PFCC
POLICE, FIRE AND CRIME COMMISSIONER FOR ESSEX

PFCC Decision Report

Please ensure all sections below are completed

Report reference number: PFCC/051/18 **Classification** Not protectively marked
Title of report: Treasury Management Strategy 2018/19
Area of County/Stakeholders affected: Countywide
Report by : Abbey Gough **Date of report:6th April 2018** **Enquiries to: Abbey Gough**

1. Purpose of report

1.1 To approve the Treasury Management Strategy (TMS) for 2018/19, this provides a framework for the effective management of the PCC's cash balances and related investments and borrowing. The strategy concentrate on 2018/19 but also considers treasury management for future years in the context of the major planned investment programme.

1.2 The strategy was presented to the PFCC at the Performance and Resources Board held on the 2nd February 2018.

2. Recommendations

2.1 To approve the Treasury Management Strategy 2018/19 attached incorporating a borrowing strategy, investment strategy, treasury management indicators, a minimum revenue provision policy and flexible capital receipts strategy.

3. Benefits of Proposal

3.1 The strategy provides a framework for the effective management of the PFCC's cash balances, related investments and borrowings. The strategy also ensures that cash is available when needed to meet payments when they are due

4. Background and proposal

4.1 CIPFA defines treasury management as:

"The management of the local authority's investment and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

4.2 One aspect of treasury management is to ensure that cash flow is adequately planned in order to ensure that cash is available when needed to meet payments when they are due. If not immediately needed any surplus monies are invested in low risk counterparties in order to earn interest.

4.3 The second main purpose of the treasury management strategy is the financing of the PCC's capital investment plans.

5. Police and Crime Plan

5.1 The Treasury Management Strategy ensures that there are sufficient funds available to meet financial commitments within the approved budget to meet operation and strategic requirements. This includes both day to day operations and longer term investment in order to deliver the Police and Crime Plan.

6. Police Operational Implications

6.1 Not applicable

7. Financial Implications

7.1 Considered in the main body of this report

8. Legal Implications

8.1 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 satisfy the requirements of the Police Reform & Social Responsibility Act 2011.

9. Staffing and other resource implications

9.1 Not applicable

10. Equality and Diversity implications

10.1 Not applicable

11. Background papers

Report Approval

The report will be signed off by the OPFCC Chief Executive and Treasurer, prior to review and sign off by the PFCC / DPFCC .

Chief Executive/M.O

Sign:

Print: DAVID CAWSON

Date: 12 APRIL 2018

Chief Financial Officer/Treasurer

Sign:

Print: ABBEY GOUGH

Date: 13.4.18

Publication

Is the report for publication? **YES** ☑ **NO** ☐

If 'NO', please give reasons for non-publication *(state 'None' if applicable)*

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

Redaction

If the report is for publication, is redaction required:

1. Of Decision Sheet **YES** ☐ **NO** ☐ **2. Of Appendix** **YES** ☐ **NO** ☐

If 'YES', please provide details of required redaction:

....

....

Date redaction carried out: ....

Treasurer / Chief Executive Sign Off – for Redactions only

If redaction is required, Treasurer or Chief Executive are to sign off that redaction has been completed.

Sign: ....

Print: ....

Chief Executive/Treasurer

Date signed: ....

Decision and Final Sign Off

I agree the recommendations to this report;

Sign: ....

Print: R. C. Hirst

PFCC/Deputy PFCC

Date signed: 17/4/18

I do not agree the recommendations to this report because;

....

....

....

Sign: ....

Print: ....

PFCC/Deputy PFCC

Date signed: ....

Support Services
Directorate

KENT POLICE ESSEX POLICE

Supporting policing
in Kent and Essex

Corporate Finance

Treasury Management Strategy 2018/19

Meeting: 2nd February 2018

Date: 26th January 2018
Author: Matthew Tokley

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Treasury Management Strategy (TMS) 2018/19

1.0 Introduction

1.1 The OPFCC has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the PFCC to approve a treasury management strategy before the start of each financial year. CIPFA have been consulting on changes to the current guidance, and issued the revised Code in January 2017. Following advice from our treasury consultants Arlingclose this document will continue to be based upon the 2011 code, whilst we fully digest the new regulatory framework for treasury management. The impact of any changes from the 2017 Code, including the requirement for a separate Capital Strategy document, will therefore be fully reflected in the 2019/20 TMS.

1.2 In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Investments in March 2010 that requires the PFCC to approve an investment strategy before the start of each financial year.

1.3 This report fulfils the PFCC's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG guidance.

1.4 The OPFCC has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the force's treasury management strategy.

1.5 CIPFA defines treasury management as:

'The management of the local authority's investments and cashflows, 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. Investments in the definition above covers all of the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment property portfolios. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework under this Code'.

1.6 One aspect of treasury management is to ensure that cash flow is adequately planned in order to ensure that cash is available when needed to meet payments when they are due. If not immediately needed any surplus monies are invested in low risk counterparties in order to earn interest.

