



west midlands
police and crime
commissioner



Agenda Item 10

**JOINT AUDIT COMMITTEE
31 MARCH 2022**

TREASURY MANAGEMENT STRATEGY 2022/23 REPORT

1. PURPOSE OF REPORT

- 1.1 This report sets out the Police and Crime Commissioner's Treasury Strategy Statement for 2022/23 and updates on debt management and investment activity during the financial year 2021/22.
- 1.2 This report updates on recent Treasury Management activity, in line with recommended best practice and the revised CIPFA Code of Practice for Treasury Management.
- 1.3 It is important to note that financial information contained within this report should not be used by any individual or organisation as a basis for making investment or borrowing decisions. The Commissioner and his treasury advisers will not accept any liability on behalf of any individual or organisation who seeks to act on the financial information contained within this report.

2. INTRODUCTION AND BACKGROUND

- 2.1 The Commissioner is legally required to produce an Annual Investment Strategy. Therefore, included is an Investment Strategy as part of the Treasury Strategy Statement shown in **Appendix B**.
- 2.2 In order to protect the Commissioner's position if an individual or organisation were to act upon this advice, it is deemed necessary to produce a disclaimer, which is shown as a note at the head of **Appendix B**.
- 2.3 The Commissioner is responsible for administering a Capital Programme of £174.4m between 2022-23 and 2025-26. As far as possible all surplus revenue money and other reserves are invested on a daily basis until they are required.

2.4 The Commissioner follows the Code of Practice for Treasury Management produced by the Chartered Institute of Public Finance and Accountancy (CIPFA). The Code emphasises the following key points:

- The Commissioner must formally adopt the Code.
- The strategy report will affirm that the effective management and control of risk are prime objectives.
- The Commissioner's appetite for risk must be clearly identified within the strategy report and the priority given to security of capital and liquidity when investing funds and an explanation as to how that will be carried out.
- Responsibility for risk management and control lies within the organisation.
- Credit ratings should be used as a starting point when considering risk but use should also be made of market data and information, the financial media, information on government support for banks and the credit ratings of that government support.
- The Commissioner needs a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits.
- Borrowing in advance of need is only allowed when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.
- There needs to be, at a minimum, a mid-year review of treasury management strategy and performance to highlight any areas of concern that have arisen since the original strategy was approved.
- The Commissioner must delegate the role of scrutiny of treasury management strategy and policies to a specific named body.
- Treasury management performance and policy setting should be subjected to prior scrutiny.
- The Commissioner, and his staff, should be provided with access to relevant training as those charged with governance are also personally responsible for ensuring they have the necessary skills and training.
- Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Commissioner.

2.5 The Commissioner's Treasury Management activity is governed by the following documents:

- 1 Treasury Policy Statement.** This is a statement, defining treasury management and the general approach to it. It emphasises firstly the control of risk and secondly the pursuit of best value as the main factors defining the approach. A copy is attached at **Appendix A**.
- 2 Treasury Management Practices (TMPs) and Schedules to TMPs.** TMPs define the overall approach to various aspects of treasury management, including such things as risk management, performance monitoring and management, segregation of duties and dealing arrangements, cash flow management, money laundering and staff training. The Schedules to TMPs deal with the criteria for selecting third parties (banks and building societies) with whom the Commissioner is prepared to deposit funds. The TMPs and Schedules are reviewed regularly by the Commissioner's CFO and electronic copies are available on request.

3 Annual Treasury Strategy Statement details the expected activities of the treasury function in the financial year 2022-23. A copy is attached at **Appendix B.**

3. DEBT MANAGEMENT ACTIVITY 2021/22

- 3.1 Since April 1986, the Police Authority had been incurring long term debt from the Public Works Loans Board (PWLB) to finance major capital expenditure. All the borrowing was transferred to the Commissioner in November 2012.
- 3.2 Borrowing at the 31 March 2022 is expected to total £101.3m, all at fixed rates and repayable over various periods up to 2072.
- 3.3 The Commissioner has the capacity to undertake variable rate borrowing (up to 20% of the total debt portfolio) should the need arise or to take advantage of favourable rates to fund identified need.
- 3.4 No Loans matured during 2021/22 and one new loan was taken out (£7.5m at 2.07% for 50 years). PWLB rates for 50 years are currently 2.37%. This increased in the early part of 2022 due to an increase in the Bank of England base rate.
- 3.5 The average rate of interest payable on debt is 3.2%. Link Asset Services, the Commissioner’s treasury advisors, continue to advise on debt restructuring to enable the Commissioner to take advantage of opportunities to reduce the overall cost of debt, set in the context of the financial constraints and markets. There were no opportunities for this during 2021/22. Rescheduling of current borrowing in the debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates, even though PWLB rates are at historically low levels.
- 3.6 The table below shows the level of borrowing and the average interest rate payable.

