Strategic Board 2018/19

Report to: the Office of the Police, Fire and Crime Commissioner for Essex

Title of Report:	**Treasury Management Strategy 2019/20**
Chief Officer	**Abbey Gough, Acting Treasurer**
Report from:	**Matt Tokley, Corporate Accounting Manager**
Date of Meeting:	**Thursday 14th March 2019**
Author on behalf of Chief Officer:	**N/A**
Date of Approval:	**N/A**

1.0 Purpose of Report

1.1 To approve the Treasury Management Strategy (TMS) for 2019/20.

2.0 Recommendations

2.1 The PFCC is recommended to:-

Approve the attached documents incorporating a treasury management strategy, investment strategy and capital strategy.

3.0 Executive Summary

3.1 The TMS provides a framework for the effective management of the PFCC's cash balances and related investments and borrowings. The strategy concentrates on 2019/20 but also considers treasury management for future years in the context of the major planned investment programme.

3.2 Please see the introduction in the main report (Annexe A, section 1.0) for a further overview of the Treasury Management function and related statutory obligations.

4.0 Current Work and Performance

4.1 The current investments position (as at 31st December 2018) is set out in Appendix A of this report.

5.0 Implications (Issues)

5.1 Financial implications are fully considered within the main body of this report.

5.2 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 and CLG Investment Guidance. The post Stage 2 treasury management arrangements satisfy the requirements of the Police Reform & Social Responsibility Act 2011.

6.0 Risks/Mitigation

6.1 Both the CIPFA Code and government guidance require the force 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 Authority'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.

7.0 Equality and/or Human Rights Implications

7.1 There is no impact on equality, diversity or human rights.

8.0 Health and Safety Implications

8.1 There are no health and safety implications for this report.

9.0 Consultation/Engagement

9.1 The paper has been prepared in consultation with Arlingclose, the OPFCC's treasury management advisers.

10.0 Actions for Improvement

10.1 These are fully considered within the main body of this report.

11.0 Future Work/Development

11.1 The Corporate Finance Team's treasury management processes for 2019/20 will be guided by the framework as set out in this report.

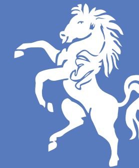
12.0 Decisions Required by the Police, Fire and Crime Commissioner

12.1 Please see recommendations section.

Annexe 1

Support Services
Directorate

KENT POLICE ESSEX POLICE



Supporting policing
in Kent and Essex

Corporate Finance

Treasury Management Strategy 2019/20

Meeting: 14th March 2019

Date: 27th February 2019
Author: Matthew Tokley

Kent
Police

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Treasury Management Strategy (TMS) 2019/20

1.0 Introduction

1.1 Treasury Management is the management of the OPFCC's cash flows, borrowing and investments, and the associated risks.

1.2 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 financial risk are therefore central to the OPFCC's prudent financial management.

1.3 Treasury risk management at the OPFCC is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the PFCC to approve a treasury management strategy before the start of each financial year. This report fulfils the OPFCC's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.4 One of the main aspects 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.

1.5 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.

1.6 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 2018 the OPFCC held £24.5m of investments with no borrowings (31st December 2017, £21.6m). This is set out in further detail in Appendix A.

2.2 The current treasury performance is reported on a fortnightly basis to the Acting Treasurer (and copied into the Chief Finance Officer for the Chief Constable), detailing the previous two week's performance as well as a plan for the following fortnight. Any deviations to this plan, with explanations for any key variances, is then followed up in the next report.

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 presented to the Police, Fire & Crime Panel on the 24th January 2019 included 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 2018/19 – 2023/24 (reported position for the Police, Fire & Crime Panel on the 24th January 2019)

