Strategic Board Programme

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

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Annexe 1

Corporate Finance

Treasury Management Strategy 2021/22

Meeting: 24th February 2021

Date: 9th February 2021 (with agreed updates actioned 29th March and 9th May 2021)

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Treasury Management Strategy (TMS) 2021/22

1.0 Introduction

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

1.2 The PFCC invests 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 risks are therefore central to the PFCC's prudent financial management.

1.3 Treasury risk management at the PFCC 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 PFCC'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 In addition to ensuring the above issues are managed effectively and the PFCC complies with its legal obligations, the other main purpose of the treasury management strategy is to assess the financing requirement of the PFCC's capital investment plans, and the level of borrowing required for that expenditure.

2.0 Local Context

2.1 On the 31st January 2021 the PFCC held £22.2m of investments with no external borrowings (31st March 2020, £16.7m). 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 PFCC's nominated Section 151 Officer (and copied into the Chief Finance Officer for the Chief Constable), summarising the previous two weeks' performance as well as setting out 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 PFCC'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 4th February 2021 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. The impact of COVID-19 may also have a significant impact on the Estates Strategy due to the wider adoption of agile working approaches and therefore these potential variables need to be noted.

2.5 The tables below demonstrate a capital programme which will provide significant challenges from 2020/21 onwards, with expenditure outstripping funding available and the PFCC falling into a capital resources deficit position before the end of the 2020/21 financial year. Over the course of the following five year period this deficit is forecast to widen to a position of nearly £60m by the end of 2025/26, with over 55% of capital expenditure (£60m of the total £110m) forecast over the six years including 2020/21, expecting to be funded by borrowing based on current forecasts. The latest information available for the capital programme including the potential funding gap, as well as the resources available are shown in Tables 1 and 2 below. It should be noted that the above narrative refers to borrowing in the context of unfunded capital expenditure. The external cash requirement element of this borrowing is explored further in subsequent paragraphs, specifically in Table 4 and paragraph 2.12.

Table 1 – 5 year Capital Investment Programme 2020/21 – 2025/26 (reported position for the Police, Fire & Crime Panel on the 4th February 2021)

CAPITAL PROGRAMME - 2021/22 BUDGET SETTING POSITION
EXPENDITURE & FINANCING SUMMARY

	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000	TOTAL £000
Capital Expenditure							
ANPR	190	280	145	145	145	1,000	1,905
Body Armour	308	370	238	238	238	-	1,391
Estates Business as Usual	1,411	4,338	11,460	12,000	10,000	-	39,209
Estates Strategy	8,114	5,521	8,813	8,029	500	-	30,977
I.T. Services	4,148	5,396	4,298	3,209	3,583	79	20,713
OPC	211	613	25	65	65	240	1,218
Other	-	-	22	-	-	-	22
SCD	453	61	2,217	2,230	2,200	2,200	9,361
Transport	2,487	2,501	-	30	-	250	5,267
	17,320	**19,079**	**27,218**	**25,945**	**16,731**	**3,769**	**110,064**
Financing Source							
Capital receipts	(6,989)	(5,620)	(8,725)	(11,528)	(4,954)	(1,517)	(39,334)
Grants & contributions	(381)	(554)	(277)	(277)	(277)	(252)	(2,018)
Revenue funding	(426)	(3,046)	(2,233)	(1,000)	(1,000)	(1,000)	(8,705)
Borrowing	(9,525)	(9,859)	(15,983)	(13,140)	(10,500)	(1,000)	(60,007)
	(17,320)	**(19,079)**	**(27,218)**	**(25,945)**	**(16,731)**	**(3,769)**	**(110,064)**
Total Unfinanced Expenditure	-	-	-	-	-	-	-

Table 2 – 5 year Capital Resources Summary 2020/21 – 2025/26 (reported position for the Police, Fire & Crime Panel on the 4th February 2021)

CAPITAL PROGRAMME - 2021/22 BUDGET SETTING POSITION
CAPITAL RESOURCES SUMMARY

	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000
Capital receipts						
Opening balance	(1,088)	-	-	-	(6,472)	(1,517)
Received	(5,901)	(5,620)	(8,725)	(18,000)	-	-
Applied for financing	6,989	5,620	8,725	11,528	4,954	1,517
Closing balance	-	-	-	**(6,472)**	**(1,517)**	-
Grants and contributions						
Opening balance	(7)	-	-	-	-	-
Received	(374)	(554)	(277)	(277)	(277)	(252)
Applied for financing	381	554	277	277	277	252
Closing balance	-	-	-	-	-	-
Revenue funding						
Opening balance	(2,000)	(3,279)	(1,233)	-	-	-
Received	(1,705)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Applied for financing	426	3,046	2,233	1,000	1,000	1,000
Closing balance	**(3,279)**	**(1,233)**	-	-	-	-
Totals						
Opening balance	(3,095)	(3,279)	(1,233)	-	(6,472)	(1,517)
Received	(7,980)	(7,174)	(10,002)	(19,277)	(1,277)	(1,252)
Applied for financing	7,796	9,220	11,235	12,805	6,231	2,769
Closing balance	**(3,279)**	**(1,233)**	-	**(6,472)**	**(1,517)**	-

