

Strategic Board 2019/20

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

Title of Report:	Treasury Management Strategy 2020/21
Chief Officer	Debbie Martin, Acting Section 151 Officer, OPFCC
Report from:	Matt Tokley, Corporate Accounting Manager
Date of Meeting:	Tuesday 17th March 2020
Author on behalf of Chief Officer:	Matt Tokley
Date of Approval:	TBC

1.0 Purpose of Report

1.1 To approve the Treasury Management Strategy (TMS) for 2020/21.

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 2020/21 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 1, 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 January 2020) 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 OPFCC'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 2020/21 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.

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Corporate Finance

Treasury Management Strategy 2020/21

Meeting: 17th March 2020

Date: 4th March 2020
Author: Matthew Tokley



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Treasury Management Strategy (TMS) 2020/21

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 January 2020 the OPFCC held £19.3m of investments with no borrowings (31st January 2019, £26.3m). These investments are set out in further detail in Appendix A.
- 2.2 The current treasury performance is reported on a fortnightly basis to the Acting Section 151 Officer (and copied into the Chief Finance Officer for the Chief Constable), summarising the previous four weeks' performance as well as a plan for the following fortnight. Any deviations to this plan, with explanations for any key variances, are 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 6th February 2020 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 a firmer and more clearer picture is now emerging. Therefore, based on the latest information available the capital programme is shown in Table 1 below.

Table 1 – 5 year Capital Investment Programme 2019/20 – 2024/25 (reported position for the Police, Fire & Crime Panel on the 6th February 2020)

CAPITAL RESOURCES AND EXPENDITURE 2019/20 to 2024/25						
	2019/20 Forecast £000	2020/21 Forecast £000	2021/22 Forecast £000	2022/23 Forecast £000	2023/24 Forecast £000	2024/25 Forecast £000
Opening balance	7,324	565	(13,222)	(29,814)	(24,240)	(42,145)
Estimated resources to be generated in year -						
Home Office - Capital Grant	956	300	300	300	300	300
Estates Capital Receipts v43.0 (end of November 2019)	6,213	7,109	3,690	25,125	-	-
Contributions and Reserves	153	47	-	-	-	-
Increased Revenue Contributions	1,478	1,705	1,000	1,000	1,000	1,000
TOTAL FORECAST CAPITAL RESOURCES	8,800	9,161	4,990	26,425	1,300	1,300
Less: Estimated capital payments in year -						
Approved Projects (as presented to the 19/12/19 Strategic Board) -						
IT Services	5,558	871	-	-	-	-
Transport	2,640	2,056	2,000	-	-	-
Estates Business as Usual	2,344	3,186	402	350	-	-
Estates Strategy	2,148	7,165	109	-	-	-
Other Services	1,139	438	339	28	6	-
Approved Projects - Total	13,829	13,716	2,850	378	6	-
Approved Total	13,829	13,716	2,850	378	6	-
FUNDS BALANCE surplus / (shortfall) - APPROVED PROJECTS	2,295	(3,990)	(11,082)	(3,767)	(22,946)	(40,845)
Subject to Approval -						
IT Services	50	4,535	5,337	4,968	4,201	3,653
Transport	180	-	-	2,030	2,000	2,000
Estates Business as Usual	-	1,000	1,000	1,000	1,000	1,000
Estates Strategy	1,500	2,860	12,150	12,000	11,500	-
Other Services	-	837	245	475	498	496
Subject to Approval - Total	1,730	9,232	18,732	20,473	19,199	7,149
Total per department -						
IT Services	5,608	5,406	5,337	4,968	4,201	3,653
Transport	2,820	2,056	2,000	2,030	2,000	2,000
Estates Business as Usual	2,344	4,186	1,402	1,350	1,000	1,000
Estates Strategy	3,648	10,025	12,259	12,000	11,500	-
Other Services	1,139	1,275	584	503	504	496
Total per department - Total	15,559	22,948	21,582	20,851	19,205	7,149
TOTAL FORECAST CAPITAL EXPENDITURE	15,559	22,948	21,582	20,851	19,205	7,149
CLOSING FUNDS BALANCE surplus / (shortfall) - ALL PROJECTS	565	(13,222)	(29,814)	(24,240)	(42,145)	(47,994)
Indicative External Borrowing for capital programme - annual	0	13,222	16,592	(5,574)	17,905	5,849
Indicative External Borrowing for capital programme - cumulative	0	13,222	29,814	24,240	42,145	47,994
INDICATIVE CLOSING FUNDS BALANCE surplus / (shortfall)	565	0	0	0	0	0
Indicative revenue impact of borrowing	£000	£000	£000	£000	£000	£000
Borrowing Costs - based on 2.50% interest rate	0	165	373	303	527	600
Minimum Revenue Provision (MRP)	500	500	800	1,700	1,700	2,800
Total indicative revenue impact of borrowing	500	665	1,173	2,003	2,227	3,400

- 2.5 The above summary presents a capital programme which will provide significant challenges from 2020/21 onwards, with significant expenditure being invested in the Force's capital programmes with resulting cash shortages forecast in these years.
- 2.6 Offset against these costs, is the continued trend of significant levels of capital receipts coming into the Force as the OPFCC rationalises its asset base and disposes of a large number of surplus assets. As at the 31st January 2020 four disposals have been achieved in the financial year as well as three receipts in respect of covenants and one for overage (totalling £3.9m). A further four disposals are expected by the end of 2019/20 (equating to an additional approximate sum of £2.3m). This income will largely fund the capital programme in 2019/20 but despite a further £36m forecast over the subsequent three years it is not anticipated that this will be enough to bridge the deficit in the OPFCC's capital programme.
- 2.7 Therefore, from 2020/21 onwards it is highly likely that structured borrowing will be required to meet the levels of expenditure required, and the OPFCC will longer be debt free (with the exception of its current CFR liability – see below). This borrowing requirement is set out in Table 2 whilst the proposed approach in dealing with these deficits is explained further in the borrowing strategy section of this document.
- 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 requirement during 2020/21.
- 2.10 The figures from 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 with cash and investment balances being 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 2019	31st March 2020	31st March 2021	31st March 2022	31st March 2023	31st March 2024	31st March 2025
Loans: Capital Financing Requirement	6.6	6.1	18.8	34.6	27.3	43.5	46.5
Less: External Borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Internal (Over) Borrowing	6.6	6.1	18.8	34.6	27.3	43.5	46.5
Less: Usable Reserves	(27.2)	(20.5)	(15.0)	(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)	21.2	15.4	(2.8)	(18.5)	(11.3)	(27.5)	(30.5)
Net Borrowing Requirement	(21.2)	(15.4)	2.8	18.5	11.3	27.5	30.5
Preferred Year-end Position	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Liability Benchmark	(11.2)	(5.4)	12.8	28.5	21.3	37.5	40.5