1.7 The OPFCC is required 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 PFCC's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

1.8 The other main purpose of the treasury management strategy is the financing of the OPFCC's capital investment plans

2.0 Local Context

2.1 On the 31st December 2017 the OPFCC held £21.6m of investments with no borrowings. This is set out in further detail in appendix A.

2.2 The current treasury performance was last reported in the Treasury Management Half Year Report 2017/18, as presented at the Performance & Resources board.

2.3 The current five year capital programme is the significant driver for both the cash flow and the OPFCC's funding requirements, with substantial work ongoing to refine the programme around the strategic objectives of the force over the next five years.

2.4 The capital programme to be presented to the Police & Crime Panel on the 22 January will include projects that have already been fully approved as well as schemes that are subject to a business case prior to approval. The changing landscape in respect of operational estate requirements, particularly with regards to capital payments and receipts means that the current programme is subject to change. However, based on the latest information available the capital programme is shown in Table 1 below.

Table 1 – 5 year Capital Investment Programme 2017/18 – 2022/23 (proposed position for Police & Crime Panel on the 22nd January 2018)

	2017/18 £000	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000
Opening balance	(1,690)	12,684	12,799	(9,321)	(20,879)	(32,426)
Estimated resources to be generated in year -						
Home Office - Capital Grant	935	935	935	935	935	935
Capital receipts forecast per Estates Tracker @ 30.11.17	21,906	12,170	2,860	200	-	18,000
Home Office ICCS Replacement	702	-	-	-	-	-
Counter Terrorism NCTPHQ	650	-	-	-	-	-
Estates Improvement Reserve	145	-	-	-	-	-
CREEST - Safer Roads Partnership	86	-	-	-	-	-
Project Fusion / NPAS	100	-	-	-	-	-
Increased Revenue Contributions	-	1,000	1,000	1,000	1,000	1,000
A: TOTAL FORECAST CAPITAL RESOURCES	**24,524**	**14,105**	**4,795**	**2,135**	**1,935**	**19,935**
Less: Estimated capital payments in year -						
2017/18 & earlier years Approved Projects (Period 08)	**10,150**	**4,395**	**3,062**	**2,323**	**2,280**	-
Subject to Approval / New Bids						
IT Services (Deliverable Programme)	-	*5,122*	*9,770*	*2,103*	*2,997*	*2,663*
Other Services - Transport	-	-	-	-	-	*2,000*
Other Services (excluding Transport)	-	*395*	*153*	*30*	*53*	*248*
Estates Business as Usual	-	*2,038*	*1,657*	*1,380*	*1,402*	*1,350*
Estates Strategy	-	*2,040*	*12,274*	*7,856*	*6,750*	*2,000*
Subject to Approval / New Bids Total		**9,596**	**23,854**	**11,369**	**11,202**	**8,261**
B: TOTAL FORECAST CAPITAL EXPENDITURE	**10,150**	**13,990**	**26,916**	**13,692**	**13,482**	**8,261**
A less B: CLOSING FUNDS BALANCE surplus / (shortfall)	**12,684**	**12,799**	**(9,321)**	**(20,879)**	**(32,426)**	**(20,752)**

2.5 The above summary shows a capital programme which will provide significant challenges from 2019/20 onwards.

2.6 In 2017/18 significant levels of capital receipts are forecast as the OPFCC rationalises its asset base and disposes of a large number of surplus assets. As at the 30th November 2017 six disposals have been achieved (totalling £5.2m) with a further eleven disposals expected by the end of 2017/18 (equating to a further £16.7m). This income will largely fund the majority of the capital expenditure in both 2017/18 and 2018/19.

2.7 From 2019/20 onwards there is an expectation that long-term borrowing will be required to meet the levels of expenditure required. The reasoning for this is shown in Table 2 with our proposed approach to this requirement set out in our borrowing strategy section.

2.8 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.

2.9 The figures in Table 1 are shown re-presented in the CFR format in Table 2 below.

Table 2 - Balance Sheet Summary and Forecast

Essex PFCC Balance Sheet Summary and Projections in £millions							
31st March:	2017	2018	2019	2020	2021	2022	2023
Loans Capital Financing Req.	9.3	7.1	6.6	15.4	25.4	34.5	30.9
Less: External Borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Internal (Over) Borrowing	**9.3**	**7.1**	**6.6**	**15.4**	**25.4**	**34.5**	**30.9**
Less: Usable Reserves	-22.2	-34.9	-35.0	-15.0	-15.0	-15.0	-26.7
Less: Working Capital Surplus	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5	-1.6
Investments / (New Borrowing)	**14.5**	**29.4**	**30.0**	**1.2**	**-8.9**	**-18.0**	**-2.7**
Net Borrowing Requirement	-14.5	-29.4	-30.0	-1.2	8.9	18.0	2.7
Preferred Year-end Position	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Liability Benchmark	**-4.5**	**-19.4**	**-20.0**	**8.8**	**18.9**	**28.0**	**12.7**

Assumptions in £m	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Debt-funded Capital Expenditure	-1.7	0.0	9.3	11.5	11.5	0.0
MRP (excluding Leases/PFI)	-0.5	-0.5	-0.5	-1.5	-2.5	-3.6
Change in Reserves	-12.7	-0.1	20.0	0.0	0.0	-11.7
Change in Working Capital	0.0	0.0	0.0	0.0	0.0	0.0
Net Cash Outflow / (Inflow)	-14.9	-0.6	28.8	10.0	9.1	-15.3

2.10 The brought forward CFR total includes £7.6m of historic borrowing as well as £1.7m of unfinanced capital expenditure from 2017/18.

