PCC
POLICE AND CRIME COMMISSIONER FOR ESSEX

Approved by:	Classification of paper:
Debbie Martin Chief Finance Officer to the Chief Constable	Not Protectively Marked

Report to PCC	**Report reference number** PCC/030/14
Date of decision **Date of report** 31 March 2014	**Area of county / Stakeholders affected** Forcewide
Title of report Treasury Management Strategy 2014/15	
Report by Alistair Greer, Corporate Accounting Manager	
Enquiries to Charles Garbett, Treasurer	

1. **Purpose of Report**

1.1 To seek of approval for the proposed Treasury Management Strategy for 2014/15

2. **Recommendations**

2.1 The PCC is recommended to:

(i) Approve the proposed Treasury Management Strategy for 2014/15

(ii) Note the Capital Prudential Indicators for 2014/15

(iii) Approve the Minimum Revenue Provision policy for 2014/15

(iv) Note the post Stage 2 Treasury Management arrangements

3. **Benefits of Proposal**

3.1 The proposed Treasury Management Strategy provides a framework for the effective management of the PCC's cash balances.

4. **Background**

4.1 This report sets out a proposed Treasury Management Strategy for 2014/15. This topic is subject to statute and recommended professional guidance, and a number of technical terms are commonly used. This report seeks to avoid jargon but, where required, these technial terms are explained fully.

4.2 The report fulfils the PCC's legal obligation under the Local Government Act 2003 to have regard to:

a) The Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition, which requires the PCC to approve a treasury management strategy before the start of each financial year

b) The Department for Communities and Local Government's revised Guidance on Local PCC Investments, issued in March 2010, which requires the PCC to approve an investment strategy before the start of each financial year.

5. **Wider Economic Context**

5.1 A commentary on the wider economic context, provided by the PCC's treasury advisors Arlingclose, is set out in Appendix A.

5.2 Arlingclose's forecast for the Bank of England base rate is for this to remain flat until the second quarter of 2016.

6. **Local Context**

6.1 The PCC is forecast to have £36.5m of investments and nil external borrowing at 31 March 2014. Forecast changes in these sums are shown in the balance sheet analysis in the table on the following page.

	31.3.13 Actual	31.3.14 Estimate	31.3.15 Estimate	31.3.16 Estimate	31.3.17 Estimate
	£m	£m	£m	£m	£m
Capital Financing Requirement	9.6	9.1	8.1	7.1	6.1
Less: External borrowing	0	0	0	0	0
Internal borrowing	**9.6**	**9.1**	**8.1**	**7.1**	**6.1**
Less: Usable reserves	-36.1	-39.3	-25.7	-20.4	-16.2
Less: Net Creditors	-2.3	-6.3	-6.3	-6.3	-5.8
Investments	**28.8**	**36.5**	**23.9**	**19.6**	**15.9**

7. Borrowing Strategy

7.1 The PCC inherited no external borrowing from the former Essex Police Authority, whose policy was to minimise interest costs by using its own cash balances (where it had Government "credit approval") to fund capital payments. This approach has been described as "internal borrowing".

7.2 The forecast reduction in internal borrowing is shown in the above table. At this stage of the planning period, it is assumed that there will be no additional borrowing over the four year period.

8. Investment Strategy

8.1 Both the CIPFA Code and the CLG Guidance require the PCC to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return or yield. The PCC's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk receiving unsuitably low investment income.

8.2 For 2014/15 The PCC may invest its surplus funds with any of the counterparties in the table below, subject to the cash and time limits shown in the table on the following page:

Counterparty	Cash limit	Duration
UK banks whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is A-	£10m each	1 year
UK Central Government (irrespective of credit rating)	unlimited	1 year
UK Local Authorities (irrespective of credit rating)	£10m each	1 year
UK building societies who have credit ratings from at least two of the three main credit ratings agencies (Fitch, Moody's and Standard & Poor) and whose lowest published long-term credit rating from is A-	£10m each	1 year

8.3 **Country limits:** investments will continue to be restricted to UK financial institutions. This limit will be reviewed after six months.

8.4 **UK Financial Institutions:** These are defined as:

i) Those that have no foreign parent bank, e.g. Barclays

ii) Those that are 100% owned by a UK bank, e.g. National Westminster, which is fully owned by Royal Bank of Scotland

iii) UK banks, and their formally guaranteed subsidiaries, that are owned by foreign parent banks, provided that the UK banks meet the following criteria:

a) they are registered in the UK as companies in their own right
b) they operate under a banking licence issued by the Bank of England
c) they are regulated by the Financial Conduct Authority

8.5 **Building Societies:** In previous years the PCC has not invested with Building Societies that do not have credit ratings. This approach will continue in 2014/15 but will be reviewed after six months. The PCC notes the building societies' regulatory framework and insolvency regime where the PCC's deposits would be paid out in preference to retail depositors and at the half year review will consider investing with unrated building societies where credit analysis carried out by Arlingclose shows them to be suitably creditworthy.

Other Information on the Security of Investments:

8.6 The PCC understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

8.7 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the PCC will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions.