	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000
Opening balance	653	8,899	4,339	(8,289)	(20,931)	(14,658)
Estimated resources to be generated in year -						
Home Office - Capital Grant	935	956	956	956	956	956
Estates Capital Receipts per Tracker v33, October 18	15,814	16,951	2,000	-	18,000	-
Contributions and Reserves	611	-	-	-	-	-
Increased Revenue Contributions	1,000	1,600	1,000	1,000	1,000	-
A: TOTAL FORECAST CAPITAL RESOURCES	**18,360**	**19,507**	**3,956**	**1,956**	**19,956**	**956**
Less: Estimated capital payments in year -						
2018/19 & earlier years Approved Projects -						
IT Services	5,185	1,931	20	-	-	-
Transport	2,744	-	-	-	-	-
Estates Business as Usual	1,209	1,962	-	-	-	-
Estates Strategy	346	5,293	158	243	-	-
Other Services	630	-	-	-	22	-
2018/19 & earlier years Approved Projects - Total	**10,114**	**9,186**	**178**	**243**	**22**	**-**
2019/20 & later years Approved Projects -						
IT Services	-	245	-	-	-	-
Transport	-	2,000	2,000	2,000	-	-
Estates Business as Usual	-	-	-	-	-	-
Estates Strategy	-	-	-	-	-	-
Other Services	-	380	333	333	-	-
2019/20 & later years Approved Projects - Total	**-**	**2,625**	**2,333**	**2,333**	**-**	**-**
Approved Total	**10,114**	**11,811**	**2,511**	**2,576**	**22**	**-**
Subject to Approval -						
IT Services	-	*5,380*	*8,243*	*2,745*	*3,708*	*2,700*
Transport	-	*80*	-	-	*2,000*	*2,000*
Estates Business as Usual	-	*2,467*	*1,380*	*1,402*	*1,350*	*1,000*
Estates Strategy	-	*3,175*	*4,450*	*7,875*	*6,350*	*10,000*
Other Services	-	*1,154*	-	-	*253*	*242*
Subject to Approval - Total	**-**	**12,256**	**14,073**	**12,022**	**13,661**	**15,942**
B: TOTAL FORECAST CAPITAL EXPENDITURE	**10,114**	**24,067**	**16,584**	**14,598**	**13,683**	**15,942**
A less B: CLOSING FUNDS BALANCE surplus / (shortfall)	**8,899**	**4,339**	**(8,289)**	**(20,931)**	**(14,658)**	**(29,644)**

2.5 The above summary shows a capital programme which will provide significant challenges from 2020/21 onwards (it should be noted that the final confirmed/approved programme for 2019/20 onwards had some minor amendments subsequent to the version above but there were no material changes).

2.6 From 2018/19 onwards significant levels of capital receipts are forecast to be realised as the OPFCC rationalises its asset base and disposes of a large number of surplus assets. As at the 31st December 2018 six disposals have been achieved (totalling £10.4m) with a further four disposals expected by the end of 2018/19 (equating to an additional approximate sum of £5.4m). This income will largely fund the majority of the capital expenditure in both 2018/19 and 2019/20.

2.7 From 2020/21 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 dealing with this deficit 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 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the OPFCC's total debt for the upcoming year should be lower than its highest forecast CFR over the next three years. Table 1 shows that the OPFCC expects to comply with this recommendation during 2019/20.

2.10 The figures in Table 1 are shown re-presented in the CFR format in Table 2 below. For this alternative presentation a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2 - Balance Sheet Summary and Forecast

Essex PFCC							
Balance Sheet Summary and Projections in £m							
Year End	31st March 2018	31st March 2019	31st March 2020	31st March 2021	31st March 2022	31st March 2023	31st March 2024
Loans: Capital Financing Requirement	8.8	6.6	6.1	13.9	25.4	17.3	30.4
Less: External Borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Internal (Over) Borrowing	**8.8**	**6.6**	**6.1**	**13.9**	**25.4**	**17.3**	**30.4**
Less: Usable Reserves	(22.4)	(28.8)	(19.3)	(15.0)	(15.0)	(15.0)	(15.0)
Less: Working Capital Surplus	(0.5)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Investments / (New Borrowing)	**14.1**	**23.2**	**14.3**	**2.2**	**(9.4)**	**(1.3)**	**(14.4)**
Net Borrowing Requirement	(14.1)	(23.2)	(14.3)	(2.2)	9.4	1.3	14.4
Preferred Year-end Position	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Liability Benchmark	**(4.1)**	**(13.2)**	**(4.3)**	**7.8**	**19.4**	**11.3**	**24.4**

Assumptions in £m							
Year End	31st March 2018	31st March 2019	31st March 2020	31st March 2021	31st March 2022	31st March 2023	31st March 2024
Debt-funded capital expenditure	0.0	(1.7)	0.0	8.3	12.6	(6.3)	15.0
MRP (excluding leases & PFI)	(0.5)	(0.5)	(0.5)	(0.5)	(1.1)	(1.9)	(1.9)
Change in Usable Reserves	1.0	(6.5)	9.5	4.3	0.0	0.0	0.0
Change in Working Capital	2.2	(0.5)	0.0	0.0	0.0	0.0	0.0
Net Cash Outflow / (Inflow)	**2.7**	**(9.2)**	**9.0**	**12.1**	**11.5**	**(8.1)**	**13.1**

2.11 The brought forward CFR total of £8.8m includes £7.1m of historic borrowing as well as £1.7m of unfinanced capital expenditure brought forward from 2017/18. The latter will be financed by capital receipts in 2018/19.