2.11 The model assumes a flat working capital surplus of £1.5m throughout the seven years shown, and cash balances are maintained at a minimum of £10m.

2.12 Usable reserves relate to general and earmarked reserves as well as capital receipts, with an expectation that these will reduce from 2019/20 onwards. Also included in this line are capital grants as well as £1m of revenue contributions per year from 2018/19 onwards.

2.13 In 2017/8 the capital receipts received in-year (£21.9m) fully finance the 2017/18 capital spend as well as being directly applied to the unfinanced 2016/17 expenditure brought forward of £1.7m.

2.14 From the above table it can be noted that the CFR increases markedly from 2019/20 as capital resources reduce. Currently this model assumes no external borrowing for presentational and approval purposes but there is an expectation that this will be required to finance capital programme spend from 2019/20 and reduce the burden on the OPFCC's internal cash balances (see the assumptions section of Table 2 for details of what capital expenditure will need to be debt-funded e.g. £32.3m in total).

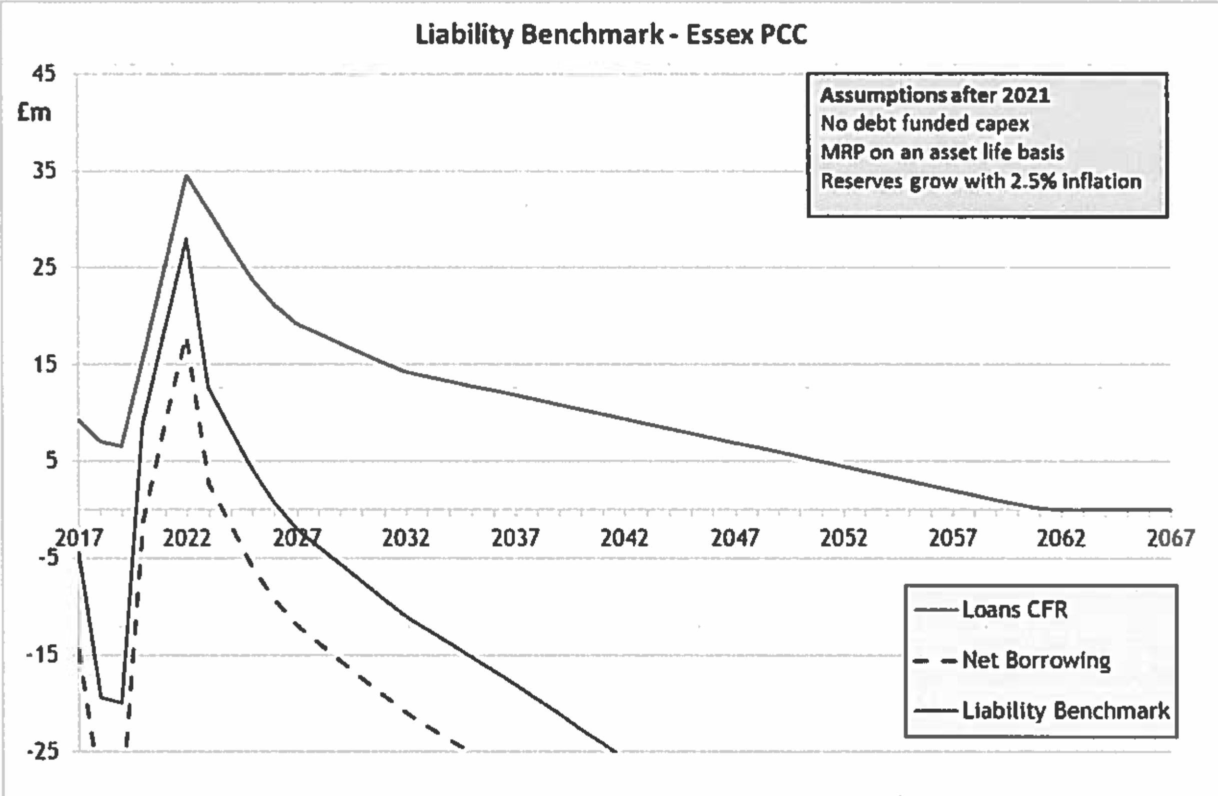
2.15 The cost of borrowing for the capital programme relates to two elements, minimum revenue provision (MRP) and the cost of debt interest. MRP is based on asset life of the projects which need to be financed, and is the material element of the cost of borrowing. Please see section 7 for further detail on the subject of MRP. The debt interest element is not currently included above but has less financial impact than MRP. Please refer to the borrowing strategy (section 3) for further detail on these costs. From table 2 it should be noted that the cost of borrowing increases to £1.5m in 2020/21, with £2.5m due in 2021/22 and £3.6m in 2022/23.