Public Works Loan Board (PWLB) Borrowing

Loan Type	Borrowing £'m		Average Interest Rates %	
	2020/21	2021/22	2020/21	2021/22
Fixed	93.8	101.3	3.29	3.20
Variable	0.0	0.0	0.0	0.0
Total	93.8	101.3*	3.29	3.20

*Not including £0.7m of short-term interest payable as shown in statement of accounts

3.7 Appendix E shows the maturity profile of the Loan portfolio

4. INVESTMENT ACTIVITY 2021/22

- 4.1 Any surplus funds have been invested on a daily basis. The PCC uses an investment benchmark to assess the investment performance of its investment portfolio of Sterling overnight Index average (SONIA).
- 4.2 Interest earned on investments up to the end of March 2022 is predicted to average 0.09%, approximately 1 basis point above the SONIA rate. Although the interest earned

is lined with the benchmark it must be remembered that the primary objective of the PCC's treasury management strategy is security and liquidity so it is these factors that will be pursued ahead of yield.

4.3 The Commissioner approved a list of counter parties with whom investments could be placed for 2021/22. At 21 March 2022, the Commissioner had £95m invested with a range of maturity dates between instant access and two years, and a further £5m with CCLA property fund with no maturity date.

4.4 All of the Commissioner's investments are with UK based entities. The split of these investments is as follows and detailed in Appendix D:

- 50% British Banks/Building Societies,
- 30% Money Market Funds (MMF's)
- 15% Local Authorities,
- 5% CCLA

Since the final recovery, in January 2014, of investments frozen in the Icelandic bank Landsbanki, the Commissioner has held no investments with foreign banks.

4.5 During 2021/22 MMF's were used in full for the first time by the PCC. This will generate approximately £14k of additional income in the 21/22 financial year.

4.6 Based on market information provided by Link Asset Services, the counter party list has been fully reviewed to reflect: current market conditions, credit ratings of sovereign nations, and the impact of Government support for the banking sector. As a consequence, the limits, both financial and duration, have been adjusted for some institutions. The group and individual limits (£65m) for the part government owned institutions (National Westminster Bank, Royal Bank of Scotland) remain the same as in 2021-22. (The NatWest group are the bankers for the PCC and any uninvested funds reside here). During 2021-22 there were a number of times where the cash held in the NatWest account exceeded £65m. This was due to the lack of suitable counterparties to invest in given the low interest rate environment that was present in 2021 which meant that it was uneconomical to invest surplus monies and it was deemed more prudent to keep money residing in the NatWest account.

4.7 Similarly, all Local Authorities are eligible for inclusion on the counter party list because ultimately, they have the support of the national government. However, during 2020/21 it became known that some Local Authorities issued Section 114 notices, effectively stating they cannot balance the budget for the year and placing a freeze on any non-essential spending. (It should be noted that the repayment of investments falls outside the scope of this as it is a legal obligation). As a result of this, additional due diligence is now carried out on any Local Authority investments to ensure that investments are secure and to avoid any adverse publicity.

4.8 If institutions now fall below the set criteria they have been removed from the list and added if they become eligible. A copy of the latest list, which will be kept under review by the Commissioner's CFO, in accordance with the TMP Statements, is attached at **Appendix C**. Details of the criteria are contained within the annual investment strategy in **Appendix B**.

4.9 The day to day work of Treasury Management is carried out in the Finance Department with oversight from the Director of Commercial Services. The Treasury Management Strategy is therefore managed using appropriate delegations and periodic management

reporting to the Director of Commercial Services and the Commissioner's CFO. This will continue for the next financial year.

5 TREASURY STRATEGY STATEMENT 2022/23

5.1 The Treasury Strategy Statement covers the Commissioner's latest capital funding requirements, view of interest rate movements, and strategy for borrowing and investment in the light of that view. As such, it needs to be reviewed annually. The Treasury Strategy Statement for 2022/23 is attached at **Appendix B**.

5.2 Following on from recent Bank of England rate rises (December 21, February 22 and March 22) future interest rate expectations can be found below. These are important for the PCC as these determine the rate at which the PCC can borrow and invest:

Short-term rates.

- The short-term Bank of England base rate is expected to reach 1.25% by December 22.

Long-term rates.

- Very long-term rates (50-year PWLB rate) are 2.37%.
- PWLB is the Government organisation from whom the PCC borrows its money for capital expenditure.

5.3 The Local Government Act 2003 introduced a new system of "prudential borrowing" which allows the Commissioner to set borrowing limits subject to criteria of prudence and affordability. These criteria are set out in more detail in the CIPFA Prudential Code that specifically requires a number of prudential indicators are set. The full range of prudential indicators was considered when the 2022/23 Budget and Precept were agreed in February 2022. This is particularly relevant when set in the context of the overall limitation of planned capital resources and therefore a potential increase in prudential borrowing across the medium-term plan. The proposed indicators that relate to treasury management, including the Estates Strategy, are set out in the Treasury Strategy Statement.

5.4 The Local Government Act 2003 also requires the Commissioner to set out a treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act); this sets out the Commissioner's policies for managing investments and for giving priority to the security and liquidity of those investments.