2.12 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.

2.13 Usable reserves relate to general and earmarked reserves as well as capital receipts, with an expectation that these will reduce from 2020/21. Also included are capital grants and £1m of revenue contributions per year from 2018/19 onwards.

2.14 In 2018/19 the capital receipts forecast to be received in-year (£15.8m) fully finance the 2018/19 capital spend (as well as being directly applied to the unfinanced 2016/17 expenditure of £1.7m, as referred to in paragraph 2.11).

2.15 From the above table it should be noted that the CFR increases markedly from 2020/21 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 2020/21 and reduce the burden on the OPFCC's internal cash balances (see the assumptions section of Table 2 for what capital expenditure will need to be debt-funded e.g. £35.9m of gross debt in total, made up of £8.3m, £12.6m and £15.0m in three different years).

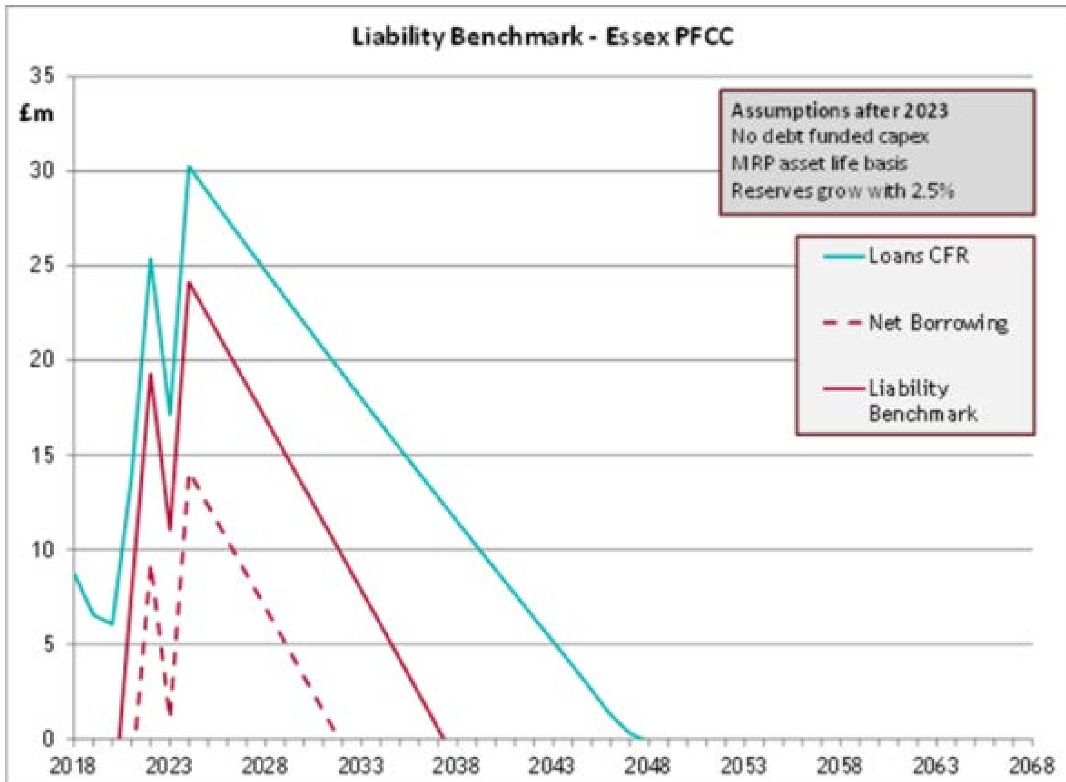
2.16 The cost of borrowing for the capital programme relates to two elements, minimum revenue provision (MRP) and the cost of debt interest. MRP is based on the asset life of the projects which need to be financed, and is the material element of the cost of borrowing. Please see section 7 for further 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 £1.1m in 2021/22, with £1.9m due in both 2022/23 and 2023/24.