2.16 To assist with its long-term treasury management strategy the OPFCC and its advisers Arlingclose have created a liability benchmark, which forecasts the PFCC's need to borrow over a 50 year period. This is shown in Table 3 below. Following on from the medium-term forecasts in the above tables, the benchmark assumes the following from 2022/23 onwards:

- No debt funded Capital expenditure
- Minimum revenue provision on new capital expenditure based on the asset life method
- Income, expenditure and reserves all increasing by 2.5% inflation a year

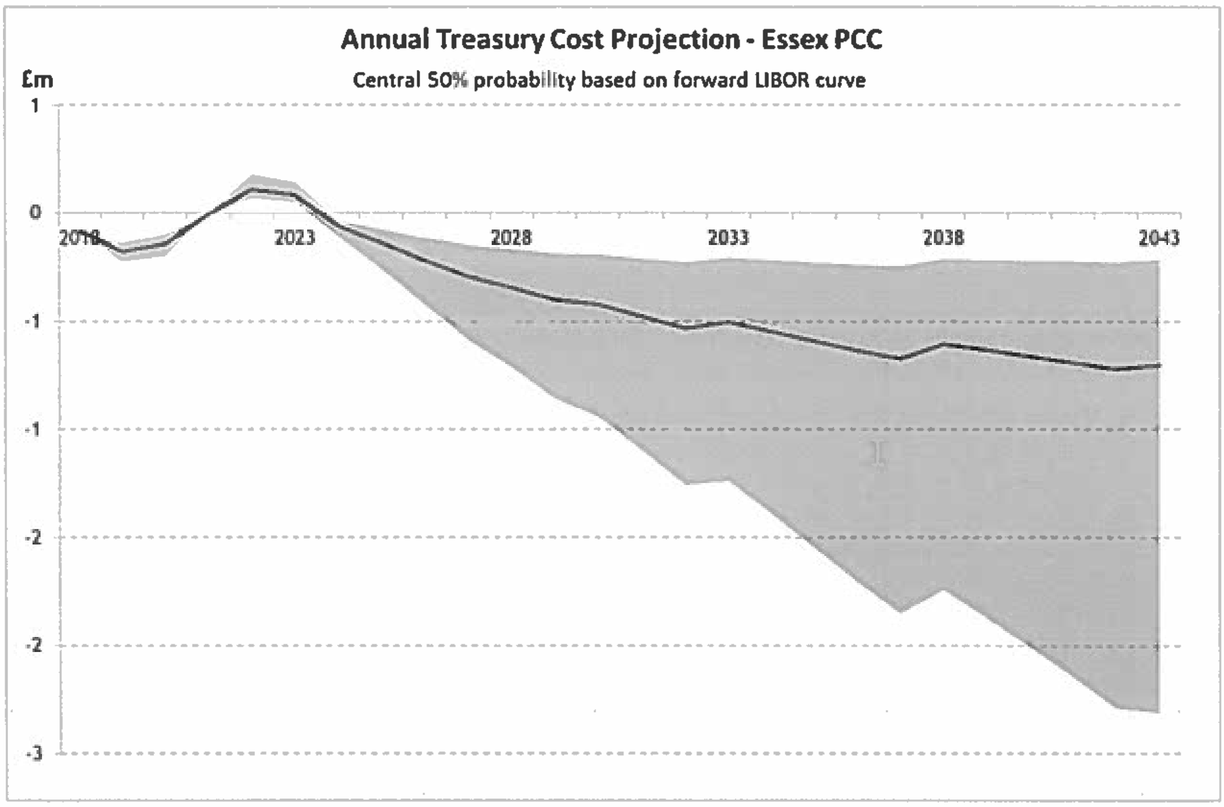
2.17 The chart below directly links to Table 2 in respect of the three trends shown. For the 'Loans CFR' line this shows the CFR peaking at £34.5m in 2021/22 with an initial steep decline as both the historic debt and short-life asset debt is repaid. Thereafter the property-based spend is repaid over 40 years. The other two lines 'Net Borrowing' and 'Liability Benchmark' link directly to the same lines in Table 2.

Table 3 – Liability Benchmark Chart



2.18 The chart below shows a longer-term projection of net treasury costs.

Table 4 – Annual Treasury Cost Projection – Essex OPFCC



2.19 The chart in Table 4 relates to the forecast variability of interest rates over the next 25 years and how this could potentially affect our returns and cost of borrowing. The chart shows that as time progresses the OPFCC is expecting to pay more interest for borrowing as it moves from a net credit position in 2022/23 to a net deficit position a couple of years later. This trend then continues for the remainder of the term.