Assumptions in £m							
Year End	31st March 2019	31st March 2020	31st March 2021	31st March 2022	31st March 2023	31st March 2024	31st March 2025
Debt-funded capital expenditure	0.0	0.0	13.2	16.6	(5.6)	17.9	5.8
Minimum revenue provision (MRP)	(0.5)	(0.5)	(0.5)	(0.8)	(1.7)	(1.7)	(2.8)
Change in Usable Reserves	(5.0)	6.7	5.4	0.0	0.0	0.0	0.0
Change in Working Capital	0.0	(0.5)	0.0	0.0	0.0	0.0	0.0
Net Cash Outflow / (Inflow)	(5.5)	5.8	18.2	15.8	(7.3)	16.2	3.0

- 2.11 The brought forward CFR total of £6.6m is solely based upon pre-2008 historic borrowing.
- 2.12 The model assumes a flat working capital surplus of £1m from 2019/20 onwards, with cash balances maintained annually 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 a minimum £1m of revenue contributions per year from 2018/19 onwards.
- 2.14 In 2019/20 the capital receipts forecast to be received in-year (£6.2m) is the main reason why the 2019/20 capital spend is fully financed in year, without any borrowing requirement.
- 2.15 Table 2 clearly demonstrates 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. Please refer to the assumptions section of

Table 2 for what capital expenditure will need to be debt-funded e.g. £53.6m of gross debt in total, made up of £13.2m (2020/21), £16.6m (2021/22), £17.9m (2023/24) and £5.8m (2024/25).

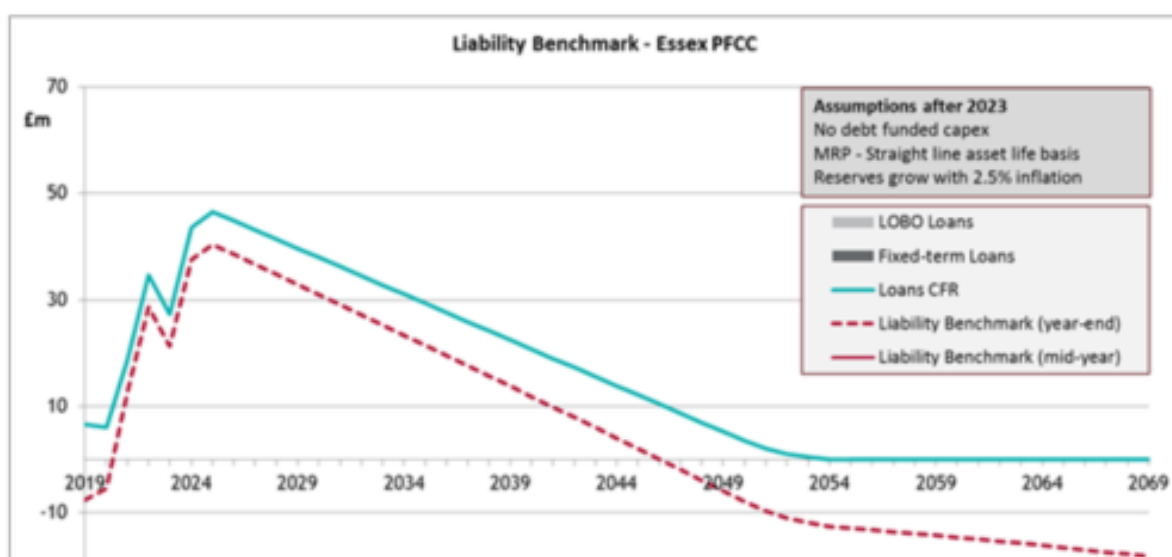
2.16 The cost of borrowing for the capital programme relates to two elements, minimum revenue provision (MRP) and the cost of debt interest. MRP is based on the asset life of the projects which need to be financed, and is the material element of the cost of borrowing. Please see section 7 for further detail on the subject of MRP. The debt interest element is not currently included within Table 2 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 MRP costs increase to £1.7m in 2022/23 and 2023/24, with £2.8m due in 2024/25.

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 (charged to the Council Tax requirement one year in arrears)
- 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 under £50m 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 2023/24 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 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 up to £50m between 2020/21 and 2024/25 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 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 continuing to be 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 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
- 3.5 The main route of local government borrowing options has previously been the Public Works Loans Board (PWLB) but following the government decision to raise PWLB rates by 1% in October 2019 this is now a relatively expensive borrowing option. The OPFCC will therefore now look to borrow any long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.
- 3.6 Alternatively, the OPFCC may arrange starting loans during 2020/21, 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.
- 3.7 In addition, the OPFCC may also use short-term loans to cover unplanned cash flow shortages.

- 3.8 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)
 - Any other bank or building society authorised to operate in the UK
 - Any other UK public sector body
 - UK public and private sector pension funds (except Essex Local Government Pension Scheme)
 - Capital market bond investors
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- 3.9 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
 - Private Finance Initiative (PFI)
 - Sale and leaseback
- 3.10 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to public sector entities. This is a more complicated source of finance than the PWLB for two reasons, a) borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and b) there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to the OPFCC in advance of this borrowing option being chosen.
- 3.11 **LOBOs:** These are borrowing facilities whereby the lender has the option to propose an increase in the interest rate at set dates, following which the OPFCC has the option to either accept the new rate or to repay the loan at no additional cost. The OPFCC understands that such arrangements carry an element of refinancing and liquidity risk and, if used in future, will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to the higher of 25% of all external borrowing and £5m in 2020/21.
- 3.12 In all likelihood the OPFCC will look to use either short-term borrowing from other local authorities or, where necessary, the PWLB for its external borrowing requirement in 2020/21. Based on current market conditions the OPFCC would propose to structure any borrowing over the short-term only which for local authorities would mean an approximate uplift of 0.25% in cost above the UK bank rate. However, with the UK government expecting to cut rates due to the global impact of the coronavirus, the full impact on borrowing options will need to be considered in more detail. For the PWLB, whilst the attractiveness of this route has reduced following the issues described in paragraph 3.5, options will nonetheless still be considered for EIP (equal instalment payments), maturity and annuity loans, 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 assuming this is still available. This discounts certain loans at

20 basis points if an organisation can demonstrate its solvency with a sound and viable medium-term financial strategy, which can support the request for borrowing. The OPFCC's Medium Term Financial Strategy (MTFS) would 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. A proposed borrowing approach is demonstrated in Table 4 below.