2.6 Included within the above figures is the continued trend of capital receipts coming into the force as the PFCC rationalises its asset base and disposes of a large number of surplus assets. As at the 31st January 2021 five disposals have been achieved in the financial year (totalling £3.1m). Further disposals are expected by the end of 2020/21 equating to an additional approximate sum of £2.5m, and thus a total forecast amount of £5.9m. Whilst in the past this income has been largely sufficient to fund the capital programme each year it is no longer the case that these funds will bridge the deficits in the PFCC's capital programme.

2.7 Therefore, from 2020/21 onwards the capital resources position will be in deficit meaning structured borrowing will be required, on top of the existing £6.065m historic capital financing requirement (CFR) as at the start of 2020/21. From 2021/22 onwards there is also expected to be a requirement to source external borrowing to meet this funding gap e.g. the capital borrowing position will have a direct impact on treasury management and force cashflows. This borrowing requirement is set out in Table 3 below, whilst the proposed approach in dealing with these deficits is explained further in the borrowing strategy section of this document.

Table 3 – 5 year CFR and MRP Summary 2020/21 – 2025/26 (reported position for the Police, Fire & Crime Panel on the 4th February 2021)

CAPITAL PROGRAMME - 2021/22 BUDGET SETTING POSITION

Capital Financing Requirement (CFR) & Minimum Revenue Provision (MRP) SUMMARY

	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000	TOTAL £000
Opening CFR	**6,065**	**15,090**	**24,212**	**39,210**	**50,816**	**59,453**	**6,065**
Capital Expenditure							
Approved projects - long-life	9,527	6,239	460	-	-	-	**16,226**
Approved projects - short-life	7,794	2,243	57	35	35	-	**10,164**
Subject to Approval projects - long-life	-	-	1,000	1,000	1,000	-	**3,000**
Subject to Approval projects - short-life	-	3,118	4,663	3,616	3,931	-	**15,328**
New bids - long-life	-	3,620	13,250	13,500	9,500	1,000	**40,870**
New bids - short-life	-	3,860	7,788	7,794	2,265	2,769	**24,476**
	17,321	**19,080**	**27,218**	**25,945**	**16,731**	**3,769**	**110,064**
Financing Applied							
Capital receipts	(6,989)	(5,620)	(8,725)	(11,528)	(4,954)	(1,517)	**(39,334)**
Grants & contributions	(381)	(554)	(277)	(277)	(277)	(252)	**(2,018)**
Revenue funding	(426)	(3,046)	(2,233)	(1,000)	(1,000)	(1,000)	**(8,705)**
	(7,796)	**(9,220)**	**(11,235)**	**(12,805)**	**(6,231)**	**(2,769)**	**(50,057)**
Minimum Revenue Provision							
Historic unfinanced borrowing	(500)	(500)	(500)	(500)	(500)	(500)	**(3,000)**
Current projects - long-life	-	(238)	(485)	(852)	(1,181)	(1,443)	**(4,200)**
Current projects - short-life	-	-	-	(182)	(182)	(182)	**(545)**
	(500)	**(738)**	**(985)**	**(1,534)**	**(1,863)**	**(2,125)**	**(7,745)**
Closing CFR	**15,090**	**24,212**	**39,210**	**50,816**	**59,453**	**58,327**	**58,327**

FINANCING COSTS	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000	TOTAL £000
Minimum Revenue Provision (MRP)	500	738	985	1,534	1,863	2,125	**7,745**
Borrowing Costs (based on 0.5%)	-	20	63	80	119	125	**408**
Total revenue impact of borrowing	**500**	**759**	**1,048**	**1,614**	**1,981**	**2,250**	**8,153**
Incremental impact to MTFS	**500**	**259**	**290**	**566**	**367**	**269**	
Cumulative impact to MTFS	**-**	**259**	**807**	**1,921**	**3,402**	**5,153**	

2.8 The underlying need to borrow for capital purposes is measured by the 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 PFCC's total external debt for the upcoming year should be lower than its highest forecast CFR in the preceding year, the current year and the next two years. Table 3 above and Table 4 below shows that the PFCC expects to comply with this requirement during 2021/22 e.g. Table 4 shows the expected highest value of external borrowing for 2021/22 to be £17.5m (covered further in paragraph 2.12) which is lower than the highest forecast CFR value of £50.8m (2023/24) across the specified four year period, as per Table 3.

2.10 The figures from Table 3 are shown re-presented in Table 4 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 3 above, but with a wider treasury management/organisational perspective, including cash and investment balances being kept to a minimum at each year-end to maintain sufficient liquidity but reduce credit risk. In addition, a 'peak to trough cashflow' adjustment is included to calculate the mid-year liability benchmark figure, which represents a more accurate financial position of the PFCC, rather than at year-end which is normally closer to the lowest cash point throughout the year. This figure is estimated based upon council tax and other grant inflows, most notably the Home Office pension grant.