6. FINANCIAL IMPLICATIONS

6.1 The financial implications of the Treasury Management function are included in the Commissioner's annual budget. The estimated total net cost of capital financing in 2022/23 (including direct charges to revenue) is £5.1m.

7. LEGAL IMPLICATIONS

7.1 These matters are governed by the Local Government Act 2003, which empowers the Commissioner to do anything which is calculated to facilitate or is conducive or incidental to the discharge of their various statutory functions.

7.2 Adoption of the CIPFA Code of Practice on Treasury Management in the Public Services as part of the Commissioner's Standing Orders and Financial Regulations gives it the

status of "a code of practice made or approved by or under any enactment" and hence proper practice under the provisions of the Local Government Act 2003.

- 7.3 The Commissioner's CFO continues to delegate the responsibility for the discharge of Treasury Management on a daily basis to the Director of Commercial Services through the appropriate Finance Department staff.

8. EQUALITY IMPLICATIONS

- 8.1 Any issues of Equality and Diversity that may arise during the undertaking of Treasury Management activities will be noted, considered and reported upon.

9. RECOMMENDATIONS

- 9.1 It is recommended that the Joint Audit Committee:
- a. Note the treasury management activity in 2021-22 set out in paragraphs 3 and 4, and the interest rate observations in paragraph 5.
 - b. Approve the Treasury Strategy Statement for 2022/23 set out in **Appendix B**.
 - c. Approve the criteria for selecting counter parties in **Appendix B** and the current eligible counter parties and their limits as set out in **Appendix C**.
 - d. Continue to include a mid-year review of Treasury Management activity in the Joint Audit Committee's work plan in accordance with the CIPFA Code of Practice for Treasury Management.

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TREASURY POLICY STATEMENT AND TREASURY MANAGEMENT PRACTICES

TREASURY POLICY STATEMENT

1. The Commissioner defines treasury management activities as:
 - the management of cash flows;
 - banking, money market and capital market transactions;
 - the effective control of the risks associated with those activities;
 - the pursuit of optimum performance consistent with those risks.

2. The Commissioner regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Commissioner.

3. The Commissioner acknowledges that effective treasury management will provide support towards the achievement of business and service objectives. It is therefore a commitment to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques within the context of effective risk management.

4. Treasury operations are managed within the overall strategy approved by the Commissioner at the following levels:
 - Formal reviews of strategy and performance by the Commissioner's CFO, Director of Commercial Services, and Assistant Director Finance in conjunction with representatives from the external advisors (Link Asset Services).
 - Monthly monitoring is conducted by the Commissioner's CFO, Director of Commercial Services and Assistant Director Finance.
 - On a daily basis by trained staff under the direction of the Assistant Director Finance.
 - Reports to the Joint Audit Committee and treasury activity.
 - The annual review of the strategy for the Commissioner.

Note:

It is important to note that the Treasury Strategy Statement is adopted by the Commissioner based upon advice from external treasury advisors, and accordingly the Strategy is tailored to meet the specific and unique needs of the Commissioner. All financial information contained within this Report and Statement should not be used by any individual or organisation as a basis for making investment or borrowing decisions. The Commissioner and the treasury advisors will not accept any liability on behalf of any individual or organisation who seeks to act on the financial information contained within this Report and Statement.

TREASURY STRATEGY STATEMENT 2022/23**1.0 INTRODUCTION**

1.1 This Treasury Strategy Statement details the expected activities of the treasury function in the financial year 2022/23. The suggested strategy is based upon views of interest rates as advised by external advisors, supplemented with leading market forecasts. The strategy covers:

- the current portfolio position;
- prudential indicators;
- prospects for interest rates;
- the borrowing requirement & strategy;
- the investment strategy;
- debt rescheduling opportunities; and
- MRP strategy.

2.0 CURRENT PORTFOLIO POSITION

2.1 The Commissioner's estimated portfolio position as at 1st April 2022 will be as follows:

<u>Treasury Investments</u>	
	£m
Maturity less than 1 year	70.0
Maturity between 1 and 5 years	10.0
CCLA	5.0
	85.0
<u>Treasury external borrowing</u>	
-PWLB fixed rate	101.3
- PWLB variable rate	0.0
	101.3
Net Treasury Borrowing	-16.3

2.2 The average rate of interest on the above debt is expected to be 3.20%.

The treasury investments less than 5 years relates to Bank, Building society, Local Authority Investments and Money Market Funds. The £5.0m investment placed with CCLA relates to the property fund and is for at least five years.