Table 4 – Borrowing 2020/21

Borrowing approach	Maximum limit 2020/21 (*1)	Proposed element within borrowing profile 2020/21(*2)	Proposed % profile within borrowing structure 2020/21 (*3)
PWLB (non-LOBO's)	£20m	£1.5m	10%
PWLB (LOBO's)	Higher of £5m or 25% of all external borrowing	£0m	n/a
Any institution approved for investments	£20m	£9m	60%
Any other bank or building society authorised to operate in the UK	£20m	£1.5m	10%
Any other UK public sector body	£20m	£3m	20%
UK public and private sector pension funds (except Essex Local Government Pension Scheme)	£5m	£0m	n/a
Capital market bond investors	£5m	£0m	n/a
UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues	£5m (but subject to paper to OPFCC)	£0m	n/a

Notes:-

(*1) Any borrowing undertaken in 2020/21 will be restricted to the authorised limit for the OPFCC, as set out in the Capital Strategy document.

(*2) Based upon £15m expected borrowing requirement in 2020/21, as set out in Table 1.

(*3) Guideline debt profile only.

- 3.13 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).
- 3.14 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.

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 in excess of £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 first quarter of 2020/21 (depending on the timing of forecast capital receipts) with cash balances reducing as the financial year progresses, ultimately dropping into a deficit position during the second half of the year.
- 4.2 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.
- 4.3 Where balances are expected to be invested for more than one year, the OPFCC 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. In 2019/20 the current approach adopted by the OPFCC is not to place investments any longer than one year. However, the proposal is to change this approach for 2020/21 onwards, thus giving the OPFCC additional options to place funds into higher interest earning opportunities, whilst maintaining sufficient liquidity to manage its working capital via the approaches described in paragraph 4.4.
- 4.4 Following the outbreak of the Coronavirus and the associated impact on the wider economy, there is a risk that the UK could enter a recession in 2020/21. In addition there is a significant possibility that the Bank of England will reduce 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. 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 continued priority will be to continue to invest the majority of surplus funds in secure and highly liquid financial instruments over the coming twelve months. The main areas the OPFCC will be focusing on will be local authority deposits, treasury bills and a wider use of money market funds. In respect of the latter, the intention is to set up at least two additional money market funds domiciled in the UK. This will provide additional liquidity and access to more favourable interest rates, whilst continuing to manage operating risks in respect of Brexit.

4.5 Whilst the PFCC continues to review all investment options available, including diversifying into higher yielding asset classes, the ongoing uncertainty in respect of Brexit and what this means to the UK economy, means that the OPFCC is not planning to radically change its current investment approach at the current time. This approach reflects the heightened uncertainty over the ultimate impact of the EU Exit process and the increased financial risks arising. However, the OPFCC will consider some diversification into more secure and higher yielding asset classes, with an amount of money ring-fenced for longer-term investment into a pooled fund (see paragraph 4.13) if this does not unduly impact on the wider Treasury Management Strategy priorities and the pooled fund in question meets the approved criteria as set out within this strategy. This diversification will represent the first steps into a potential substantial change in investment strategy over the coming years. Please refer to paragraph 4.14 for the next steps forward on this work.

4.6 **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:-

4.7 **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.

4.8 **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.

4.9 **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.

4.10 **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.

4.11 **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.

- 4.12 **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.
- 4.13 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, following discussions with the OPFCC and its treasury advisors during 2019/20, some activity is planned within 2020/21. A subsequent paper will be presented to the OPFCC with further detail about this proposal including analysis of risk and compliance, as well as the potential additional yields by using them. Therefore, whilst in theory pooled funds are permitted within the 2020/21 Treasury Management Strategy additional information and analysis will be provided to the OPFCC before any related investments are made.
- 4.14 For 2020/21 the OPFCC may invest its surplus funds in any of the approved instruments (as specified in 4.6) 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 below A-	£1m (overnight)	n/a	n/a	n/a	n/a

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
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
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
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

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
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 4.16 of the 2020/21 Treasury Management Strategy for further details				
Other pooled funds (including estates trusts, property funds and equity shares)	£5m per fund, but subject to the conditions set out in see paragraph 4.13 of the 2020/21 Treasury Management Strategy				

*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.

4.15 **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

- 4.16 **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) Investment exposure is diversified, as far as practical, over multiple MMF's, with broadly equal exposure to each fund.
 - iii) Assuming condition i) is initially met, investments in each MMF are limited to 10% of total investments held at any time.
 - iv) Overall exposure to MMF's as a whole is limited to 50% of total investments held at any time.
- 4.17 **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.
- 4.18 **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
- 4.19 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.
- 4.20 Investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
- 4.21 **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.