2.17 To assist with its long-term treasury management strategy the OPFCC and its advisers Arlingclose have created a Liability Benchmark Chart, 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 2024/25 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

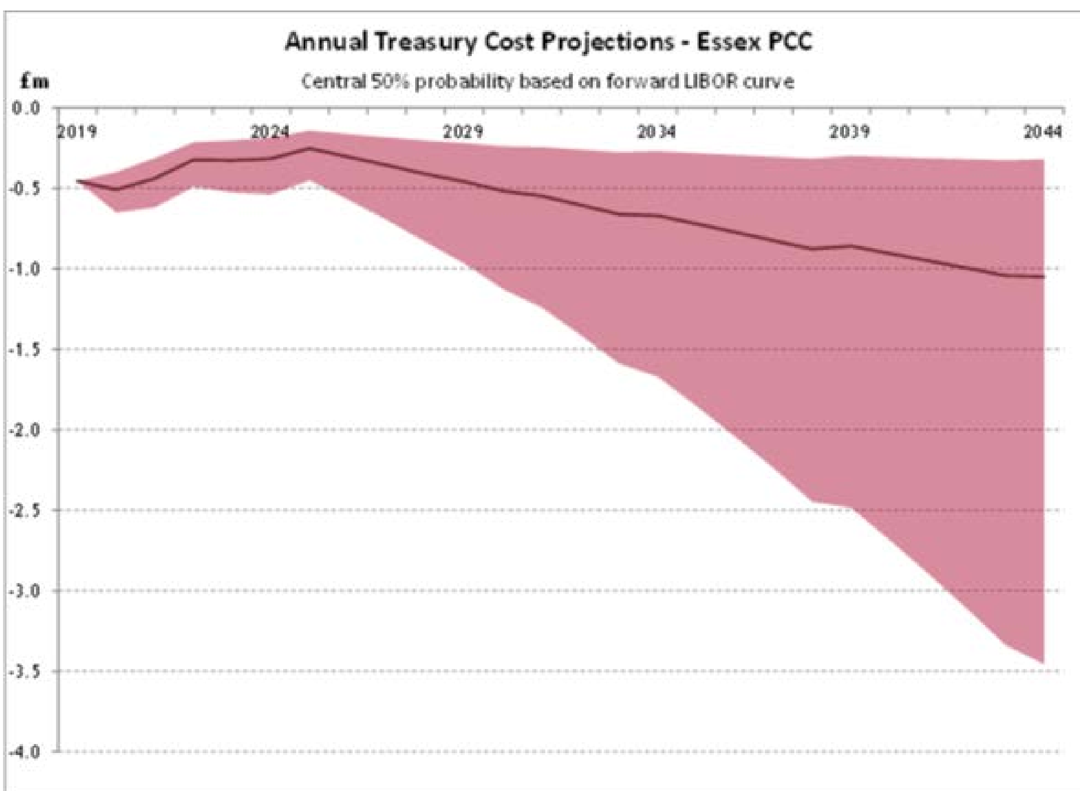
2.18 The chart below directly links to Table 2 in respect of the three trends shown. For the 'Loans CFR' line this shows the CFR peaking at just over £30m around 2025. There is an initial decline as both the historic debt and short-life asset debt is repaid. Thereafter the CFR steadily rises in proportion with capital expenditure, with a small drop in 2022/23 when capital receipts in respect of the Chelmsford HQ site are expected to be realised. From that point on 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



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

Table 4 – Annual Treasury Cost Projection – Essex OPFCC



2.20 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 over the period shown, with a marked decrease in the net deficit position from 2025/26 onwards. This trend then continues for the remainder of the term.

2.21 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 2020/21 and 2023/24 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 OPFCC is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

3.4 The benefits of internal and short-term 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 OPFCC with this 'cost of carry' and breakeven analysis. Its output may determine whether the OPFCC borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term. Alternatively, the OPFCC may arrange starting loans during 2019/20, 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 cash flow 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:-

- Leasing
- 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 2020/21 and beyond. Based on current market conditions the OPFCC 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 OPFCC 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 OPFCC 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.