Table 4 – 5 year Liability Benchmark Summary 2020/21 – 2025/26 (reported position for the Police, Fire & Crime Panel on the 4th February 2021)

2021/22 BUDGET SETTING POSITION
BALANCE SHEET SUMMARY & FORECAST

	31st March 2020 £000	31st March 2021 £000	31st March 2022 £000	31st March 2023 £000	31st March 2024 £000	31st March 2025 £000	31st March 2026 £000
Loans: Capital Financing Requirement	6,065	15,090	24,212	39,210	50,816	59,453	58,327
Loans: External Borrowing (existing)	-	-	-	-	-	-	-
Internal/(over) borrowing	**6,065**	**15,090**	**24,212**	**39,210**	**50,816**	**59,453**	**58,327**
Less: Usable Reserves	(19,823)	(21,155)	(15,749)	(15,048)	(14,147)	(13,247)	(13,246)
Less: Working Capital Surplus	(300)	(500)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Investments/(new borrowing)	**14,058**	**6,565**	**(7,463)**	**(23,162)**	**(35,668)**	**(45,206)**	**(44,081)**
Net borrowing requirement	(14,058)	(6,565)	7,463	23,162	35,668	45,206	44,081
Preferred Year-End Position	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Liability Benchmark	**(4,058)**	**3,435**	**17,463**	**33,162**	**45,668**	**55,206**	**54,081**
Peak to Trough Cash Flow	(58,400)	(59,900)	(61,400)	(62,900)	(64,500)	(66,100)	(67,700)
Liability Benchmark (mid-year)	**(62,458)**	**(56,465)**	**(43,937)**	**(29,738)**	**(18,832)**	**(10,894)**	**(13,619)**

ASSUMPTIONS FOR BALANCE SHEET SUMMARY & FORECAST

	31st March 2020 £000	31st March 2021 £000	31st March 2022 £000	31st March 2023 £000	31st March 2024 £000	31st March 2025 £000	31st March 2026 £000
Debt-funded capital expenditure	-	9,525	9,860	15,983	13,140	10,500	1,000
Minimum revenue provision (MRP)	(500)	(500)	(738)	(985)	(1,534)	(1,863)	(2,125)
Change in Usable Reserves	2,986	(1,332)	5,405	701	901	901	1
Change in Working Capital	-	(200)	(500)	-	-	-	-
Net Cash Outflow/(Inflow)	**2,486**	**7,493**	**14,027**	**15,699**	**12,506**	**9,538**	**(1,125)**

2.11 The model assumes a flat working capital surplus of £1m from 2021/22 onwards, with cash balances maintained annually at a minimum of £10m. Usable reserves relate to general and earmarked reserves as well as capital receipts, with a profile based upon the current Medium-Term Financial Strategy (MTFS).

2.12 Table 4 demonstrates that the Liability Benchmark increases markedly from 2021/22 as capital resources reduce. Whilst this model assumes no existing external borrowing for presentational purposes, this requirement is shown in the 'Investments/(new borrowing)' line within the table, with £7.5m external borrowing required by the end of 2021/22 to reduce the burden on the PFCC's internal cash balances. Extrapolating this requirement forward to the end of 2025/26 shows an expected total amount of £44.1m of forecast external debt to fund capital expenditure during this period. Comparing this value to the cumulative £60.0m of 'Debt-funded capital expenditure' line in the assumptions sub-table, leaves a variance of £15.9m which is the element which will be funded from internal cash resources. It should also be noted that Table 4 sets out a minimum £10m amount of desired cash available which the PFCC requires to meet short-term cashflow commitments. Therefore, whilst external debt is forecast to be £7.5m by the end of 2021/22 this will actually most likely be comprised of £17.5m external borrowings and £10m investments. The revised total external debt across the medium-term is therefore actually forecast to be £54.1m taking this factor into account.

2.13 Whilst the 'Liability benchmark (mid-year)' figures in Table 4 do not provide meaningful information in respect of borrowing requirements for the period concerned, the figures do highlight that the PFCC typically has large surpluses of cash during the middle half of each financial year, due to the timings of grants and council tax precept income which are received during the first half of each year. However, as can be seen from the table above these figures also reduce significantly over the medium-term period, in line with the liability benchmark figure trend.