- 4.22 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.
- 4.23 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.
- 4.24 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% <u>rise</u> in interest rates	(£50,000)
Upper limit on one year revenue impact of a 1% <u>fall</u> in interest rates	(£50,000)

- 5.3 The above figures reflect the potential impact of a rise or decrease in the current base rate of 0.75% to either 1.75% or -0.25%. The figures shown show the estimated net impact arising with potentially more costs arising in both instances. 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:

	2020/21	2021/22	2022/23
Limit on principal invested beyond one year	£5m	£10m	£10m

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 2020/21 is £0.150m based on expected yield, balanced against the OPFCC requirement to focus on liquidity and security of funds. The budget for debt interest payable in 2020/21 is £0.151m based on an anticipation that the OPFCC will have a borrowing requirement during the upcoming year. 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 public sector entities to adopt. The PFCC 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

Investment position at 31st March 2019

	31/3/19 £000	Start date	Maturity date	Approx. Rate %
Call/notice accounts				
Santander UK PLC	1,650			0.70%
Barclays Bank PLC	1,499			0.50%
Total	3,149			
Money market funds				
Aberdeen	5,000			0.74%
Insight	5,000			0.71%
Total	10,000			
Fixed term deposits				
Bank of England DMO	3,500	25/09/19	01/10/19	0.50%
Bank of England DMO	1,500	30/09/19	07/10/19	0.50%
Nationwide BS	1,500	15/07/19	15/01/20	0.81%
Coventry BS	1,500	15/07/19	15/01/20	0.86%
Goldman Sachs	1,500	15/07/19	15/01/20	0.85%
Total	9,500			
Treasury Bills				
Bank of England DMO	4,991	08/07/19	07/10/19	0.69%
Bank of England DMO	4,991	15/07/19	14/10/19	0.72%
	9,982			
Other				
Lloyds current account	618			0.40%
	618			
Total all investments	33,249			

Investment position at 31st January 2020

	31/1/20 £000	Start date	Maturity date	Approx. Rate %
Call/notice accounts				
Santander UK PLC	260			0.70%
Barclays Bank PLC	1,500			0.50%
Total	1,760			
Fixed term deposits				
Bank of England DMO	2,000	27/01/20	07/02/20	0.41%
Derbyshire Council	5,000	27/01/20	28/02/20	0.60%
Coventry BS	1,500	15/01/20	23/03/20	0.63%
Total	8,500			
Money market funds				
Aberdeen	5,000			0.75%
Insight	4,000			0.70%
Total	9,000			
Other				
Lloyds current account	35			0.40%
	35			
Total all investments	19,295			

External Context

Economic background: The global economic outlook has rapidly deteriorated with the escalation and spread of coronavirus (COVID-19) to all regions and concerns over its scale and longevity. The economic shock is affecting both supply and demand sides of economies through disruption to trade, containment efforts by governments, corporates and individuals and the damage to sentiment could halve global growth from 2.9% to 1.5% in 2020 (OECD), with a worse-case scenario of a sharper contraction and global recession.

Prior to the virus, the more stable political environment had prompted a partial return in business and household confidence, and a bounce in economic activity and inflation. Whether this can be maintained or at least returned to during this year depends on the extent and duration of the virus impact.

Elsewhere, the UK's progress negotiating its exit from the European Union, following the agreement of the deal in January 2020, together with its future trading arrangements, will continue to be a major influence on the OPFCC's treasury management strategy for 2020/21.

UK Consumer Price Inflation (CPI) for January registered 1.8% year on year, up from 1.3% in December 2019. Core inflation, which excludes the more volatile components, rose to 1.6% from 1.4% in January. The most recent labour market data showed the unemployment rate at 3.9% with the employment rate at 76.5%, a record high. The headline 3-month average annual growth rate for pay was 2.9% in January as wages decreased slightly. In real terms, after adjusting for inflation, pay growth was 1.8%.

GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The Bank of England maintained the bank rate to 0.75% in January following a 7-2 vote by the Monetary Policy Committee. However, it is now expected that the MPC will deliver two 0.25% cuts in bank rate in quick succession, the first at an emergency meeting in March. This is due to the economic impact of coronavirus, which has rapidly become the major source of economic uncertainty.

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would

recommence its quantitative easing programme from November.

In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back of the ongoing trade war with China. The Fed has recently cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

Credit outlook: Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for any further impact of Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Interest rate forecast: The OPFCC's treasury management adviser Arlingclose is forecasting that the bank rate will reduce by two 0.25% rate cuts in quick succession. The risks to this forecast are deemed to be significantly weighted to the downside, particularly in light of the relatively new government, the need for greater clarity on the impact of Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise due to the issues of Brexit, now have more global issues directly impacting the UK economy.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

Economic & Interest Rate Forecast - underlying assumptions

Underlying assumptions:

The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.

Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.

A Brexit deal has been signed off on the 31 January 2020 but the ongoing impact is still to be assessed. While the Conservative government has maintained economic and political uncertainty, the key concern is the transitional period which will maintain and create additional uncertainty over the next few years.

UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.

While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in January 2020.

Inflation is running below target at 1.6%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.

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

Forecast:

It is now expected that the MPC will deliver two 0.25% cuts in bank rate in quick succession, the first at an emergency meeting in March. The downside risk is for the bank rate to fall to zero. Substantial risks to this forecast remain, arising from the economic impact of coronavirus, which has rapidly become the major source of economic uncertainty arising from disrupted global supply, falling demand and the effects of containment measures by governments and households.

Arlingclose judges that the risks are weighted to the downside.

Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.

We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Average
Official Bank Rate														
Upside risk	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.23
Arlingclose Central Cas	0.50	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.44
Downside risk	0.50	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.44
3-month money market rate														
Upside risk	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.25
Arlingclose Central Cas	0.50	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.44
Downside risk	0.50	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.44
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	0.23
Arlingclose Central Cas	0.65	0.40	0.45	0.60	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.65
Downside risk	0.30	0.30	0.40	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.57
5yr gilt yield														
Upside risk	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	0.38
Arlingclose Central Cas	0.30	0.20	0.25	0.35	0.60	0.60	0.60	0.65	0.65	0.70	0.70	0.70	0.70	0.54
Downside risk	0.35	0.35	0.40	0.55	0.60	0.60	0.60	0.65	0.65	0.70	0.70	0.70	0.70	0.58
10yr gilt yield														
Upside risk	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Cas	0.50	0.40	0.45	0.60	0.65	0.70	0.70	0.75	0.75	0.80	0.80	0.85	0.85	0.68
Downside risk	0.50	0.50	0.60	0.70	0.65	0.70	0.65	0.70	0.70	0.70	0.70	0.70	0.70	0.65
20yr gilt yield														
Upside risk	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Cas	0.75	0.70	0.75	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.00	1.05	0.88
Downside risk	0.50	0.50	0.60	0.70	0.65	0.70	0.65	0.70	0.70	0.70	0.70	0.70	0.70	0.65
50yr gilt yield														
Upside risk	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Cas	0.75	0.70	0.75	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.00	1.05	0.88
Downside risk	0.50	0.50	0.60	0.70	0.65	0.70	0.65	0.70	0.70	0.70	0.70	0.70	0.70	0.65