2.20 For some wider observations in respect of the current external context for Treasury Management please see appendix B.

3.0 Borrowing Strategy

3.1 The OPFCC currently has no external borrowing but, as per Table 3 in section 2, expects to borrow in excess of £30m between 2019/20 and 2021/22 based on the current capital programme projections.

3.2 The PFCC's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the OPFCC's long-term plans change is a secondary objective.

3.3 Given the significant cuts to public expenditure and in particular to local government funding, the PFCC's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost-effective in the short-term to either use internal resources, or to borrow short-term loans instead. By doing so, the PFCC is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

3.4 The benefits of borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the PFCC with this 'cost of carry' and breakeven analysis. Its output may determine whether the OPFCC borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term. Alternatively, the PFCC may arrange starting loans during 2018/19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

3.5 The OPFCC may also use short-term loans to cover unplanned cashflow shortages.

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

- Public Works Loan Board (PWLB) and any successor body
- Any institution approved for investments (see investments strategy section below)

3.7 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:-

- Operating and finance leases
- Hire purchase

3.8 In all likelihood the OPFCC will look to use either short-term borrowing from other Local Authorities or alternatively the PWLB for its external borrowing requirement in 2019/20 and beyond. Based on current market conditions the PFCC would propose to keep any borrowing short which for local authorities would mean an approximate uplift of 0.25% in cost above the base rate. For the PWLB the options for EIP (equal instalment payments), maturity and annuity loans will need to be considered, whilst the term will be based on financial considerations (as stated above) as well as the useful economic lives of the assets being financed. The PFCC will look to apply for the certainty rate where available. This discounts certain loans at 20 basis points if a sound financial strategy has been produced to support the need for the borrowing. The OPFCC's Medium Term Financial Strategy (MTFS) should be able to provide this assurance. As well as local authorities and the PWLB the PFCC will continue to investigate other sources of finance, such as bank loans that may be available at more favourable rates.

3.9 The PFCC will use variable rate loans where appropriate. These loans leave the OPFCC exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators (as set out in section 5 of this report).

3.10 The PWLB allows the OPFCC to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The PFCC may take advantage of this, replacing some loans, or simply repaying them, where this is expected to lead to an overall cost saving or a reduction in risk.

4.0 Investment Strategy

4.1 The OPFCC holds significant invested funds, representing income received in advance of expenditure, as well as balances and reserves held. In the past twelve months, the OPFCC's investment balance has been as high as £50m with a normal peak occurring in the early summer months following the receipt of the annual Police Officer Pension top up grant from the Home Office. Similar levels are expected to be maintained in the forthcoming year with some increases expected dependent on the profile of capital receipts being received.

4.2 Both the CIPFA code and the CLG guidance require the OPFCC to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate or return, or yield. The PFCC's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the force will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. However, the current approach adopted by the PFCC is not to place investments any longer than 365 days.

4.3 Given the increased risk and low returns from short-term unsecured bank investments, as well as the dynamic nature of the OPFCC's cashflow, the aim is to invest more money in secure and highly liquid financial instruments in the coming twelve months. The main areas the PFCC will be focusing on will be local authority deposits, treasury bills, local authority bills and using money market funds for the first time.

4.4 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 exposure.

4.5 **Approved Instruments:** The OPFCC may lend or invest money using any of the following instruments (subject to the cash limits (per counterparty) and the time limits shown in table 5 below):

- interest-bearing bank accounts and call accounts
- fixed term deposits and loans,
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments
- money market funds

These can be categorised as follows:-

4.6 **Banks unsecured**: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

4.7 **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised agreements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in.

4.8 **UK central government**: Loans, bonds and bills issued or guaranteed by the UK national government, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with UK central government may be made in unlimited amounts for up to 50 years.

4.9 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made following an external credit assessment.

4.10 For 2018/19 the OPFCC may invest its surplus funds in any of the approved instruments (as specified in 4.5) with any of the counterparties in the table on the following page, subject to the cash, time and credit rating limits shown:-

Table 5 – Approved investment counterparties

Counterparty	% or Cash Limit	Maximum Duration (for fixed-term investments only)
UK financial institution whose lowest published long-term credit rating is A (or equivalent)	Higher of 5%* or £1m	1 year (unlimited if a call account with same day access to funds)
Lloyds Bank (operational bank account): i) (Higher of) 5%/£1m limit applies (with one year maximum duration) with the exception being where planned cash outflows for salaries and creditor payments necessitate a maximum up to £5m provided that Lloyds remains a UK bank and has a credit rating of A or better. ii) If at any time Lloyds credit rating is less than A	£5m £1m	Overnight Overnight
UK central government including Debt Management Office (irrespective of credit rating)	Unlimited	50 years
UK local authorities (irrespective of credit rating)	£5m (per authority)	1 year (per authority)
Money market funds whose lowest published credit rating is AAA or higher	£5m (per fund)	N/A

*Note: the % of total investments for each counterparty will be rounded down before reviewing this cash limit. For a fixed-term deposit this % is calculated at the time of the investment only whereas for same-day access investments this limit will be reviewed daily.