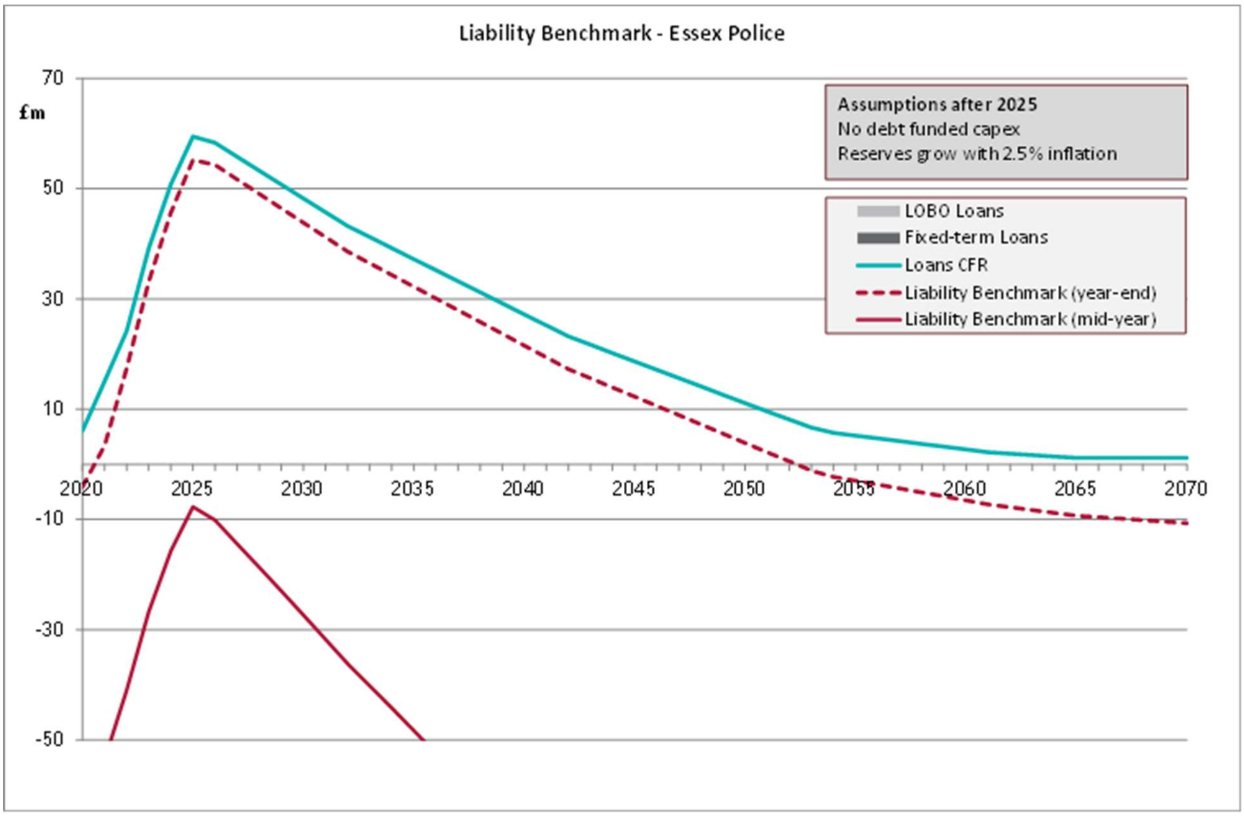
2.14 The cost of borrowing for the capital programme relates to two elements, minimum revenue provision (MRP) and the cost of debt interest. MRP is based on the asset life of the projects which need to be financed, and is the material element of the cost of borrowing. Please see the PFCC's Capital Strategy for further detail on the subject of MRP. The debt interest element is included within Table 3 and has less financial impact than MRP, particularly in light of the current market position. Please refer to the borrowing strategy (section 3) for further detail on these costs. From Table 4 it should be noted that annual MRP costs increase from £0.5m in 2020/21 to £2.1m in 2025/26.

2.15 Following on from the medium-term forecasts within Table 4, a long-term liability benchmark has been created in Table 5 below, which forecasts the PFCC's need to borrow over a 50 year period. This assumes the following from 2025/26 onwards:

- No further 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

2.16 The chart below directly links to Table 4 in respect of the trends shown. For the 'Loans CFR' line this shows the CFR peaking at just under £60m around 2025. From that point onwards the CFR steadily decreases with short-term projects prioritised for financing by existing resources, and property-based spend being allocated to borrowing and being repaid over 40 years. Whilst this trend gives a potential estimate of the longer-term CFR it should be noted that slippages to the capital programme will most likely change this profile. In addition, the model assumes no further debt-funded capital spend beyond 2025/26 which in reality is unlikely.

Table 5 – Liability Benchmark Chart



2.16 For some wider observations in respect of the external context and assumptions for the future, please see Appendix B.

3.0 Borrowing Strategy

3.1 The PFCC currently has no external borrowing but, as per paragraph 2.12, expects to borrow circa £44m between 2020/21 and 2025/26 based on the current capital programme projections, the vast majority of which is expected to be externally-sourced cash which will not exceed the PFCC's authorised limit of (external) borrowing.

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 PFCC's long-term plans change is a secondary objective.