3.11 Other mechanisms of borrowing, such as the use of the Municipal Bonds Agency (created in 2014 by the Local Government Association as an alternative to the PWLB) will continue to be monitored and reviewed in greater detail as we get closer to 2020/21 when the Force will have an underlying need to borrow.

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 £57m 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 The CIPFA code requires 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 OPFCC is not to place investments any longer than one year.

4.3 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.

4.4 If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its bank rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally requested.

4.5 Given the increasing risk and very low returns from short-term unsecured bank investments, as well as the dynamic nature of the OPFCC's cash flow, the aim is to continue to invest in secure and highly liquid financial instruments in the coming twelve months. The main areas the OPFCC will be focusing on will be local authority deposits, treasury bills, local authority bills and using money market funds.

4.6 Whilst the PFCC continues to review all investment options available, including diversifying into higher yielding asset classes, the current uncertainty in respect of the UK's exit from the European Union means that the OPFCC is not planning to radically change its investment approach at the current time. This follows the decision from Fitch to place both the UK's AA sovereign long term rating and UK banks on 'Rating Watch Negative' (RWN) in February and March 2019 respectively. The RWN reflects the heightened uncertainty over the ultimate outcome of the EU Exit process and the increased risk of a disruptive 'no deal' scenario, where the UK leaves the EU without a withdrawal agreement in place.

4.7 **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, call accounts and notice 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:-

4.8 **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.

4.9 **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.

4.10 **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 generally a lower risk of insolvency, although they are not zero risk. Investments with the UK central government may be made in unlimited amounts for up to 50 years.

4.11 **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.

4.12 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England) as well as similar regulatory bodies across the UK. As providers of public services, they retain the likelihood of receiving government support if needed.

4.13 **Pooled funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term money market funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

4.14 Bonds, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short-term. These allow the OPFCC to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability needs to be monitored regularly. At present these instruments are not currently used but will be reviewed in further detail during 2019/20. A subsequent paper will be presented to the OPFCC with an overview of whether these instruments meet the criteria set out in paragraph 4.2 above, as well as the estimated additional yields by using them. If approved amendments will be made to the 2019/20 Treasury Management Strategy. Until this time equity and property funds will not be utilised by the OPFCC, whilst Bonds will only be used for the durations shown in Table 5.

4.15 For 2019/20 the OPFCC may invest its surplus funds in any of the approved instruments (as specified in 4.7) 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

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK central government (including Debt Management Office)	n/a	n/a	£ unlimited (50 years)	n/a	n/a
UK local government	n/a	n/a	£5m per authority (5 years)	n/a	n/a
Lloyds Bank plc (operational bank account) where credit rating is A- or above	Higher of £1m or 5%* (1 year) An exception applies where planned cash outflows (e.g. salaries or creditor payments) necessitate additional funds being held:- £5m (overnight)	n/a	n/a	n/a	n/a
Lloyds Bank plc (operational bank account) where credit rating is below A-	£1m (overnight)	n/a	n/a	n/a	n/a
Between AA- and AAA (fixed-term duration)	UK financial institutions: Higher of £1m or 5%* (1 year) Non-UK financial institutions: Higher of £1m or 5%* (6 months)	UK financial institutions: Higher of £1m or 5%* (1 year) Non-UK financial institutions: Higher of £1m or 5%* (6 months)	Higher of £1m or 5%* (1 year) Longer exposure - under review	UK financial institutions: Higher of £1m or 5%* (1 year) Non-UK financial institutions: Higher of £1m or 5%* (6 months) Longer exposure - under review	UK financial institutions: Higher of £1m or 5%* (1 year) Non-UK financial institutions: Higher of £1m or 5%* (6 months) Longer exposure - under review