3.0 PRUDENTIAL INDICATORS for 2022/23 to 2025/26

- 3.1 The Prudential Code for Capital Finance in Local Authorities (Prudential Code) is applicable to the Police and Crime Commissioner and has been developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) to provide a code of practice to underpin the system of capital finance embodied in Part 1 of the Local Government Act 2003. PCCs, like Local Authorities, are free to determine their own level of capital investment controlled by self-regulation.
- 3.2 The key objectives of the Prudential Code are to ensure that capital investment plans are affordable, prudent and sustainable.
- 3.3 The Prudential Code supports a system of self-regulation that is achieved by the setting and monitoring of a suite of Prudential Indicators that directly relate to each other. The indicators establish parameters within which the PCC should operate to ensure the objectives of the Prudential Code are met.
- 3.4 The Prudential Code introduced requirements for the manner in which capital spending plans are to be considered and approved. It requires the Commissioner to set a number of prudential indicators over a period of three years. The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy:

External debt

These indicators are intended to ensure that levels of external borrowing are affordable, prudent and sustainable. The authorised limit for external debt is a statutory limit (section 3 of the Local Government Act 2003) that should not be breached under any circumstances. The proposed limits set out below have been calculated to take account of the current Commissioner's capital expenditure and financing plans and allowing for the possibility of unusual cash movements. If this limit is likely to be breached, it would be necessary for the Commissioner to determine if it is prudent to raise the limit or to instigate procedures to ensure that such a breach does not occur.

The operational boundary for external debt is a management tool for day to day monitoring and has been calculated with regard to the Commissioner's capital expenditure and financing plans allowing for the most likely, prudent, but not worst-case scenario for cash flow. Temporary breaches of the operational boundary, due to variations in cash flow, will not be regarded as significant.

	2022/23	2023/24	2024/25
	£m	£m	£m
Authorised limit for external debt - Borrowing	125.0	135.0	145.0
Operational boundary - Borrowing	120.0	130.0	140.0

The Commissioner's actual external debt as at 31/03/22 is currently expected to be £101.3m, excluding transferred debt managed by Dudley M.B.C.

CIPFA Code of Practice for Treasury Management in the Public Services

The Commissioner continues to adopt the CIPFA Code of Practice for Treasury Management in the Public Services first adopted by the Police Authority in March 2002.

Interest rate exposures

These indicators allow the Commissioner to manage the extent to which he is exposed to changes in interest rates. The upper limit for fixed interest reflects the fact that it is possible to construct a prudent treasury strategy on the basis of using only fixed rate debt and investments, so long as the maturity dates of these debts and investments are reasonably spread. The same does not apply to variable rates where a 100% exposure could lead to significant year on year fluctuations in the cost of debt. The upper limit for variable rate exposure allows for the use of variable rate debt to offset the exposure to changes in short-term rates on the portfolio of investments. This limit reduces over time as the strategy is to gradually reduce the level of investments.

	2021/22 %	2022/23 %	2023/24 %
Upper limit for fixed interest rate exposure Net principal fixed rate borrowing / investments	100	100	100
Upper limit for variable rate exposure Net principal variable rate borrowing / investments	20	20	20

Maturity structure of borrowing and Investments longer than 364 days

The purpose of the prudential limits for principal sums invested for periods longer than 364 days is for the Commissioner to contain his exposure to the possibility of loss that might arise as a result of having to seek early repayment of principal sums invested. The maturity structure of fixed rate borrowing is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

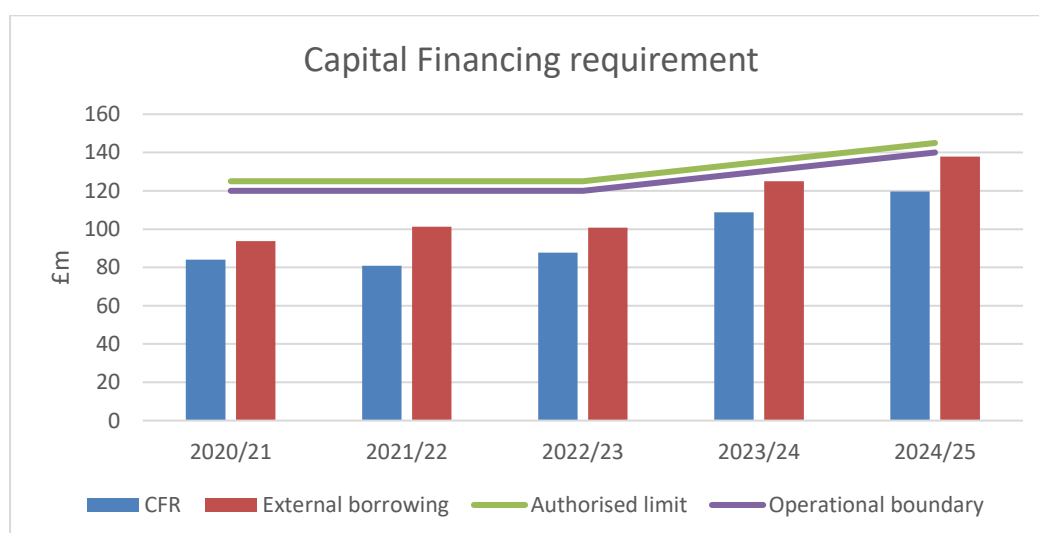
Upper limit of principal invested for periods over 364 days	£40m
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Maturity structure of fixed rate borrowing	Upper limit %	Lower limit %
Under 12 months	25	0
12 months and within 24 months	25	0
24 months and within 5 years	50	0
5 years and within 10 years	75	0
10 years and above	100	25

3.5 In considering the capital programme for 2022/23, the anticipated future borrowing requirements were considered in the context of overall capital resources and the impact on the revenue budget.