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%

PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Support Services

Directorate



KENT POLICE

ESSEX POLICE



Supporting policing
in Kent and Essex

Corporate Finance

Investment Strategy 2020/21

Meeting: 17th March 2020

Date: 6th March 2020

Author: Matthew Tokley



**ESSEX
POLICE**



**Kent
Police**

Corporate Finance, Essex Police Business Centre, Chelmsford Road, Great Dunmow, Essex CM6 1LW
Tel: 01245 452615

www.essex.police.uk www.kent.police.uk

Investment Strategy 2020/21

1.0 Introduction

- 1.1 Local authorities (including police forces) invest their money for three broad purposes:
- Because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
 - To support local public services by lending to or buying shares in other organisations (**service investments**), and
 - To earn investment income (known as **commercial investments** where this is the main purpose, e.g. investment properties).
- 1.2 The investment strategy document was introduced in 2019/20, meeting the requirement of statutory guidance issued by the government in January 2018, and focuses on the second and third of the categories listed in paragraph 1.1.
- 1.3 For the forthcoming year the OPFCC has decreed that service investments and commercial investments will not be used. Whilst this paper therefore satisfies the 2018 MHLG Investment Guidance in does not set out any detail or proposed approach in respect of these latter two types of investment.
- 1.4 The OPFCC will continue to concentrate on treasury management investments during 2020/21.

2.0 Treasury Management Investments

- 2.1 The OPFCC typically receives its income in cash (from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure. These activities, plus any impact of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy.
- 2.2 The balance of treasury management investments is expected to fluctuate between £0m and £60m during the 2020/21 financial year.
- 2.3 **Contribution:** The contribution that these investments make to the objectives of the Force is to support effective treasury management activities.
- 2.4 **Further detail:** Full details of the OPFCC's policies and its plan for 2020/21 for treasury management investments are covered in a separate document, the treasury management strategy.

3.0 Service Investments: Loans

- 3.1 **Contribution:** The OPFCC has the option to lend money to support local public services and stimulate local economic growth.

3.2 Examples of who the OPFCC could lend to for this purpose are listed below:-

- Suppliers
- Local businesses
- Local charities
- Housing associations
- Local residents
- Employees

3.3 **Security:** The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the authority concerned, upper limits on the outstanding loans to each category of borrower will typically be set at the start of each financial year. Accounting standards also require any authority to set aside loss allowance for these loans, reflecting the likelihood of non-payment.

3.4 **Risk assessment:** In the event the OPFCC enter into service loans with any of the above stakeholders a separate risk of loss will be calculated.

3.5 It is not currently expected that the OPFCC will enter into any service loans during 2020/21 and therefore no borrowing limits or details of calculating the risk of loss for such loans have been included in this report.

4.0 **Service Investments: Shares**

4.1 **Contribution:** The OPFCC has the option to invest in shares to support local public services and stimulate local economic growth.

4.2 Examples of who the OPFCC could invest in for this purpose are listed below:-

- Suppliers
- Local businesses

4.3 **Security:** One of the risks in investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk upper limits on the sum invested in each category of shares will typically be set at the start of each financial year.

4.4 **Risk assessment:** In the event the OPFCC invest in shares with any of the above stakeholders a separate risk of loss will be calculated, including the maximum periods for which funds may prudently be committed.

4.5 It is not currently expected that the OPFCC will undertake any service investments relating to shares during 2020/21 and therefore no investment limits or details of calculating the risk of loss for such investments have been included in this report. This includes any shares which meet the criteria of 'non-specified' investments in the government guidance.

5.0 **Commercial Investments: Property**

- 5.1 **Contribution:** The OPFCC has the option to invest in property with the intention of making a profit that will be spent on local public services.
- 5.2 **Security:** In accordance with government guidance the OPFCC will consider a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.
- 5.3 A fair value assessment of the OPFCC's investment property portfolio will be made for the preceding twelve month period at each year-end. The underlying assets provide security for investment.
- 5.4 Should the year-end accounts and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to the Commissioner detailing the impact of the loss on the security of investments and revenue consequences arising therefrom. Any mitigating actions which need to be taken to protect the capital invested will also be referenced in this report.
- 5.5 **Risk assessment:** The OPFCC will assess the risk of loss before entering into and whilst holding any property investments.
- 5.6 **Liquidity:** Compared to other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. Where these investments are used assurance will need to be obtained to ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed.
- 5.7 It is not currently expected that the OPFCC will undertake any commercial property investments during 2020/21 and therefore no detailed guidance in respect of how the risk of loss for such investments will be managed, have been included in this report.

6.0 **Other Categories of Investment**

- 6.1 **Loan Commitments and Financial Guarantees:** Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the OPFCC and reference to these types of investment are included here for completeness.
- 6.2 **Borrowing in Advance of Need:** Government guidance states that the OPFCC must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. It should be noted that the OPFCC previously included this option in its Treasury Management Strategy (e.g. to take advantage of cheaper borrowing) but this approach will no longer be considered. Any future investment/borrowing options in respect of taking advantage of future interest rates forecasts will be discussed with our advisers Arlingclose, to ensure we comply with regulations and risk exposure is minimised.

7.0 **Capacity, Skills and Culture**

- 7.1 **Corporate Governance:** Decision-making in respect of cashflow forecasting, investments and borrowing has been delegated by the OPFCC to the Corporate Finance Team who undertake daily processes and periodically report to the Acting Treasurer, both in respect of retrospective performance and forward-looking plans. The Corporate Accounting Manager will prepare an annual treasury management strategy, investment strategy and capital strategy at the start of each year. A half-year treasury performance report will be prepared during the year followed by an outturn performance report each May. All the above papers will be submitted to boards administered by the OPFCC, with final approval/sign-off by the PFCC.
- 7.2 **Training:** The CIPFA Code requires the OPFCC to ensure that persons with responsibility for treasury management receive adequate training to undertake their duties. This applies to both staff delegated with responsibilities and decision making duties for related tasks, as well as those responsible for scrutiny. In respect of the latter, the PFCC and Deputy PFCC, Acting Treasurer and Essex Police Chief Finance Officer will all be provided with appropriate training and awareness. This will be achieved by internal workshops as well as attendance at external courses such as those run by Arlingclose or CIPFA. Relevant staff will also be encouraged to study professional qualifications from CIPFA and other appropriate organisations.
- 7.3 **Treasury Management Consultants:** The OPFCC uses Arlingclose as its external treasury management advisers. The PFCC recognises that responsibility for treasury management decisions remains with the PFCC at all times and will ensure that undue reliance is not placed upon our external service providers. The PFCC also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The PFCC will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review.