3.3 Given the significant cuts to local government funding, the PFCC's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates 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 PFCC 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. The PFCC's treasury advisors Arlingclose will assist with this via a 'cost of carry' and breakeven analysis. Its output may determine whether the PFCC borrows additional sums at long-term fixed rates in 2021/22 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 is typically via HM Treasury and following the government decision to reduce its Public Works Loan Board (PWLB) rates by 1% in November 2020 this is once again a more viable source of funds. In addition, the PFCC will also look to borrow from other sources including banks, pensions and other 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 PFCC may arrange starting loans during 2021/22, 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 PFCC 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:-

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- 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 issues bonds on the capital markets and lends 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 PFCC 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 PFCC has the option to either accept the new rate or to repay the loan at no additional cost. The PFCC 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 2021/22.

Proposed borrowing approach 2021/22

3.12 In all likelihood the PFCC will look to use either local authorities or the PWLB for its external borrowing requirement in 2021/22. Based on current market conditions the PFCC would propose to structure any borrowing over the short-term only which for local authorities would mean an approximate rate of around 0.10%, equating to the current UK base rate.

3.13 For the PWLB, options will 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 continue to apply for the certainty rate, which discounts 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 PFCC's Medium Term Financial Strategy (MTFS) would be able to provide this assurance.

3.14 The PFCC has readily available access to the local authority markets for cash on a daily basis via its brokers, as well as dealing portals such as 'iDealTrade' and 'Kings'. Whilst rates vary on a daily basis based on bids submitted the local authority cash market remains a key component of the PFCC's borrowing options.

3.15 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 external borrowing approach for 2021/22 is presented in Table 6 below.

Table 6 – External Borrowing 2021/22

Borrowing approach	Maximum limit 2021/22 (note 1)	Proposed £ element within borrowing profile 2021/22 (note 2)	Proposed % element within borrowing profile 2021/22 (note 3)
PWLB (non-LOBO's)	£25m	£4.5m	25%
PWLB (LOBO's)	Higher of £5m or 25% of all external borrowing	£0m	0%
Any institution approved for investments	£25m	£0m	0%
Any other bank or building society authorised to operate in the UK	£25m	£0m	0%
Any other UK public sector body	£25m	£13m	75%
UK public and private sector pension funds (except Essex Local Government Pension Scheme)	£5m	£0m	0%
Capital market bond investors	£5m	£0m	0%
UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues	£5m (subject to specific approval from OPFCC)	£0m	0%

Notes on external borrowing limits:-

1. Any borrowing undertaken in 2021/22 will be restricted to the authorised limit for the PFCC, as set out in the Capital Strategy document.
2. Based upon £17.5m expected borrowing requirement in 2021/22, as per Table 4 e.g. assumes all debt-funded capital expenditure in year will be externally sourced.
3. Should the actual approach deviate from the above borrowing profile, this will be reported in-year to the PFCC.

4.0 Investment Strategy

4.1 The PFCC holds significant invested funds, representing income received in advance of expenditure, as well as balances and reserves held. In the past twelve months, the PFCC'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. In 2021/22 these balances are expected to reduce with a cash position close to zero by the end of the first quarter (depending on the timing of forecast capital receipts). Thereafter, cash balances will initially increase following the grant receipt, but then reduce over the subsequent months and ultimately falling into a deficit position during early 2022.

4.2 The PFCC 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.

4.3 Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as SONIA (expected to replace LIBOR at the end of 2021), subject to the limits on interest rate exposure. Where balances are expected to be invested for more than one year, the PFCC 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.

4.4 The COVID-19 pandemic has increased the risk that the Bank of England will set its bank rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Despite this rate cut not yet happening, the PFCC has nonetheless already received negative returns on some of its fixed term deposits with the Debt Management Deposit Facility (DMADF) during 2020/21. Since investments cannot in effect pay negative income, negative rates should actually be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested. This latter approach will be the expected wider market route adopted in a negative rate environment.

4.5 Given the increasing risk and very low returns from short-term unsecured bank investments, as well as the need to prioritise liquidity for the PFCC's cash flow, the continued priority will be to invest the majority of surplus funds in secure and highly liquid financial instruments over the coming twelve months. The main areas the PFCC will be focusing on will be money market funds and call accounts, as well as DMADF deposits, local authority deposits and treasury bills. In respect of money market funds two new accounts with Federated and Aviva will be in use with effect from the start of the 2021/22 financial year, both of which are domiciled in the UK thus providing extra assurance in respect of any ongoing impact felt in the economy following the UK's exit from the European Union.

4.6 Whilst the PFCC continues to review all investment options available, the ongoing uncertainty in the UK and global economies, means that the PFCC is not planning to radically change its investment approach at the current time. This approach incorporates the continued uncertainty over the longer-term impact of the EU Exit process and the increased financial risks arising. However, should economic conditions allow, the PFCC 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 if this does not unduly impact on the wider Treasury Management Strategy priorities, and the Strategic pooled fund in question meets the approved criteria as set out within this strategy. Please refer to paragraph 4.15 for further information on this.