	31 March 2021 £'m	31 March 2022 £'m	31 March 2023 £'m	31 March 2024 £'m	31 March 2025 £'m
<i>Capital Financing Requirements</i>	84.1	80.8	87.4	108.8	119.6
Existing borrowing	93.8	93.8	101.3	100.8	125.0
Repayments	0.0	0.0	-3.0	-0.8	-2.2
New Borrowing	0.0	7.5	2.5	25.0	15.0
Net External borrowing	93.8	101.3	100.8	125.0	137.8

3.6 The CFR is the historic underlying need to borrow for capital expenditure net of all capital receipts, grant, revenue contributions etc. The CFR increases when unfinanced expenditure is incurred and reduces when provision is made to repay that debt (through MRP).



3.7 External Borrowing is used to finance capital expenditure in land and buildings. Therefore, although there is an increased liability on the balance sheet this is offset by an increase in the value of assets to be utilised by the commissioner.

3.8 The PCC is currently in a 'overborrowed position'. This is likely to continue to occur for the foreseeable future. There are a number of reasons why the PCC is in an 'overborrowed' position but among them is the meaningful levels of Minimum Revenue Provision (MRP) that have been applied on recent years. In essence this is a natural position to be in if new external debt is not required (or it not cost effective to repay debt early- see 3.9), as an annual provision is made to set aside cash in advance of loans maturing. If loans are not due for maturity for some time then all other things being equal the CFR will reduce as historic borrowing is depreciated through the MRP charge.

3.9 The table above shows how the CFR is expected to change over the period of the MTFP. Although the level of actual debt exceeds the Capital Financing Requirement it is currently prohibitively expensive to prematurely repay existing debt. If there are cost-effective opportunities to avoid, or reduce, an overborrowed position they will be considered as long as they are in the best long-term financial interests of the PCC.

4.0 PROSPECTS FOR INTEREST RATES

4.1 The prospect for interest rates is important for the PCC to understand as it can affect the interest rate earned on investments and the rate at which it can borrow money for capital purposes.

4.2 The Commissioner continues to use Link Asset Services (LAS) as a treasury advisor and has made use of their services in formulating a view on interest rates. LAS has in turn drawn upon the work of a number of City economic forecasters. Having discussed these, the following view of the prospects for interest rates over the next twelve months and beyond has been derived:

4.3 Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its December 2021 meeting and a further rise of 0.25% in February 22 and March 22 to bring the current rate to 0.75% (as at March 22)

4.4 LINK group have provided the following interest rate forecasts:

Interest Rate Forecasts								
Bank Rate	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Link	0.75%	1.00%	1.00%	1.25%	1.25%	1.25%	1.25%	1.25%
Cap Econ	0.75%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5Y PWLB RATE								
Link	2.20%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%
Cap Econ	2.30%	2.30%	2.40%	2.50%	2.70%	2.80%	2.90%	3.00%
10Y PWLB RATE								
Link	2.30%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%
Cap Econ	2.40%	2.50%	2.50%	2.60%	2.70%	2.80%	3.00%	3.10%
25Y PWLB RATE								
Link	2.40%	2.50%	2.50%	2.60%	2.60%	2.60%	2.60%	2.60%
Cap Econ	2.60%	2.60%	2.60%	2.60%	2.80%	2.90%	3.00%	3.10%
50Y PWLB RATE								
Link	2.20%	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.40%
Cap Econ	2.40%	2.50%	2.60%	2.60%	2.80%	2.90%	3.00%	3.10%

4.5 Significant risk to the forecasts:

- **War escalation** – Increased sanctions on Russia leading to inflation pressures
- **Coronavirus mutations** – leading to further lockdowns
- **Labour and Supply shortages**
- **The Monetary Policy Committee** acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- **The Monetary Policy Committee** tightens monetary policy too late to ward off building inflationary pressures.

- **The Government** acts too quickly to cut expenditure to balance the national budget.
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **Major stock markets** e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the “moral hazard” risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- **Geopolitical risks**, for example in Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

4.6 The balance of risks to the UK economy:

The overall balance of risks to economic growth in the UK is now to the downside, including risks from Covid and its variants and the conflict in Ukraine/Russia - both domestically and their potential effects worldwide.

4.7 It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC’s 2% target after the spike up to around 8%. The forecast includes two increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- The current conflict in Ukraine and the subsequent sanctions on Russia is resulting in rising prices of Oil and commodities which is already impacting the UK.
- Current key supply shortages could spill over into causing economic activity in some sectors to take a significant hit.
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- However, counter to this is the fact that consumers are sitting on over £160bn of excess savings left over from the pandemic and it is unknown when will they spend this sum, in part or in total.
- It looks as if the economy coped well with the end of furlough on 30th September 2021. It is estimated that there were around 1 million people who came off furlough then and

there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.