8.0 **Investment Indicators**

- 8.1 Where the OPFCC chooses to use a range of investments (as those shown in paragraphs 2 – 5) in addition to its treasury management investments, a range of quantitative indicators will typically be used to allow the PFCC and the public to assess the OPFCC's total risk exposure as a result of its investment decisions and financial instruments portfolio.
- 8.2 As the OPFCC does not currently plan to be involved in any service investments or place any commercial investments during 2020/21, no separate indicators have been included in this report and all related aspects of risk management for treasury activity, and associated indicators, are included instead within the separate treasury management strategy document.

Support Services

Directorate



KENT POLICE

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Supporting policing
in Kent and Essex

Corporate Finance

Capital Strategy 2020/21

Meeting: 17th March 2020

Date: 5th March 2020
Author: Matthew Tokley



Corporate Finance, Essex Police Business Centre, Chelmsford Road, Great Dunmow, Essex CM6 1LW
Tel: 01245 452615

www.essex.police.uk www.kent.police.uk

Capital Strategy 2020/21

1.0 Introduction

- 1.1 The OPFCC has adopted the Chartered Institute of Public Finance and Accountancy's *Prudential Code of Practice in the Public Services*, which now requires the PFCC to approve a capital strategy before the start of each financial year. Para 21 Prudential Code states: *The Capital Strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.*
- 1.2 This is a new requirement under the CIPFA Prudential Code effective from 1st April 2019. The Prudential Code provides a clear set of objectives and a framework within statutory legislation that proposes new capital expenditure to be evaluated to ensure that all new capital investment is targeted at meeting the pledges within the PFCC's vision, aims and priorities.
- 1.3 The Capital Strategy forms a key part of the Commissioner's overall Corporate Planning Framework. It provides a mechanism by which the OPFCC's capital investment and financing decisions can be aligned over a medium term (five year) planning timescale.
- 1.4 This document sets the framework for all aspects of the capital and investment expenditure; including planning, outcomes, prioritisation, management, funding and repayment. The strategy has direct links to the other management plans such as the Estates Strategy, IT Strategy and the Treasury Management Strategy and forms a key part of the Medium Term Financial Strategy (MTFS).
- 1.5 There are four main areas of spend which feature within the Capital Programme: Estates Strategy, Estates Business as Usual, Transport and Information Technology. These support the vision and strategic priorities for the PFCC as highlighted in the *Police and Crime Plan 2016/2020*.
- 1.6 The Capital Strategy also provides a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance the reader's understanding of these sometimes technical areas.

2.0 Objectives

- 2.1 The key aims of the Capital Strategy are to:
 - Provide a clear set of objectives and a framework within statutory legislation that proposes new capital expenditure to be evaluated to ensure that all new capital investment is targeted at meeting the criteria set out in paragraph 2.1.

- Identify, programme and prioritise capital requirements and proposals arising from business plans submitted through a stringent gateway appraisal mechanism comprising of strategic outline cases (stage 1) and full business cases (stage 2);
- Consider options available for funding capital expenditure and how resources may be maximised to generate investment in the area and to determine an affordable and sustainable funding policy framework, whilst minimising the ongoing revenue implications of any such investment;
- Identify the resources available for capital investment over the five year MTFS planning period;
- Ensure the strategy has an overall balance of risk on a range of investments incorporating timespan, type of investment and rate of return;
- Establish effective arrangements for the management of capital expenditure including the assessment of project outcomes, budget profiling, deliverability, value for money and security of investment; and
- Deliver projects that focus on supporting the long-term benefits to policing in Essex, as per the priorities listed below:
 - More local, visible and accessible policing
 - Crack down on anti-social behaviour
 - Breaking the cycle of domestic abuse
 - Reversing the trend in serious violence
 - Tackle gangs and organised crime
 - Protecting children and vulnerable people
 - Improve safety on our roads

3.0 Governance of the Capital Programme

- 3.1 Governance processes will be put in place and adhered to, following standing orders and financial regulations to ensure that available resources are allocated optimally and deliver value for money, and that capital programme planning is determined in parallel with the service and revenue budget planning process within the framework of the MTFS. These include:-
- The PFCC Performance and Resources Board which is responsible for approving capital and revenue budget monitoring reports as well as scrutinising the MTFS documents;
 - The PFCC Strategic Board which is ultimately responsible for approving the capital strategy and the five year capital programme (2020/21 to 2024/25), changes to the programme within financial regulations and for the approval of final business cases (stage 2); and
 - The Police, Fire and Crime Panel, formally approve the capital programme and MTFS (the 2020/21-2024/25 programme was approved on the 6th February 2020).

- 3.2 The PFCC will require the Chief Constable to put in place mechanisms which will seek to ensure that there is an integrated approach to addressing cross-cutting issues and developing and improving service delivery through its capital investment in pursuance of the PFCC's over-arching aims. These include:-
- The Capital Management Board which has overall responsibility for the management and monitoring of the capital programme and ensuring the impact on service delivery is well-managed and ensures value for money;
 - The Estates Change Board and IT Steering Board which have overall responsibility for the strategic review of their projects; and
 - Specific Project boards with key stakeholders may be set up to manage and take the project forward, and identify any risks which could affect the project or the Force.