8.8 If these restrictions mean that insufficient financial institutions of high credit quality are available to invest the PCC's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified Investments

8.9 The CLG Guidance defines specified investments as those:

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

8.10 The PCC defines "high credit quality" organisations as those having a credit rating of [A-] or higher that are domiciled in the UK.

Non-specified Investments

8.11 Any investment not meeting the definition of a specified investment is classed as non-specified. One of their characteristics is that the duration is for over one year, which is in excess of the investment limits. The PCC will therefore not use non-specified investments during 2014/15.

Approved Instruments

8.12 The PCC may lend or invest money using any of the following instruments:

- interest-bearing bank accounts,
- fixed term deposits and loans,
- certificates of deposit,

- bonds, notes, bills, commercial paper and other marketable instruments

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

Liquidity management:

8.14 The PCC uses a comprehensive cash flow model to forecast its cash flow and to determine the maximum period for which funds may prudently be committed.

9. Treasury Management Indicators

9.1 The PCC is recommended to agree the following treasury indicators. The purpose of these is to limit treasury risks and provide a control and performance framework for treasury activities.

9.2 **Interest Rate Exposures**: This indicator is set to control the PCC's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as a proportion of interest receivable will be:

	2014/15	**2015/16**	**2016/17**
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	100%	100%	100%

9.3 **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the PCC's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2014/15	**2015/16**	**2016/17**
Limit on principal invested beyond year end	£0m	£0m	£0m

9.4 **Operational Boundary**
This term refers to a limit on total debt, which the PCC would not normally expect to exceed. Currently, this equates to the level of internal borrowing inherited from the former Police Authority, which is being repaid at £0.5m pa.

	2013/14 Estimate £m	**2014/15 Estimate** £m	**2015/16 Estimate** £m	**2016/17 Estimate** £m
Borrowing ("internal")	9.1	8.1	7.1	6.1
Other long term liabilities	0.0	0.0	0.0	0.0
Total	**9.1**	**8.1**	**7.1**	**6.1**

9.5 **Authorised Limit for External Borrowing**
This is the limit that the PCC is required to set for total external borrowing, including short-term borrowing. Once set for the year, it cannot be exceeded, as determined in section 3 (1) of the Local Government Act 2003. It is recommended that the PCC allows some leeway of, say, £2m to allow for any unexpected short term borrowing requirements that may arise during 2014/15 and the following two years:-

	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Borrowing ("internal")	9.1	8.1	7.1	6.1
Short term external borrowing	0.0	2.0	2.0	2.0
Other long term liabilities	0.0	0.0	0.0	0.0
Total	**9.1**	**10.1**	**9.1**	**8.1**

<u>**Other Items**</u>

9.6 There are a number of additional items that the PCC is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

9.7 **Policy on Use of Financial Derivatives:** A financial derivative is a financial contract which derives its value from the performance of another entity such as an asset, index, or interest rate.

These can be distinguished between:

a) Standalone financial derivatives, i.e. those that are not embedded into a loan or investment, e.g. such as swaps, forwards, futures and options. In the absence of a legal power, the PCC will not use standalone derivatives

b) Embedded derivatives, e.g. forward investments and callable deposits. These may be used, but within the normal parameters of risk management

9.8 **Investment Training:** The needs of the PCC's treasury management staff for training in investment management are assessed as part of the annual staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

9.9 **Investment Advisers:** The PCC has appointed Arlingclose as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled by periodic comparison of the service delivered against the requirements set out in the contract specification.

9.10 **Investment of Money Borrowed in Advance of Need**: Should the PCC decide to borrow in the future, it will not borrow more than or in advance of needs in order to profit from the investment. Any decision to borrow in advance will be within the approved Capital Financing Requirement estimates and will be considered carefully to ensure that this represents the best long term value for money.

Since amounts borrowed will be invested until spent, the PCC is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the PCC's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £10.1m during 2014/15.

10. Capital Prudential Indicators

10.1 The following capital prudential indicators reflect decisions taken as part of the budget setting process and are reported here for noting.

10.2 The first capital prudential Indicator is a summary of the PCC's capital expenditure plans:-

	2012/13 Actual £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Total	7.8	6.2	12.3	12.5	6.8

10.3 The second capital prudential indicator is the PCC's Capital Financing Requirement, which shows the following projections.

	2012/13 Actual £m	2013/14 Estimate £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m
Capital Fin Req (CFR)	9.6	9.1	8.1	7.1	6.1
Movement in CFR		(0.5)	(1.0)	(1.0)	(1.0)

10.4 The third indicator identifies the trend in the cost of capital (borrowing and other long term costs, net of investment income) against total net revenue.

	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
%	0.19%	0.11%	0.28%	0.28%	0.28%

10.5 The fourth indicator shows the incremental impact of capital investment decisions on the PCC's Band D Council Tax.

	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2014/15 Estimate	2015/16 Estimate
£	£0.51	£0.31	£0.07	£0.19	£0.31

11. Minimum Revenue Provision (MRP) Policy Statement

11.1 The PCC is required to pay off an element of the CFR through the MRP and through additional voluntary payments if required. CLG Regulations require the PCC to approve an MRP Statement in advance of each financial year. A variety of options are available, so long as there is prudent provision.