- There is also the possibility of surprises on the Covid front beyond the Omicron mutation.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, LINK expect to have to revise their forecasts again - in line with news headlines.

4.8 The overall Treasury Management strategy will be based on the projections above. However, the Commissioner will maintain flexibility to take account of unexpected variations from the forecast.

4.9 As a result of the above interest rate forecast, investment returns are expected to improve in 2022/23. However, the cost of borrowing is also likely to increase and given the requirement to borrow for the Capital Programme the interest repayable cost for the PCC is likely to increase.

5.0 ANNUAL INVESTMENT STRATEGY

5.1 The Commissioner's investment activities have regard to guidance issued by the Government and CIPFA.

5.2 In making investment decisions, the Commissioner's investment priorities will be security first (capital preservation), liquidity second and then yield (return). Pursuit of the best possible return on investments will only be allowed to the extent that this is consistent with very low levels of risk in terms of security and liquidity.

5.3 In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Commissioner will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as a wider range of options.

5.4 The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Commissioner will not engage in such activity.

5.5 The Commissioner will make use of both specified investments and non-specified investments. Specified investments are those that satisfy the following conditions:

- a) The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.
- b) The Commissioner requires that the investment be repaid or redeemed within 12 months of the date on which the investment was made.

- c) The investment does not involve the acquisition of share capital or loan capital in any corporate body.
- d) The investment satisfies any of the following conditions:

The investment is made with the UK government (Debt Management Agency Deposit Facility), a local authority, a parish council or a community council.

The investment is made with a body which has been awarded a “high credit rating” by a credit rating agency.

- If the body is not a UK bank, the sovereign country must be awarded a “high credit rating” by a credit rating agency.

For the purposes of this strategy, use is made of the creditworthiness service provided by Link Asset Services to define a “high credit rating”

- UK banks and building societies – short-term rating F1 or higher and viability rating of “a-” or higher.
- Foreign banks – short-term rating F1+, and a viability rating of a minimum of “a” with a sovereign rating of AAA.
- Money market Funds (MMF’s) – Any AAA rated fund

These will be supported by other accredited rating systems (Standard & Poor’s and Moody’s), credit watches and outlooks, Credit Default Swap data, and information from the financial press. A full list of the credit ratings to be used can be found in **Appendix C**.

- 5.6 Since the credit crisis, there are some semi-nationalised banks in the UK with credit ratings which do not conform to the credit criteria usually used to identify banks which are of high credit worthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for the rating agencies to assign them an individual rating for their standalone financial strength. However, these institutions are now recipients of at least an F2 short term rating (effectively taking on the creditworthiness of the Government). That is deposits made with them are effectively being made to the Government. This relates to National Westminster Bank and Royal Bank of Scotland.
- 5.7 The Commissioner’s CFO will monitor credit ratings through the receipt of credit rating bulletins from the treasury management consultants at Link Asset Services. Institutions that cease to meet the criteria above will immediately cease to be treated as specified investments.
- 5.8 Non-specified investments are those that do not meet the criteria in 5.4 to 5.6 above. In determining which categories of non-specified investments may prudently be used, account will be taken of advice from the advisors, Link Asset Services, and, if investments are for 12 months or more, long-term credit ratings will be utilised as determined by Fitch IBCA.
- 5.9 So far, the following categories of investment have been identified as prudent for use for non-specified investments. The table also shows the maximum value of investments that may be held:

Category of investment	Maximum value for this category of investments
Sterling deposits in excess of 364 days with Local Authorities and UK banks (where these are not "specified investments" as defined above).	£40m
Property Funds based in the UK	£5m

- 5.10 Property funds provide investors with long term income and potential long-term capital appreciation. These types of funds are actively managed in a diversified portfolio of commercial property
- 5.11 In determining the maximum period for which investments may be held, regard to the most recent cash flow forecast will be taken. No investment will be entered into where the cash-flow forecast indicates that, as a result of that investment, the Commissioner would be forced to borrow money in a future year that would not otherwise have had to be borrowed.
- 5.12 Also at the time of making a new investment, long-term investments (investments of one year's duration or more) should not constitute more than 30% of the total pool of investments.
- 5.13 Investments with a single institution should not exceed 25% (15% for Building Societies) of the total pool of investments at month end. Investments with a group of banks should not exceed 30% of the total pool of investments at month end.
- 5.14 There is currently no impact expected on investment or borrowing strategies as a result of United Kingdom leaving the European Union

6.0 CAPITAL BORROWING REQUIREMENT & STRATEGY

- 6.1 The Commissioner's CFO has undertaken a review of capital investment requirements and likely resource levels. Although there is some uncertainty around specific requirements and future funding levels, it is certain that there will be a need to borrow further to fund the Estates Strategy over the life of the Capital Programme.
- 6.2 The next financial year is expected to see a continuation of the relatively low bank rate which may present an opportunity to review the Commissioner's external borrowing strategy. If investments exceed the borrowing requirement over the next year, and cash can be accessed from maturing investments, consideration needs to be given to the potential of internal borrowing.
- 6.3 As long-term borrowing rates are expected to be higher than rates on the loss of investment income, and look likely to be so going forward, it may be preferable to borrow sooner rather later to avoid higher interest costs.
- 6.4 The Commissioner's CFO will continue to cautiously monitor the interest rate market and adopt a pragmatic approach to any changing circumstances such as the evolving Estates Strategy or deployment of new technology.