4.0 Capital Priorities

- 4.1 Underlying the capital strategy is the recognition that the financial resources available to meet the seven priorities as laid out in his Police and Crime Plan are constrained in the current economic and political climate. Therefore we must seek ways in which investment decisions can be no less than self-sustaining or generate positive returns both in terms of meeting corporate objectives and producing revenue savings.
- 4.2 The Estates Strategy identifies significant backlog maintenance issues across the property portfolio. It identifies the necessary investment needed to bring the remaining asset stock up to current standards, which would require a level of investment that is currently unaffordable. The current buildings are outdated and unsuitable for modern policing. Therefore the priority is to dispose of any surplus assets then the limited capital resources available via grant and capital receipts are prioritised to maximise outputs with minimal ongoing future revenue costs.
- 4.3 Collaboration with partners such as the Essex Fire and Rescue Service (ECFRS), neighbouring police forces and district councils across Essex, provide opportunities to co-locate and share assets for the good of the community. Every opportunity to share with these collaborative partners will be explored as a principle before any further assets are purchased.
- 4.4 Business cases for approval by the Commissioner will:-
- Measure proposed investment against the seven priorities in the Police and Crime Plan and invest accordingly;
 - Reduce the backlog maintenance liability by rationalising office accommodation and other operational estate. The rationalisation will be in the form of moving out of leased / rented accommodation and sales of surplus assets;
 - Invest in energy saving initiatives which reduce future running costs and reduce CO2 emissions;
 - Invest in opportunities to provide a future income stream to support revenue through the optimisation of resources;
 - Invest in ICT hardware and software on a case by case basis. The primary focus being channel shift into improved technologies

5.0 Capital Expenditure and Financing

5.1 Capital expenditure is where the OPFCC spends money on non-current assets, such as property or vehicles that will be used for more than one year. This includes spending on assets owned by other bodies, and, where applicable, loans and grants to other bodies enabling them to buy assets.

5.2 Section 16 of the Local Government Act 2003 specifies that there are three routes through which expenditure can qualify as capital expenditure for capital financing purposes:

- The expenditure results in the acquisition, construction or subsequent addition to a tangible or intangible non-current asset in accordance with proper practices;
- The expenditure meets one of the definitions specified by Regulations; or
- The Secretary of State makes a direction that the expenditure can be treated as capital expenditure.

The Local Authorities (Capital Financing and Accounting) (England) Regulations 2003 then exempts these three categories of expenditure from being charged to revenue.

5.3 The OPFCC is able to determine its own plans for capital investment, subject to adhering to a number of statutory provisions and professional requirements, including the CIPFA Prudential Code for Capital Finance in Local Authorities (*referred to as the Prudential Code*). The Prudential Code requires the OPFCC to assess and demonstrate that its capital investment plans are affordable, prudent and sustainable.

5.4 The strategy, the outcomes of which inform the MTFS, is intended to maximise the financial resources available for investment in service provision and improvements within the MTFS framework, whilst ensuring that each business case has a robust self-sustaining financial model that delivers on the wider outcomes and benefits for the force.

5.5 The main sources of capital funding are summarised as:-

5.5.1 Central government and regional funding

- Formula grant allocations – The OPFCC is anticipating that formula grants for capital projects will reduce to negligible levels by the end of the current MTFS period. This necessitates a different approach to funding.
- Specific grant allocations – Grants are allocated to specific programmes or projects and the OPFCC seeks to maximise such allocations, developing appropriate schemes which reflect government and partnership-led initiatives and agendas, but which also address the priority needs of policing in Essex.
- Grant and funding bids – The OPFCC will continue to bid for future resource allocations using innovative service delivery mechanisms. Examples of this funding includes the Police Transformation Fund and Regional Growth Fund.

5.5.2 Capital receipts

- Any consideration received in exchange for the sale of an asset which is above £10,000 is deemed a capital receipt, for use in financing further capital projects. The costs of disposing of such assets can also be capitalised and offset against the capital receipt, assuming they do not exceed 4% or more of the capital receipt value. Due to the number of property sales currently forecast over the short to medium term this is currently a significant income source for the OPFCC.

5.5.3 Debt

- External and internal borrowing is only used once all other sources of funding has been utilised. Due to the estate rationalisation the OPFCC currently has sufficient forecast capital receipts to fund its capital spend up to 2019/20. However, external borrowing will be needed to fund the shortfall from 2020/21 onwards.
- It should be noted that debt is only a temporary source of finance, since loans and leases must be repaid, and this therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP) or alternatively proceeds from selling capital assets (known as capital receipts). Further details of the OPFCC's minimum revenue provision approach is shown in section 10 of this document.

5.5.4 Reserves

- Any funding which has been allocated in a specific year, but is not required until future years will be carried forward in earmarked capital reserves. These reserves will vary from year to year, depending on the level of funding available and the timing of their respective projects.
- Reserves can be created from most sources of funding; grants, receipts, and insurance receipts/reserves.
- Working with other authorities/partners there may be opportunities in securing other additional funding.

5.5.5 Revenue

- Capital expenditure may be funded directly from revenue (CERA – capital expenditure charged to revenue account). In addition to specific revenue funds

previously set aside, capital expenditure may be funded by specific revenue budget provision. However, the general pressures on the revenue budget and the extent to which the OPFCC can raise Council Tax, limit the extent to which this option may be exercised as a source of capital funding. The de-minimis limit for spend which can be capitalised is **£10,000 (£7,500 for vehicles)**.

- 5.6 For details of the forecast capital expenditure for the period 2020/21 to 2024/25 (and the proposed financing plan for these years) please refer to section 2 of the **2020/21 Treasury Management Strategy**. The main elements of the capital projects covered in this time period relate to those areas referred to in paragraph 4.4, but individual project detail can also be found in the appendices to the 2020/21 budget approved at the Police, Fire and Crime Panel on the 6th February 2020). These reports can be viewed via a link on the OPFCC website.
- 5.7 The OPFCC's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. For the difference between capital expenditure before and after the 1st April 2008 (e.g. in respect of CFR classifications) please refer to section 10. The CFR is expected to decrease by £0.5m during 2020/21. Based on the figures reported in the 2020/21 Treasury Management Strategy the OPFCC's estimated CFR is as follows:-

	31.3.19 actual CFR	31.3.20 forecast CFR	31.3.21 forecast CFR	31.3.22 forecast CFR	31.3.23 forecast CFR
Unfinanced amounts in respect of capital expenditure incurred before 1 st April 2008	£6.6m	£6.1m	£5.6m	£5.1m	£4.6m
Unfinanced amounts in respect of capital expenditure incurred after 1 st April 2008	£0.0m	£0.0m	£13.2m	£29.5m	£22.7m
Total	£6.6m	£6.6m	£18.8m	£34.6m	£27.3m

- 5.8 **Asset Management:** To ensure that capital assets continue to be of long-term use, the OPFCC has an asset management strategy in place. This is known as the Estates Strategy, the latest copy of which can be found on the OPFCC website.
- 5.9 **Asset Disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt.

