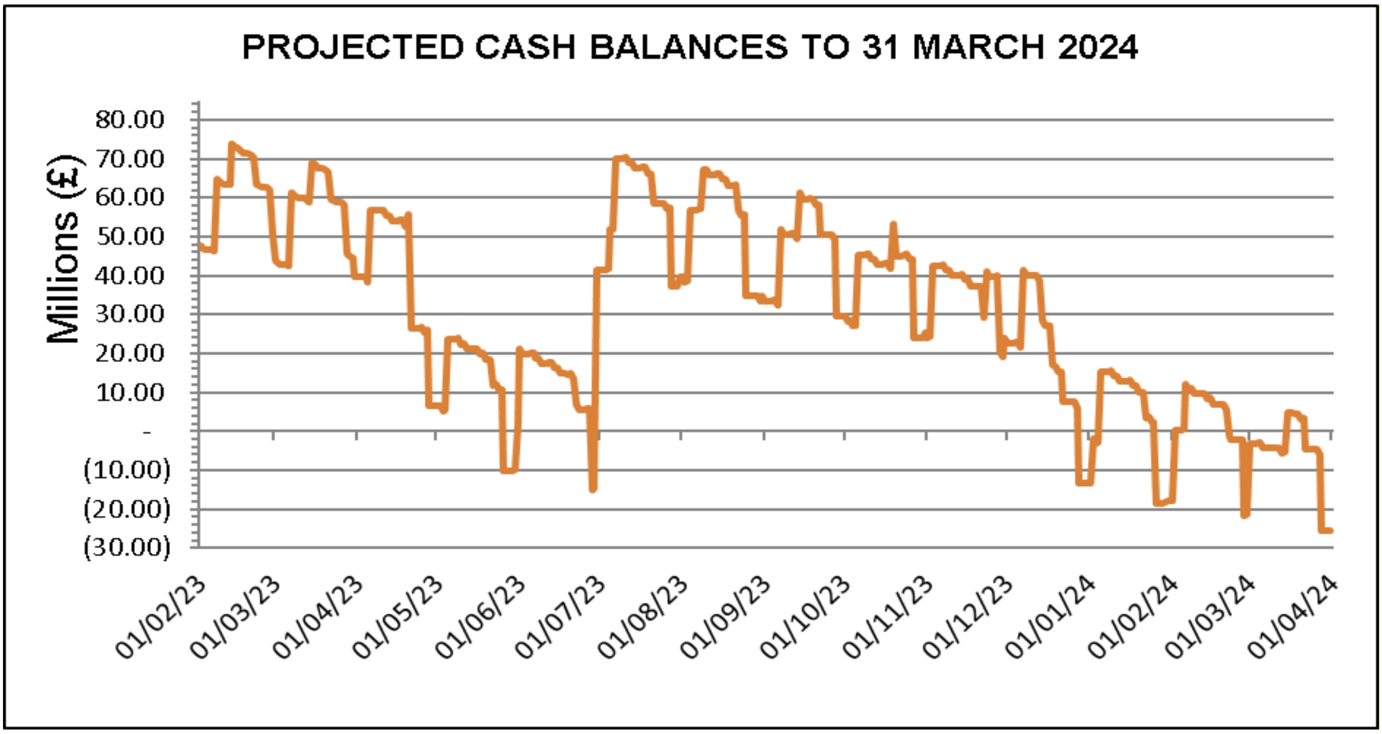
8.1. To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as the table above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk. The liability benchmarks are shown in the graph below:



8.2. The liability benchmark graph above shows that there is an actual need to undertake borrowing in 2023/24 and beyond until at least 2060/61 based upon the current capital programme so consideration will be given to undertake some long-term borrowing in the next few years.

9. Borrowing Strategy

9.1. The data shown above demonstrates that the Commissioner does have a significant borrowing requirement both in the short and long term. This requirement could be met by taking a series of long-term loans. However, this may be too simplistic an approach as there will be some internal resources that could be used to replace borrowing especially as the receipt of income is not even during the year. The diagram below shows the cashflow forecasts for 2023/24 before any further borrowing decisions are taken:



9.2. The graph illustrates there are times when cash flow is negative and therefore short-term loans could be used to meet the borrowing need in the year. However, as capital expenditure is incurred over the next few years this will becoming increasingly difficult.

9.3. It is therefore anticipated that the borrowing strategy will be to meet requirements by a mixture of long- and short-term borrowing. 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 both debt maturity profile and the latest interest rate forecasts to assess whether long- or short-term borrowing is taken.