11.2 The PCC is recommended to approve a policy that provides for an MRP of 4% of CFR at the end of 2012/13. (Option 2 under CLG Regulations).

11.3 As the PCC currently has internal debt, it is necessary to use the MRP as the means to write down the debt over time. In the past this has been done by calculating the provision as 4% of the outstanding sum and making additional voluntary revenue provisions, so that the combined contribution matches the budget provision of £1m.

11.4 It is proposed that this approach is formally adopted for 2014/15, which will formalise decisions taken as part of the 2014/15 budget setting process.

12. Post Stage 2 Treasury Management Arrangements

12.1 Under Stage 1, and in previous years, the day-to-day treasury management activity has been carried by the Essex Police Corporate Finance Department.

12.2 There will need to be changes to the treasury management arrangements post Stage 2 The Police Reform & Social Responsibility Act 2011 stipulates that the Chief Constable cannot borrow monies. The PCC must approve all treasury management transactions, including investment and borrowing.

12.3 The approval to enter into treasury management transactions will be delegated to the Treasurer under the Scheme of Delegation.

13.0 Police and Crime Plan

Not applicable

14.0 Police Operational Implications

Not applicable

15.0 Financial Implications

Fully covered within the main body of this report.

16.0 Legal and Contractual Implications

16.1 Approval of the Treasury Management Strategy satisfies the requirements of the Local Government Act 2003, CIPFA Prudential Code, CLG MRP Guidance, CIPFA Treasury Management Code & CLG Investment Guidance. The post Stage 2 treasury management arrangements satisfies the requirements of the Police Reform & Social Responsibility Act 2011.

17.0 Staffing and Other Resource Implications

Not applicable

18.0 Equality and Diversity Implications

Not applicable

19.0 Background Papers

None

Appendix A

Wider Economic Context

Economic background: The Bank of England's Monetary Policy Committee (MPC) through its recent forward guidance is committed to keeping policy rates low for an extended period using the Labour Force Survey unemployment rate of 7% as a threshold for when it would consider whether or not to raise interest rates, subject to certain knock-outs. Unemployment was 7.1% in November 2013 and has fallen much faster than expected but has not led to any wage growth and productivity remains stagnant.

The flow of credit to households and businesses is slowly improving but is still below pre-crisis levels. Inflation has fallen faster than expected and currently sits at the MPC's 2% target, this will allow real wage increases (i.e. after inflation) to slowly turn positive and aid consumer spending.

Stronger GDP data showed the economy expanded 1.9% over 2013. There is clear momentum in the economy and although some weakness remains in some components of growth, most notably business investment, the Bank of England's most recent Credit Conditions Survey indicates that whilst demand for credit from small business remained flat, for medium sized companies it grew significantly. The supply of credit to corporate also increased significantly in Q4 2013.

Arlingclose forecasts the first rise in official interest rates in Q2 2016 and another in Q4 2016 but their long-held theme of low for even longer remains unchanged. The above indicators alongside business investment remain the key to modestly higher interest rates. Without them official interest rates will remain unchanged and the Governor of the Bank of England has already signalled that Forward Guidance is being reviewed.

Credit outlook: The credit risk of banking failures has diminished, but not dissipated altogether. Regulatory changes are afoot in the UK, US and Europe to move away from the bank bail-outs of previous years to bank resolution regimes in which shareholders, bond holders and unsecured creditors are 'bailed in' to participate in any recovery process.

This is already manifest in relation to holders of subordinated debt issued by the Co-op which will suffer a haircut on its conversion bail-in to alternative securities and/or equity There are also proposals for EU regulatory reforms to Money Market Funds which will, in all probability, result in these funds moving to a VNAV (variable net asset value) basis and losing their 'triple-A' credit rating wrapper.

Diversification of investments between creditworthy counterparties to mitigate bail-in risk will become even more important in the light of these developments.

Interest rate forecast: Arlingclose's forecast is for the Bank Rate to remain flat until late 2016, the risk to the upside (i.e. rates being higher) are weighted more heavily towards the end of the forecast horizon, as the table below shows. Gilt yields are expected to rise over the forecast period with medium and long-dated gilts expected to rise by between 0.7% and 1.1%.

Report Approval

The report will be signed off by the Chief Executive and CFO and the PCC Solicitor where legal implications arise.

Chief Executive/M.O ……………………………

Chief Financial Officer ……………………………

PCC Legal Advisor ……………………………… (as necessary)

Decision

I agree the recommendations to this report

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PCC/~~Deputy PCC~~

I do not agree the recommendations to this report because

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PCC/Deputy PCC

Publication

Reasons for non-publication *(state 'None' if applicable)*

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Signed/Print name

Report for publication **YES** ☐

NO ☐

If the report is not for publication, the Chief Executive will decide if and how the public can be informed of the decision.