- 6.5 The Commissioner may choose to forward borrow and lock in lower interest rates if the opportunity presents itself. This will involve committing to borrow an amount of money at a date in the future at a designated rate. The Commissioner will then be committed to take on the borrowing even if the requirement to borrow is no longer present or the prevailing interest rate drops.

7.0 DEBT RESCHEDULING AND PREMATURE REPAYMENT OPPORTUNITIES

- 7.1 The introduction of different PWLB rates on 1 November 2007 for new borrowing as opposed to early repayment of debt, and the setting of a spread between the two rates (of about 40 – 50 basis points for the longest period loans narrowing down to 25 – 30 basis points for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive.
- 7.2 Due to short term borrowing rates expected to be considerably cheaper than longer term rates, there may be opportunities to generate savings by switching from long term debt to short term debt. These savings will need to be considered in the light of their short-term nature and the cost of refinancing short-term loans as they mature. Any rescheduling and repayment of debt is likely to cause a rebalancing of the Commissioner's debt maturities towards a flatter maturity profile because in the past there has been a concentration on longer dated PWLB loans.
- 7.3 The potential for making savings by reducing investment balances by repaying debt prematurely will be considered as short-term rates on investments will be lower than rates paid on currently held debt. However, this will need careful consideration in the light of premiums that may be due on early debt repayment. It is therefore unlikely that this will be economically attractive.

8.0 MINIMUM REVENUE PROVISION STRATEGY

- 8.1 Capital expenditure is expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, and equipment. Occasionally the Commissioner has to borrow to fund this expenditure. The loans taken out for this purpose are fully repayable at a future point in time (they are paid off at maturity and not in instalments). The concept of Minimum Revenue Provision was introduced to prescribe a minimum amount which must be charged to the revenue account each year in order to make provision to meet the cost of that borrowing.
- 8.2 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 which came into force on 31 March 2008 states that an annual MRP statement needs to be produced which details the methodology for the charge to revenue for debt redemption. The Regulations require that the Commissioner "shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent".
- 8.3 Methods of making prudent provision for MRP include four options. Options 1 and 2 should only be used in relation to Capital expenditure incurred before 1 April 2008 and Capital expenditure incurred on or after that date which the Commissioner is satisfied forms part of Supported Capital Expenditure. For all unsupported borrowing covered by the Prudential Code on or after 1 April 2008, Options 3 or 4 must be used.
- 8.4 The MRP options are:

- **Option 1 – Regulatory Method.** MRP is equal to the amount determined in accordance with the former sections 28 and 29 of the 2003 Regulations as if they had not been revoked.
- **Option 2 – Capital Financing Requirement Method.** MRP is equal to 4% of the Capital Financing Requirement at the end of the previous year.
- **Option 3 – Asset Life Method.** Revenue provision is spread over the determined useful life of the Asset either in equal instalments or using an annuity method. The first charge can be delayed until the asset is operational. (Typically, 40 years)
- **Option 4 – Depreciation Method.** MRP is equal to the provision required in accordance with depreciation accounting in respect of the asset.

8.5 Historically option 2 has been used for Capital expenditure incurred before 1 April 2008. For all subsequent Capital expenditure financed by borrowing, the equal instalment method of Option 3 has been used.

8.6 It is proposed that the basis for the MRP charge for the pre-2008 borrowing is changed to 40 years (option 3). The rationale for this is that it is more reflective of the useful life of our assets. A report from the asset register indicates that the average asset life is 45 years. This gives the PCC a rationale on which to base the revised calculation.

8.7 This change in methodology will result in a budget saving of approximately £350k in 2022/23 (all other things being equal) and will mean the MRP charge is written down to nil earlier than in option 2.

9.0 **2021 Changes to the Treasury Management Codes and Prudential Code-Changes which will impact of future Treasury Management Strategies**

9.1 CIPFA published the revised codes on 20th December 2021 and has stated that implementation of the Prudential Code is not required until the 2023/24 financial year. There is no implementation date specified for the Treasury Management Code. The PCC has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to the PCC for approval.