4.11 **UK financial institutions**: these are defined as:

i) Those that have no foreign bank, e.g. Barclays
ii) Building societies
iii) Those that are 100% owned by a UK bank, e.g. National Westminster (which is fully owned by Royal Bank of Scotland)
iv) 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 or are a full branch of a bank registered and regulated in the European Union or passported under EU legislation
   b) They operate under a banking licence issued by the Bank of England

c) They are regulated by the Financial Conduct Authority

4.12 **Money market funds (MMF)**: the guideline exposure for these funds will be as follows:-

i) Investment exposure of no more than 0.5% of the total MMF (if a government MMF then this can be 2%)
ii) Assuming condition i) is initially met, investments in each MMF are then limited to £5m maximum
iii) Overall exposure to MMF's as a whole to £10m maximum

4.13 **Custodian service**: The OPFCC may use a custodian service; which is defined as "a financial institution that holds customers' securities for safekeeping so as to minimize the risk of their theft or loss". A custodian service will provide access to tradable instruments, higher interest rates and a wider range of counterparties that fit with the PFCC's investment criteria

4.14 **Non-treasury investments:** Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the CLG guidance, the OPFCC may also purchase property for investment purposes. Such loans and investments will be subject to the OPFCC's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy. The OPFCC currently has no non-treasury investments.

4.15 **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the OPFCC's treasury advisers, who will notify changes in ratings as they occur. Investments limits are set by reference to the lowest published long-term credit rating from Flitch, Moody's or Standard & Poor's. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- No new investments will be made
- Any existing investments that can be recalled or sold at no cost will be
- Full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

4.16 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as 'rating watch negative' or 'credit watch negative') so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

4.17 Investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

4.18 **Other Information on the Security of Investments**: The PFCC 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.

4.19 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 OPFCC 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.

4.20 If these restrictions mean that insufficient financial institutions of high credit quality are available to invest the PFCC'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.

4.21 The OPFCC may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bail-in. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in rather than made insolvent, increasing the chance of the OPFCC maintaining operational continuity.

Specified Investments

4.22 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".

4.23 The PFCC defines "high credit quality" organisations as those having a credit rating of A or higher that are domiciled in the UK. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of AAA or higher.

Non-specified Investments

4.24 Any investment not meeting the definition of a specified investment is classed as non-specified. The PFCC does not intend to make any investments denominated in foreign currencies nor make any investments that are due to mature on dates longer than one year from the settlement date. The OPFCC will therefore not use non-specified investments during 2018/19.

Liquidity management:

4.25 The OPFCC uses a comprehensive cash flow model to forecast its cash flow and to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the OPFCC being forced to borrow on unfavourable terms to meet its financial commitments.

5.0 Treasury Management Indicators

5.1 The OPFCC measures and manages its exposure to treasury management risks using the following indicators.

5.2 **Interest Rate Exposures:** This indicator is set to control the OPFCC's exposure to interest rate risk for borrowing. The upper limits on fixed and variable rate interest rate exposures, expressed as a proportion of net principal borrowed or interest payable will be:

Interest Rate Exposures	**2018/19 %**	**2019/20 %**	**2020/21 %**
Fixed			
Upper limit for fixed interest rate exposure on debt (maximum actual debt at fixed rates as % of net borrowing)	100	100	100
Upper limit for fixed interest rate exposure on investments (maximum % of investments at fixed rates)	(100)	(100)	(100)
Net fixed rate exposure	**0**	**0**	**0**

Interest Rate Exposures	**2018/19 %**	**2019/20 %**	**2020/21 %**
Variable			
Upper limit for variable interest rate exposure on debt (maximum actual debt at variable rates as % of net borrowing)	25	25	25
Upper limit for variable interest rate exposure on investments (maximum % of investments at variable rates)	(50)	(50)	(50)
Net variable rate exposure	**(25)**	**(25)**	**(25)**

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

5.3 **Security:** The OPFCC has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit rating	A

5.4 **Liquidity:** The OPFCC has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments on a daily basis, without the need for additional borrowing.

	Target
PFCC bank account overdraft facility available	£1m

5.5 **Principal sums invested for periods longer than 365 days:** The purpose of this indicator is to control the OPFCC's exposure to the risk of incurring losses by seeking early repayment of its fixed term investments. The limits on the total principal sum invested to final maturities longer than 365 days will be:

	2018/19	**2019/20**	**2020/21**
Limit on principal invested beyond 365 days	£0m	£0m	£0m

6.0 <u>Prudential Indicators 2018/19</u>

6.1 The Local Government Act 2003 requires the PFCC to have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the OPFCC has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

6.2 **Estimates of capital expenditure**: The OPFCC's planned capital expenditure and financing is summarised in Section 2, Table 1 of this strategy document.