4.7 Under the new IFRS 9 (Financial Instruments) accounting standard, the accounting for certain investments depends on the PFCC's business model for managing them. The PFCC aims to achieve value from its treasury investments by a business model of collecting the contractual cashflows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

4.8 For 2021/22 the PFCC may invest its surplus funds with any of the counterparty types in Table 7 below, subject to the limits shown.

Table 7 – Investment limits 2021/22

Treasury investment counterparties and limits 2021/22	Maximum time limit	Counterparty limit £	Sector limit £
UK central government (including DMADF facility)	10 years	Unlimited	Unlimited
UK local authorities & other government entities	5 years	£5m	Unlimited
Secured investments - UK (between A and AAA) fixed term-duration	1 year	Higher of £1m or 5%*	Unlimited
Secured investments - Non-UK (between A and AAA) fixed term-duration	6 mths	Higher of £1m or 5%*	Unlimited
Lloyds Bank plc (operational bank account) where at least A	1 year	Higher of £1m or 5%**	n/a
Lloyds Bank plc (operational bank account) where below A	Overnight	£1m	n/a
Banks, Building societies and registered providers - UK unsecured (between A and AAA) fixed term duration	1 year	Higher of £1m or 5%*	Unlimited
Banks, Building societies and registered providers - Non-UK unsecured (between A and AAA) fixed term duration	6 mths	Higher of £1m or 5%*	50%
Banks, Building societies and registered providers - unsecured (between A and AAA) with same day access e.g. call accounts	n/a	Higher of £1m or 5%*	Unlimited
Money market funds (minimum AAA rated)	n/a	10%*	50%
Strategic pooled funds	n/a	£5m	50%
No published credit ratings (non-government)	n/a	n/a	n/a
Other investments	Approval to be sought from OPFCC		

<u>Notes on investment limits</u>:
* The 5% limit is based upon the total exposure to the counterparty concerned and is calculated on the % of total investments held. 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. The 5% limit is a guideline and is not a fixed threshold e.g. exposure to counterparties will be managed with a target of 5% but a wider tolerable margin of between 5% and 15% will typically be adopted to make daily cashflow processes manageable, particularly when balances are subsequently expected to reduce over the short-term period and this does not cause undue risk exposure.
** In relation to the PFCC's operational bank account with Lloyds, an exception applies where forecast cash outflows (e.g. salaries or supplier payments) necessitate additional funds being held. In these instances, a balance of up to £10m is permitted to be held overnight (e.g. one day's duration).
*** The minimum credit ratings referred to in Table 7 relate to the lowest published long-term credit ratings for the counterparty or instrument concerned. However,

investment decisions are never solely based on credit ratings, and all other relevant factors including external advice will be considered.

Types of investments

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 are deemed to have zero credit risk due to the ability to create additional currency, and therefore investments may be made in unlimited amounts for up to 50 years.

4.10 **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral and counterparty credit ratings will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

4.11 **Operational bank account:** The PFCC may incur operational exposure through the use of its own banking facilities, relating 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, and balances will therefore be kept in accordance with the criteria in Table 7. 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 than made insolvent, increasing the chance of the PFCC maintaining operational continuity.

4.12 **Banks & building societies (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.

4.13 **Registered Providers (unsecured):** Loans and bonds issued or guaranteed by registered providers of social housing or 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.

4.14 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and typically low price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wider diversification of investment risks, coupled with the services of a professional fund manager. These funds come under pressure during early 2020 as the demand for liquidity grew due to external factors, and significant withdrawals were required. As it remains unclear how much the Bank of England would be willing to support MMF market participants in future, as well as the potential for further regulations to be introduced, the 50% sector limit has been maintained. Therefore, whilst the investment guidance for money market funds (MMF) is set out in Table 7 the guideline exposure for these funds will also incorporate the following:-

1) Investment exposure of no more than 0.5% of the total MMF (if a government MMF then this can be 2%).
2) Investment exposure is diversified, as far as practical, over multiple MMF's, with broadly equal exposure to each fund.
3) Assuming condition 1) is initially met, investments in each MMF are limited to 10% of total investments held at any time.
4) Overall exposure to MMF's as a whole is limited to 50% of total investments held at any time.

4.15 **Strategic pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the PFCC 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 in meeting the PFCC's investment objectives will be monitored regularly. At present these instruments are not currently used but, following previous discussions with the PFCC and its treasury advisors during 2019/20 and subsequently in 2020/21, this is an area of investments which will be considered during 2021/22. A subsequent paper will be presented to the PFCC with further detail about this proposal including analysis of risk and compliance, as well as the potential yields involved. Therefore, whilst in theory strategic pooled funds are permitted within the 2021/22 TMS additional information and analysis will be provided to the PFCC before any related investments are made.

4.16 **Other investments:** This category covers treasury investments not listed above, for example real estate investment trusts, unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the PFCC's investment at risk.

4.17 **Custodian service**: The PFCC 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 PFCC's treasury advisors, 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 set out in Table 7 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.