9.2 The revised Treasury Management Code requires all investments and investment income to be attributed to one of the following three purposes: -
 - Treasury Management
 - Service Delivery
 - Commercial return

9.3 The revised Treasury Management code will require an authority to implement the following: *adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a minimum of ten years, with material differences between the liability benchmark and actual loans to be explained;*

- long term treasury investments, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case;

- pooled funds are to be included in the indicator for principal sums maturing in years beyond the initial budget year;
- amendment to the knowledge and skills register for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;
- reporting to members is to be done quarterly, to include prudential indicators.
- environmental, social and governance (ESG) issues to be addressed within an authority's treasury management policies and practices (TMP1). (*This area is under further development by CIPFA.*)

9.4 There are also a number of requirements from the prudential code relating to commercial investments. However, it is anticipated that the PCC will not be participating in any commercial investments in the near future.

9.5 The Joint Audit Committee will be updated on how all these changes will impact our current approach and any changes required will be incorporated into, and formally adopted, within the 2023/24 Treasury Management Strategy Statement report.

APPENDIX C

EXTERNAL INVESTMENTS - APPROVED COUNTERPARTY LIST 2022/23

BRITISH BANKS & SUBSIDIARIES	FITCH RATING		LIMIT £m	GROUP LIMIT	PERIOD
	L/T	S/T			
Lloyds Banking Group				30	6mth
Lloyds Bank	A+	F1	30		6mth
RBS Group				65	6mth
National Westminster	A+	F1	65		6 mth
Royal Bank of Scotland	A+	F1	65		6 mth
HSBC	A+	F1+	30		1 year
Santander UK plc	A+	F1	30		6mth
Standard Chartered Bank	A+	F1	30		6mth
Barclays	A+	F1	30		6mth
Goldman Sachs	A+	F1	30		6mth
Handelsbanken Plc	A+	F1+	30		1 year
National Bank of Kuwait	A+	F1	30		6mth
Bank of England (DMADF)			100		1 year +

BUILDING SOCIETIES	FITCH RATING		LIMIT £m	PERIOD
	L/T	S/T		
Nationwide	A	F1	30	6mth
Leeds	A-	F1	30	100 days
Skipton	A-	F1	30	6mth
Yorkshire	A-	F1	30	100 days
Coventry	A-	F1	30	6mth

FOREIGN COUNTRIES	NATIONAL RATING	LIMIT	
		£m	PERIOD
Australia	AAA	20	3mth
Denmark	AAA	20	3mth
Germany	AAA	20	3mth
Netherlands	AAA	20	3mth
Singapore	AAA	20	3mth
Sweden	AAA	20	3mth
Switzerland	AAA	20	3mth
USA	AAA	20	3mth

Investments with foreign banks will only be made if they are in Sterling and it is economically attractive to do so. The minimal national credit rating for the country and bank must then be AAA.

LOCAL AUTHORITIES	LIMIT for each LA £000	PERIOD
All Local Authorities**	30	1 year+

** Local authorities may be subject to lower limits throughout the year if they are deemed to be under severe financial stress.

Money Market funds		LIMIT £000	PERIOD
All	AAA	30	<1 year

Long Term Ratings AAA to DDD the best quality to junk bonds

Short Term Ratings F1+ to F3 the safest to the riskier

Local Authorities are assumed to have the same ratings as UK Government.

APPENDIX D

INVESTMENTS AS AT 21/03/22

Maturity	Borrower	Principal £	Rate %	Type
25-Mar-22	Wokingham BC	5,000,000	1.45	Local Authority
25-Mar-22	National Bank of Kuwait	10,000,000	0.2	Bank
25-Mar-22	National Bank of Kuwait	10,000,000	0.2	Bank
07-Apr-22	Coventry BS	10,000,000	0.37	Building Society
19-Apr-22	National Bank of Kuwait	10,000,000	0.33	Bank
16-Jun-22	Goldman Sachs	10,000,000	0.42	Bank
07-Jul-23	Dudley MBC	10,000,000	1.70	Local Authority
	Total	65,000,000		
Instant	Money market Fund CCLA	30,000,000	variable	CCLA/Bank
5 to 10 years	CCLA	5,000,000	variable	Property Fund

Loan maturity profile

Maturity Date	Loan amount	Interest rate	Annual int. payable
31/03/2023	580,000	6.125%	35,525.00
31/03/2023	2,420,000	6.125%	148,225.00
15/10/2023	800,000	6.625%	53,000.00
15/10/2024	2,200,000	6.625%	145,750.00
15/10/2025	2,000,000	6.625%	132,500.00
23/01/2051	15,000,000	3.700%	555,000.00
15/06/2056	5,587,000	4.450%	248,621.50
01/03/2057	8,200,000	4.350%	356,700.00
15/08/2058	5,000,000	4.390%	219,500.00
01/09/2061	2,000,000	4.875%	97,500.00
07/12/2068	10,000,000	2.640%	264,000.00
10/12/2068	10,000,000	2.540%	254,000.00
12/02/2069	5,000,000	2.370%	118,500.00
28/03/2069	10,000,000	2.160%	216,000.00
08/10/2069	15,000,000	1.630%	244,500.00
14/03/2072	7,500,000	2.070%	170,250.00
	<u>101,287,000</u>		<u>3,259,571.50</u>