6.0 Flexible Capital Receipts Strategy

- 6.1 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.
- 6.2 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 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.
- 6.3 A capital receipts strategy (covered within the Estates Strategy for the OPFCC) 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. This information should be prepared before the start of each financial year with any subsequent revisions made to the strategy as the year progresses.
- 6.4 The current guidance for the use of flexible capital receipts to finance revenue projects has extended the use of this option up until 31st March 2022 (e.g. a further three years from the original cut-off date of the 31st March 2019).
- 6.5 At the current point in time the PFCC does not anticipate taking advantage of this financing option on the basis all capital receipts need to be retained to pay for subsequent years capital expenditure (e.g. it must be recognised that use of capital receipts to fund revenue expenditure negates the use of the same funds for capital investment). It is therefore unlikely at the current time that the OPFCC will be in a position to take advantage of this approach before the flexibility is withdrawn in 2022.

7.0 Borrowing Approach

- 7.1 When borrowing the OPFCC must demonstrate compliance with the Prudential Code making sure that it is affordable, prudent and sustainable. To meet this requirement the OPFCC aims to achieve a low but certain cost of finance whilst retaining flexibility should plans change in future. These objectives are often conflicting, and the OPFCC therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0% to 3.0%).
- 7.2 Prudential borrowing does provide an option for funding additional capital development but one which has to be funded each year from within the revenue budget or from generating ongoing longer term income streams.
- 7.3 It is forecast that there will be a requirement for structured external borrowing during 2020/21 and this is covered within further detail in the 2020/21 Treasury Management Strategy.

7.4 **Affordable borrowing limit:** The OPFCC is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance a lower ‘operational boundary’ is also set as a warning level should debt approach the affordable borrowing limit. The limits for the current year and subsequent three years are shown below:-

	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit
Authorised limit – borrowing	£20m	£25m	£40m	£40m
Operational boundary	£10m	£20m	£30m	£30m

7.5 The OPFCC’s borrowing strategy for the coming year is outlined in further detail within the **Treasury Management Strategy 2020/21 (section 3)**.

8.0 **Liabilities**

8.1 In addition to the debt referred to in paragraph 5.7, the OPFCC is committed to future payments to cover its fund pension fund deficit for its Police Officer and Police Staff schemes (valued at £3.249m as at the 31st March 2019). The OPFCC has also set aside significant funds in provisions and reserves for various purposes, as referred to in the OPFCC Statement of Accounts (the latest version of which, the 2018/19 accounts, can be found on the OPFCC website). The OPFCC is also at risk of having to pay for some of its contingent liabilities (again referred to in the 2018/19 Statement of Accounts) and some funds have been set aside for these during 2019/20 based on best estimates of potential liabilities.

8.2 Decisions on incurring new discretionary liabilities are taken by Heads of Department in consultation with the Chief Finance Officer of the Chief Constable, and the Acting Treasurer for the OPFCC. The risk of liabilities crystallising and requiring payment is monitored by Corporate Finance and reported quarterly to the Chief Constable and the PFCC during the year, within the budget monitoring reporting process.

9.0 **Revenue Budget Implications**

9.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP is charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream e.g. the budget requirement for the OPFCC (the amount funded from Council Tax and general government grants). The ratios for the previous, current and subsequent three years are shown below:-

	2018/19 actual	2019/20 forecast	2020/21 forecast	2021/22 forecast	2022/23 forecast
Interest receivable	(£0.167m)	(£0.180m)	(£0.150m)	(£0.150m)	(£0.150m)
Interest payable	£0.002m	£0.002m	£0.167m	£0.375m	£0.305m
MRP	£0.500m	£0.500m	£0.500m	£0.800m	£1.700m
Net financing costs	£0.335m	£0.322m	£0.517m	£1.025m	£1.855m
Net budget requirement	£277,400m	£297,600m	£314,700m	£319,600m	£324,700m
Proportion of net revenue stream	0.0012%	0.0011%	0.0016%	0.0032%	0.0057%

- 9.2 Further details on the revenue implications of capital expenditure can be found within the 2020/21 budget papers presented to the Police, Fire and Crime Panel (see paragraph 5.6 for further details).
- 9.3 **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Prudential Code limits the charging of MRP for an asset to a maximum of 50 years. The PFCC is satisfied that the proposed capital programme is prudent, affordable and sustainable.

10.0 Minimum Revenue Provision (MRP) Policy Statement

- 10.1 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 2018.
- 10.2 The broad aim of the CLG guidance is to ensure that capital expenditure is financed 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.
- 10.3 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.

10.4 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).

10.5 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 e.g. capital expenditure incurred during 2020/21 will not be subject to an MRP charge until 2021/22.

10.6 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

10.7 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 (Option 3 of the CLG guidance in England and Wales).

10.8 If applicable, for any capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the OPFCC will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational.

10.9 Based upon the OPFCC's latest estimate of its Capital Financing Requirement on 31st March 2020, the budget for MRP has been set as follows:

	31.03.2020 Estimated CFR £m	2020/21 Estimated MRP £
Capital expenditure before 01.04.2008	6.100	0.500
Capital expenditure after 01.04.2008	0.000	0.000
Total	6.600	0.500

10.10 The capital financing requirement arising from the period prior to 01.04.2008 relates to miscellaneous unfinanced capital expenditure relating to various assets no longer held by the OPFCC.

10.11 Whilst the guideline MRP for the pre-April 2008 expenditure is 4% (e.g. £244k per annum based on the forecast £6.1m of pre-2008 debt at the end of 2019/20) the PFCC has chosen to increase this to a more prudent £500k per annum. Whilst the current guidance allows for an outstanding CFR to be held in respect of assets no longer held it is the OPFCC's intention to clear this debt as soon as possible (taking into account other budget constraints) and the £500k value being repaid per annum reflects this objective. Whilst there is expected to be unfinanced capital expenditure in 2020/21 there will not be any related MRP costs arising until 2021/22 (as per the explanation in paragraph 10.5).