6.3 **Estimates of capital financing requirement:** The capital financing requirement (CFR) measures the OPFCC's underlying need to borrow for a capital purpose. This is explained in further detail in Section 7 of this strategy document. The estimates of the CFR for the period up to 2022/23 is shown in Section 2, Table 2.

6.4 **Gross debt and the capital financing requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the PFCC should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement or the current and next two financial years. This is a key indicator of prudence.

Debt	31.03.18 Revised £m	31.03.19 Revised £m	31.03.20 Revised £m	31.03.21 Revised £m
Borrowing	0	0	9.3	20.8
Total Debt	**0**	**0**	**9.3**	**20.8**

Total debt is expected to remain below the CFR during the forecast period.

6.5 **Operational Boundary for External Debt**: The operational boundary is based on the PFCC's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the OPFCC's estimates of capital expenditure, the capital financing requirement and cashflow requirements, and is a key management tool for in-year monitoring.

Operational Boundary	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Borrowing	10	20	20	40
Total Debt	**10**	**20**	**20**	**40**

6.6 There is no statutory limit on borrowing but there are prudential borrowing limits which need to be determined with reference to a range of indicators such as operational costs, level of reserves, savings requirements, robustness of budgetary control and reserves available. Taking all of these aspects into account the repayment of any borrowing has to be affordable.

6.7 **Authorised Limit for External Debt**: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the OPFCC can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements. The limits for each subsequent year can be reset on an annual basis.

Authorised Limit	2017/18 Limit £m	2018/19 Limit £m	2019/20 Limit £m	2020/21 Limit £m
Borrowing	10	20	30	50
Total Debt	**10**	**20**	**30**	**50**

7.0 Minimum Revenue Provision (MRP) Policy Statement

7.1 Where the OPFCC finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the PFCC to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* (the CLG guidance) most recently issued in 2012.

7.2 The broad aim of the CLG guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by government grants, reasonably commensurate with the period implicit in the determination of those grants.

7.3 The CLG guidance requires the PFCC to approve an annual MRP statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following guidance incorporates options recommended in the guidance as well as locally determined prudent methods.

7.4 For capital expenditure incurred before 1st April 2008 MRP will be determined as 4% of the Capital Financing Requirement in respect of that expenditure (Option 2 of the CLG guidance in England and Wales).

7.5 For capital expenditure incurred after the 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset (in equal instalments), starting in the year after the asset becomes operational.

7.6 The useful lives of the relevant assets for expenditure after 31st March 2008 will be determined by reference to our Property, Plant and Equipment accounting policy in the Statement of Accounts. This lists the asset lives as follows:-

- Buildings 20-60 years
- Vehicles 3-8 years
- Plant, IT & equipment 3-30 years
- Marine vessels 10-25 years

7.7 Purchase of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.

7.8 Capital expenditure incurred during 2018/19 will not be subject to an MRP charge until 2019/20.

7.9 Based upon the OPFCC's latest estimate of its Capital Financing Requirement on 31st March 2018, the budget for MRP has been set as follows:

	31.03.2018 Estimated CFR £m	**2018/19 Estimated MRP £**
Capital expenditure before 01.04.2008	7.090	0.500
Capital expenditure after 01.04.2008	0.000	0.000
Finance leases	0.000	0.000
Total	**7.090**	**0.500**

7.10 The capital expenditure before 01.04.2008 relates to the Joint Air Support Consortium which Essex Police was a member of with Cambridgeshire and Suffolk Police Authorities. Each member operated an individual helicopter which was subsequently disposed of to NPAS.

7.11 Capital expenditure after 01.04.2008 relates to unfinanced costs in 2016/17 relating to the rebuild of Southend Police Station. This will be fully financed in 2017/18 and therefore does not show in the above table.

7.12 Whilst the guideline MRP for the pre-April 2008 expenditure is 4% (e.g. £304k per annum based on the £7.59m of pre-2008 debt at the start of 2017/18) the PFCC has chosen to increase this to a more prudent £500k per annum. There is not expected to be any further unfinanced capital expenditure in 2017/18.

7.13 All of the above MRP guidance needs to be viewed in the context of the 'Consultation on the proposed changes to the prudential framework of capital finance (Minimum Revenue Provision Guidance)'. This consultation was issued by the DCLG and concluded on the 22nd December 2017. It included various proposals for changes to MRP approach to ensure prudent provisions are being applied by all public sector bodies. It should be noted that the findings/outcomes of this consultation may have a bearing on a revised MRP approach being proposed in the future.

8.0 Flexible Capital Receipts Strategy

8.1 The Government have issued statutory guidance on the flexible use of capital receipts. The PFCC is able to use capital receipts generated in year to finance individual projects that would otherwise be a charge to the revenue accounts.

8.2 Expenditure that qualifies for the flexible use of capital receipts is expenditure on any project that is designed to generate ongoing revenue savings in the delivery of public savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that reduces costs or demand for services in future years.