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

4.21 **Counterparty exposure:** A group of entities under the same ownership will be treated as a single organisation when reviewing counterparty limits and criteria. In addition, any balances held in the PFCC’s operational bank accounts will be included in the calculation of exposure to that entity, as well as any investments.

4.22 **Other Information on the Security of Investments**: The PFCC understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the PFCC’s treasury management advisors. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

4.23 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the PFCC 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. If these restrictions mean that insufficient financial institutions of high credit quality are available to invest the PFCC’s cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

4.24 **Liquidity management:** The PFCC uses an internally created cashflow forecasting process 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 PFCC being forced to borrow on unfavourable terms to meet its financial commitments. The PFCC will typically look to spread its liquid cash over several call accounts and money market funds to ensure that access to cash is maintained in the event of operational difficulties for any one provider. Limits on long-term investments are set by reference to both the criteria in Table 7 as well as the PFCC’s medium-term financial strategy.

5.0 Treasury Management Indicators

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

5.2 **Interest rate exposures**: These indicators are set to control the PFCC's exposure to interest rate movements, and place limits on the total amount of risk the PFCC is exposed to. The one year impact indicator calculates the theoretical impact on the revenue account of a 1% movement in all interest rates over the duration of one financial year:-

Interest rate risk indicator	**Limit**
Upper limit on one year revenue impact of a 1% rise in interest rates	(£150,000)
Upper limit on one year revenue impact of a 1% fall in interest rates	£150,000

5.3 The above figures reflect the potential impact of a rise or decrease in the current base rate of 0.10% to either 1.10% or -0.90%. The figures shown are the estimated net impact on investments and borrowing in each instance. In the event of a 1% increase investments would increase but anticipated borrowing costs would rise. Conversely, a 1% decrease would mean further negative returns on investments but potential an opportunity to access cheaper borrowing. 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 PFCC has adopted a voluntary measure of its exposure to credit risk by using minimum credit rating criteria for the counterparties it invests money with. This data is reviewed within monthly reports from Arlingclose, with daily updates received as and when there are significant credit rating changes for a counterparty. Further detail of this process is covered within paragraphs 4.18 and 4.19.

	Target
Minimum credit rating (*excluding operational bank account but only where short-term cashflow requirements demand this, or whilst actively seeking other banking arrangements – see Table 7, 4.8*)	A

5.5 **Liquidity:** The PFCC 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
Gross bank account overdraft facility available	£10m
Net bank account overdraft facility available	£1m

5.6 In addition, the PFCC will look to keep a minimum amount of money in call accounts and money market funds to ensure it is fully able to meet unforeseen commitments as they arise.

	Target
Minimum amount of investment portfolio held in call accounts and money market funds	Lower of £10m or 50% of total investments

5.7 **Principal sums invested in fixed-term deposits for periods longer than a year:** The purpose of this indicator is to control the PFCC's exposure to the risk of incurring losses by seeking early repayment of its investments. Based on current economic conditions it is not proposed that the PFCC enters into any fixed-term investments beyond 365 days in the immediate future. The only exception to this rule will be investments with central or local government entities, should worthwhile investments be identified.

	2021/22	2022/23	2023/24
Limit on principal invested beyond one year (non-government)	£0m	£0m	£0m

5.8 **Maturity structure of borrowing:** This indicator is set to control the PFCC's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing in 2021/22 will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 24 months	75%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	25%	0%
10 years and above	25%	0%

6.0 <u>Other Items</u>

6.1 The CIPFA Code requires the PFCC to include the following in its Treasury Management Strategy:

6.2 **Financial Derivatives:** In the absence of any explicit legal power to do so, the PFCC 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.

6.3 **Markets in Financial Instruments Directive:** The PFCC 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 PFCC's treasury management activities, the Head of Finance believes this to be the most appropriate status.

6.4 **Third-party funds held:** The PFCC regularly receives large sums of cash in relation to seizures from the Proceeds of Crime Act, the Police and Criminal Evidence Act and the Misuse of Drugs Act. These monies are held for varying time periods before being either being forfeited or repaid to a third party. During the 2020/21 financial year these monies have been co-mingled into the PFCC's bank accounts with interest calculated and added to any repayments. A potential revised process in respect of a new standalone bank account for these monies is currently under discussion following a recommendation from the PFCC's external auditors following its 2019/20 engagement review.