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
Between A and A+ (fixed term duration)	UK financial institutions: Higher of £1m or 5%* (1 year) Non-UK financial institutions: Higher of £1m or 5%* (3 months)	UK financial institutions: Higher of £1m or 5%* (1 year) Non-UK financial institutions: Higher of £1m or 5%* (3 months)	Higher of £1m or 5%* (1 year) Longer exposure - under review	UK financial institutions: Higher of £1m or 5%* (1 year) Non-UK financial institutions: Higher of £1m or 5%* (3 months) Longer exposure - under review	UK financial institutions: Higher of £1m or 5%* (1 year) Non-UK financial institutions: Higher of £1m or 5%* (3 months) Longer exposure - under review
A- (fixed term duration)	UK financial institutions: Higher of £1m or 5%* (6 months) Non-UK financial institutions: n/a	UK financial institutions: Higher of £1m or 5%* (6 months) Non-UK financial institutions: n/a	Higher of £1m or 5%* (1 year) Longer exposure - under review	UK financial institutions: Higher of £1m or 5%* (6 months) Non-UK financial institutions: n/a Longer exposure - under review	UK financial institutions: Higher of £1m or 5%* (6 months) Non-UK financial institutions: n/a Longer exposure - under review
Between A- and AAA (with same day access to funds e.g. call accounts or notice accounts)	Higher of £1m or 5%* (unlimited)	Higher of £1m or 5%* (unlimited)	Higher of £1m or 5%* (unlimited)	Higher of £1m or 5%* (unlimited)	Higher of £1m or 5%* (unlimited)
No published rating	n/a	n/a	n/a	n/a	n/a
Money market funds	£5m per fund (minimum AAA rated), see paragraph 4.17 of 2019/20 Treasury Management Strategy for further details				
Other pooled funds (including estates trusts, property funds and equity shares)	Under review (no investments permitted in these funds at the current time, see paragraph 4.14 of the Treasury Management Strategy for further details)				

*Note: the 5% limit is based upon the total exposure to the counterparty concerned. The balance 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 deal only whereas for investments with same-day access this limit will be reviewed daily.

4.16 **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

4.17 **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

4.18 **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.

4.19 **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 a selection of external rating agencies (mainly Fitch, 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

4.20 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. Please see paragraph 4.6 in respect of the current outlook for the UK economy.

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

4.22 **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, reports in the quality financial press and analysis and advice from the OPFCC's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

4.23 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.

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

4.25 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 bank 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.

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. The upper limits on the one year revenue impact of a 1% rise or fall in interest rates will be:-

Interest rate risk indicator	**Limit**
Upper limit on one year revenue impact of a 1% rise in interest rates	£300,000
Upper limit on one year revenue impact of a 1% fall in interest rates	(£80,000)

5.3 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

5.4 **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

5.5 **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

5.6 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the OPFCC'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 longer than one year will be:

	2019/20	**2020/21**	**2021/22**
Limit on principal invested beyond one year	£0m	£0m	£0m

6.0 Other Items

6.1 The CIPFA Code requires the OPFCC to include the following in its Treasury Management Strategy.

6.2 **Liquidity Management:** 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. Limits on long-term investments are set by reference to the OPFCC's medium-term financial strategy (MTFS) and cash flow forecast.

6.3 **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.

6.4 **Markets in Financial Instruments Directive:** The OPFCC has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services

but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the OPFCC's treasury management activities, the Acting Treasurer believes this to be the most appropriate status.

7.0 Financial implications

7.1 The budget for investment income in 2019/20 is £0.080m based on expected yield, balanced against the OPFCC requirement to focus on liquidity and security of funds. The budget for debt interest payable in 2019/20 is £0.002m based on an anticipation that the OPFCC will not have a material borrowing requirement during the upcoming year but may have some minor short-term borrowing requirements if and when cash flow deficits occur. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

8.0 Other options considered

8.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Acting Treasurer, having consulted the PFCC and the Essex Police Corporate Finance Department, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A

Investment position at 31st March and 31st December 2018

	31/3/18 £000	Start date	Maturity date	Rate %
Call/notice accounts				
Santander UK PLC	1,000			0.25%
Barclays Bank PLC	1,000			0.30%
Total	**2,000**			
Fixed term deposits				
Bank of England DMO	8,000	29/03/18	03/04/18	0.25%
Total	**8,000**			
Lloyds current account	**805**			0.15%
Total all investments	**10,805**			

	31/12/18 £000	Start date	Maturity date	Rate %
Call/notice accounts				
Santander UK PLC	1,270			0.85%
Barclays Bank PLC	1,500			0.75%
Total	**2,770**			
Money market funds				
Aberdeen	5,000			0.62%
Insight	500			0.64%
	5,500			
Treasury Bills				
Bank of England DMO	4,984	09/07/18	07/01/19	0.65%
	4,984			
Fixed term deposits				
Coventry Building Society	2,000	05/07/18	07/01/19	0.68%
Rotherham Council	5,000	24/10/18	23/04/19	0.90%
Nationwide Building Society	1,500	05/11/18	05/02/19	0.69%
Goldman Sachs	2,000	05/10/18	07/01/19	0.70%
Total	**10,500**			
Lloyds current account	**722**			0.15%
Total all investments	**24,476**			

Appendix B

External Context

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the OPFCC's treasury management strategy for 2019/20.