9.4. The table below shows the maturity profile of the existing debt of £103.537m in 2023/24

Years to maturity from 1.4.23	Debt £m	%
Under 1 Year	31.0	30.0
1-2 Years	26.4	25.5
2-5 years	7.3	7.1
5-10 years	15.0	14.5
Over 10 years	23.7	22.9

9.5. This illustrates that the portfolio does have a reasonable proportion of long-term debt to mitigate refinancing risk while taking some of the benefits of short-term borrowing.

9.6. The interest rates and Gilt rates, which determine PWLB loan rates, forecasts shown earlier in the report show rates are expected to remain at fairly constant levels albeit there may be some small reductions from March 2024. If there was an expectation that long term rates were due to increase sharply then it is likely that more long-term loans would be taken. The situation will be constantly reviewed by County Councils Treasury Management Team and the Chief Finance Officer.

9.7. 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

9.8. It is proposed that this will continue. 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.

10. Debt Restructuring

10.1. 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.

10.2. 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.

11. Policy on Borrowing in Advance of Need

11.1. 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.

11.2. 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.

12. Treasury Management Investment Strategy

12.1. 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:

- The security of capital and
- The liquidity of its investments.

12.2. 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.

13. Current Investments

13.1. On 31 December 2022 the Commissioner held £61.767m invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2022/23 the Commissioner’s investment balance has averaged at £55.291m, with the highest balance being £92.757m. The Commissioner will only use very high-quality counterparties for investments.

13.2. The Commissioner's investments are principally held with LCC with the other investments being fixed term deposits with other local authorities. On 31 December the investment balances were made up from £56.767m held at LCC along with a local authority investment of £5m maturing in year. These balances are forecast to reduce to around £40m by the end of March 2023.

13.3. The Commissioner currently has access to a call (instant access) account with LCC. This currently pays bank rate, (currently 4.0%). 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.

13.4. The interest earned during the year as of 31 December 2022 is £0.859m at an annualised rate of 2.06%. This compares favourably with the benchmark 7-day LIBID which averages a yield of 1.81% over the same period.

13.5. Investment Counterparties

- 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

13.6. 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.

13.7. 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*

13.8. 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.

13.9. 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

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

13.11. 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.

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

14. Revenue Budget

14.1. The proposed budgets for capital financing based upon the latest proposed capital programme are:

	2023/24	2024/25	2025/26	2026/27
	£m	**£m**	**£m**	**£m**
MRP	2.269	2.788	3.967	4.841
Interest payable	2.446	3.508	4.818	5.647
Interest receivable	-1.700	-1.440	-1.300	-1.300
Net budget	**3.015**	**4.856**	**7.485**	**9.188**

15. Prudential Indicators for 2023/24 to 2024/25 in respect of the Police and Crime Commissioner's Treasury Management Activities.

15.1. 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.

15.2. 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	**2023/24**	**2024/25**	**2025/26**	**2026/27**
	£000	**£000**	**£000**	**£000**
1. Adoption of the Revised CIPFA Code of Practice on Treasury Management	Adopted for all years			
2. Estimated capital expenditure	33,214	63,023	48,031	31,296
3. Authorised limit for external debt *				
Borrowing	130,000	140,000	185,000	215,000
Other long-term liabilities	5,000	5,000	5,000	5,000
TOTAL	**135,000**	**145,000**	**190,000**	**220,000**
4. Operational boundary for external debt **				
Borrowing	105,000	115,000	160,000	190,000
Other long-term liabilities	500	500	500	500
TOTAL	105,500	115,500	160,500	190,500
Note: the limits do not include the adoption of proposed accounting standards for leasing. This may lead to an increase in other long-term liabilities.				
5. Gross debt/CFR indicator				
CFR (Capital Financing Requirement)	77,751	96,262	140,652	171,654
Estimated Gross Debt	93,388	95,300	139,300	169,900
Debt to CFR (%)	120	99	99	99

The debt exceeds the CFR at 31.3.23 as some borrowing for future years has been undertaken. This is in line with the Code.				
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	£10M	£10M	£10M	£10M
8. Upper limit for total principal sums invested for over 364 days	**£50M**	**£50M**	**£50M**	**£50M**
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	
	2023/24	**2024/25**	**2025/26**	**2026/27**
10. Ratio of financing costs to revenue stream	0.87%	1.35%	2.03%	2.42%

**A prudent estimate of external debt, which includes sufficient headroom for unusual cash movements.*

*******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.*

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.