8.3 A capital receipts strategy needs to contain, as a minimum, a list of projects that plan to make use of the capital receipts flexibility along with the expected savings/service transformation. The strategy should be prepared before the start of the financial year and referred to as the initial strategy. Any subsequent revision to the initial strategy can be replaced at any time during the year with the revised strategy. The initial strategy and any revised strategy should, once approved, be made available online to the public free of charge.

8.4 At the current point in time the PFCC does not anticipate taking advantage of this approach on the basis all capital receipts will be retained for subsequent year's capital expenditure (e.g. it must be recognised that use of capital receipts to fund revenue expenditure negates the use of the same amount for capital investment). The current guidance also limits the flexible use of capital receipts up until the 31st March 2019 only. It is therefore unlikely the OPFCC will be in a position to take advantage of this approach before the flexibility is withdrawn.

9.0 Other Items

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

9.2 **Reserves:** National attention has been drawn to the overall level of usable revenue reserves amounting to £1.6bn. In order to improve the public transparency of reserves there have been discussions between the Treasurers Society (PaCCTS) and the Home Office into the practicalities of setting percentage limits to reserve levels. For general reserves an upper limit of 5% of direct revenue funding (precept plus core government grant) has been proposed. With effect from 2018/19 the force is proposing to reduce its general reserve balance to 3% of direct revenue funding. For earmarked revenue reserves there is a likely requirement to provide a clear rationale for holding reserves and explaining how reserves will be used over time. These requirements are expected to be embodied within the Home Office Financial Management Code of Practice (FMCoP), due to be published in early 2018. Forward projections within the TMS will reflect the level and use of reserves that is compliant with this approach.

9.3 **Policy on the use of financial derivatives**: In the absence of any explicit legal power to do so, the OPFCC will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used and the risks that they present will be managed in line with the overall treasury risk management strategy.

9.4 **Investment training:** The needs of the OPFCC'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. Relevant staff are also encouraged to study professional qualifications from CIPFA and other appropriate organisations.

9.5 **Investment advisers:** The OPFCC has appointed Arlingclose Limited 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.

9.6 **Investment of money borrowed in advance of need:** The OPFCC may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money option. Since amounts borrowed will be invested until spent, the OPFCC 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 OPFCC's overall management of its treasury risks.

9.7 The total amount borrowed will not exceed the authorised borrowing limit of £20m during 2018/19. The maximum period between borrowing and expenditure expected to be two years, although the OPFCC is not required to link particular loans with particular items of expenditure.

10.0 **Financial implications**

10.1 The budget for investment income in 2018/19 is £0.050m (based on an anticipation that the OPFCC will focus on liquidity and security of funds in 2018/19). The budget for debt interest payable in 2018/19 is £0.000m (based on an anticipation that the OPFCC will not have a borrowing requirement in 2018/19). If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Appendix A

Investment position at 31 March and 31 December 2017

	31/3/17 £000	Start date	Maturity date	Rate %
Call accounts				
Santander UK PLC	1,500			0.15%
Barclays Bank PLC	1,500			0.25%*
Total	**3,000**			
Fixed term deposits				
Bank of England DMO	7,000	20/03/17	03/04/17	0.10%
Bank of England DMO	4,500	27/03/17	03/04/17	0.10%
Total	**11,500**			
Lloyds current account	**843**			0.15%
Total all investments	**15,343**			

*excluding annual bonus interest calculated at 0.20%

	31/12/17 £000	Start date	Maturity date	Rate %
Call accounts				
Santander UK PLC	1,350			0.15%
Barclays Bank PLC	1,500			0.30%*
Total	**2,850**			
Fixed term deposits				
Bank of England DMO	2,000	27/12/17	08/01/18	0.10%
Coventry Building Society	1,000	03/04/17	08/01/18	0.52%
Rotherham Council	5,000	28/09/17	03/01/18	0.27%
Telford Council	5,000	30/10/17	28/02/18	0.40%
Bournemouth Council	3,000	07/11/17	07/02/18	0.32%
Nationwide Building Society	2,000	07/11/17	07/02/18	0.37%
Total	**18,000**			
Lloyds current account	**715**			0.15%
Total all investments	**21,565**			

*no annual bonus receivable on this account from June 2017 onwards

Appendix B

External Context

Economic background: The major external influence on the Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remains relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. However, this effect is expected to fall out of year-on-year inflation measures during 2018, removing pressure on the Bank of England to raise interest rates.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

Credit outlook: High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ring-fence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.

Interest rate forecast: Although at September's meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their rhetoric, implying a rise in Bank Rate in "the coming months". This was subsequently confirmed at the November meeting when a rate rise was passed with a vote of 7-2.
But stilted progress in the EU exit negotiations, softening consumer spending and a tightening of consumer credit are expected to stay the Committee's hands. The risk of a cut to zero or negative rates has diminished and there is now a chance that rates will rise further despite the economic fundamentals.

Longer-term interest rates have risen in the past year, reflecting the possibility of increasing short-term rates. Arlingclose forecasts these to remain broadly constant during 2018/19, but with some volatility as interest rate expectations wax and wane with press reports on the progress of EU exit negotiations.