The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. At its meeting ending on 6 February 2019, the MPC voted unanimously to maintain Bank Rate at 0.75%. The Committee voted unanimously to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £10 billion. The Committee also voted unanimously to maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion.

The world economy has continued to slow over recent months, with a broad-based softening across all regions. That deceleration reflects the past tightening in global financial conditions, as well as the initial impact of trade tensions on business sentiment. Global growth is expected to dip below trend in coming quarters, weighing on UK net trade, before rising to around potential rates. Activity is projected to be supported by the more accommodative monetary policies in all major economic areas that markets now expect.

UK economic growth slowed in late 2018 and appears to have weakened further in early 2019. This slowdown mainly reflects softer activity abroad and the greater effects from uncertainties at home relating to the EU Exit. These uncertainties could lead to greater-than-usual short-term volatility in UK data, which may therefore provide less of a signal about the medium-term outlook. Heightened uncertainty and elevated bank funding costs are assumed to subside over time, as greater clarity on future trading arrangements is assumed to emerge. These developments, together with looser fiscal policy, provide support to domestic spending. In the Committee's central projection, quarterly GDP growth recovers later this year, with four-quarter growth rising to 2% by the end of the forecast period.

CPI inflation fell to 2.1% in December and is expected to decline to slightly below the MPC's 2% target in the near term, largely due to the sharp fall in petrol prices which has occurred since November. As that effect unwinds, CPI inflation rises above 2%. The MPC judges that demand and potential supply are currently broadly in balance. The weaker near-term outlook is likely to lead to a small margin of slack opening up this year. Thereafter, demand growth exceeds the subdued pace of supply growth and excess demand builds over the second half of the forecast period. As a result, domestic inflationary pressures firm, as the upward pressure on inflation of sterling's past depreciation wanes. Under the assumptions that condition the February Report, inflation settles at a rate a little above the target.

The Committee judges that, were the economy to develop broadly in line with its Inflation Report projections, an ongoing tightening of monetary policy over the forecast period, at a gradual pace and to a limited extent, would be appropriate to return inflation sustainably to the 2% target at a conventional horizon.

The economic outlook will continue to depend significantly on the nature of EU withdrawal, in particular: the new trading arrangements between the European Union and the United Kingdom; whether the transition to them is abrupt or smooth; and how households, businesses and financial markets respond. The appropriate path of monetary policy will depend on the balance of these effects on demand, supply and the exchange rate. The monetary policy response to the EU Exit, whatever form it takes, will not be automatic and could be in either direction. The MPC judges at this month's meeting that the current stance of monetary policy is appropriate. The Committee will always act to achieve the 2% inflation target.

Credit outlook: The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ring-fencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ring-fenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ring-fenced banks generally being better rated than their non-ring-fenced counterparts.

The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

European banks are considering their approach to the EU Exit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

Interest rate forecast: Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher bank rate will be a more effective policy weapon should downside EU Exit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that an EU Exit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" EU Exit still hangs over economic activity. As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

Appendix C

Economic & Interest Rate Forecast - underlying assumptions

Central interest rate forecasts are predicated on there being a transitionary period following the UK's official exit from the EU.

The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher bank rate will be a more effective policy weapon if downside risks to growth crystallise.

Both the projected outlook and the increase in the magnitude of political and economic risks facing the UK economy mean significant downside risks to these forecasts, despite the potential for slightly stronger growth next year as business investment rebounds (should the EU Withdrawal Agreement be approved). The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. It is expected that the Bank of England will hold or reduce interest rates from current levels if EU Exit risks materialise.

The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. The UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.

Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.

Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.

Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast

The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around the EU Exit have dampened interest rate expectations. The central case is for the bank rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.

Gilt yields have remained at low levels. Some upward movement from current levels is expected based on the central assumption that the UK will enter a transitionary period following its EU exit in March 2019. However, the projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.