7.0 Financial implications

7.1 The budget for investment income in 2021/22 is £0.020m based on expected yield, balanced against the PFCC requirement to focus on liquidity and security of funds. The budget for debt interest payable in 2021/22 is £0.075m based on an anticipation that the PFCC will have an external 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

Appendix A

Investment position at 31st March 2020

	31/3/20 £000	Start date	Maturity date	Approx. Rate %
Call/notice accounts				
Santander UK PLC	260			0.20%
Barclays Bank PLC	1,500			0.25%
Total	**1,760**			
Money market funds				
Aberdeen	5,000			0.48%
Insight	4,000			0.31%
Total	**9,000**			
Fixed term deposits				
Bank of England DMO	5,500	31/03/20	01/04/20	0.05%
Total	**5,500**			
Other				
Lloyds current account	435			0.10%
	435			
Total treasury investments	**16,695**			

Investment position at 31st January 2021

	31/1/21 £000	Start date	Maturity date	Approx. Rate %
Call/notice accounts				
Santander UK PLC – call	2,260			0.05%
Barclays Bank PLC – call	1,000			0.05%
Barclays Bank PLC – notice	1,500			0.01%
Total	**4,760**			
Money market funds				
Aberdeen	3,000			0.03%
Insight	3,000			0.01%
Black Rock	1,500			0.01%
Total	**7,500**			
Fixed term deposits				
Bank of England DMO	1,000	25/01/20	01/02/20	0.01%
Ashford Borough Council	2,000	26/11/20	26/2/21	0.03%
Central Bedfordshire Council	5,000	14/12/20	15/3/21	0.03%
Total	**8,000**			
Other				
Lloyds current account	2,017			0.01%
	2,017			
Total all investments	**22,277**			

Appendix B

Economic & Interest Rate Forecast - underlying assumptions

Underlying assumptions:

The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.

Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.

Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.

The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.

Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.

Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.

Forecast:

Arlingclose expects the bank rate to remain at the current 0.10% level.

Our central case for bank rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out.

Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the BoE expressly rules out a negative bank rate or growth/inflation prospects improve.

Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period ends.

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

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

Annexe 2

Corporate Finance

Investment Strategy 2021/22

Meeting: 24th February 2021

Date: 9th February 2021

Author: Matthew Tokley

Investment Strategy 2021/22

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 PFCC 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. This approach is unchanged from the 2020/21 Investment Strategy.

1.4. The PFCC will continue to concentrate on treasury management investments during 2021/22.

2.0 Treasury Management Investments

2.1. The PFCC 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 2021/22 financial year.

2.3. **Contribution:** The contribution that these investments make to the objectives of the PFCC is to support effective treasury management activities.

2.4. **Further detail:** Full details of the PFCC's policies and its plan for 2021/22 for treasury management investments are covered in a separate document, the treasury management strategy.

3.0 Service Investments: Loans

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

3.2. Examples of who the PFCC 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 PFCC 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 PFCC will enter into any service loans during 2021/22 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 PFCC has the option to invest in shares to support local public services and stimulate local economic growth.

4.2. Examples of who the PFCC 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 PFCC 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 PFCC will undertake any service investments relating to shares during 2021/22 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 PFCC has the option to invest in property with the intention of making a profit that will be spent on operational policing.

5.2. **Security**: In accordance with government guidance the PFCC 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 PFCC'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 would be presented to the PFCC 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 PFCC 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 PFCC will undertake any commercial property investments during 2021/22 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 PFCC and reference to these types of investment are included here for completeness.

6.2. **Profit generating investment:** The PFCC is not involved in profit generating investment activity and nor does the PFCC require this to achieve a balanced revenue budget. Therefore, no further contingency plans are set out within this strategy for this type of activity.

6.3. **Borrowing in Advance of Need:** Government guidance states that the PFCC must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Any future investment/borrowing options in respect of taking advantage of future interest rates forecasts will be discussed with the PFCC's advisors Arlingclose, to ensure compliance with regulations and that risk exposure is minimised.

7.0 Capacity, Skills and Culture

7.1. Decision-making in respect of cashflow forecasting, investments and borrowing has been delegated by the PFCC to the Corporate Finance Team who undertake daily processes and periodically report to the Head of Finance, 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. In addition, from 2021/22, a Q1 and Q3 treasury management update report will also be submitted for scrutiny. All the above papers will be submitted to boards administered by the PFCC, with final approval/sign-off by the PFCC.

8.0 Investment Indicators

8.1. Where the PFCC 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 PFCC's total risk exposure as a result of its investment decisions and financial instruments portfolio.

8.2. As the PFCC does not currently plan to be involved in any service investments or place any commercial investments during 2021/22, 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.

Annexe 3

Corporate Finance

Capital Strategy 2021/22

Meeting: 24th February 2021

Date: 9th February 2021

(with agreed updates actioned 29th March and 9th May 2021)

Author: Matthew Tokley

Capital Strategy 2021/22

1.0 Introduction

1.1 The PFCC has adopted the Chartered Institute of Public Finance and Accountancy's *Prudential Code of Practice in the Public Services*, which requires the PFCC to approve a capital strategy before the start of each financial year.

1.2 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 gives 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.

1.4 Decisions made this year on capital and treasury management will have financial consequences for the PFCC for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

1.5 The strategy has direct links to the other management plans such as the Estates Strategy, IT Strategy and the Treasury Management Strategy and also links into the Medium Term Financial Strategy (MTFS).

2.0 Capital Expenditure and Financing

2.1 Capital expenditure is where the PFCC spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The PFCC has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not normally capitalised as deemed 'below deminimis' and are charged to revenue in year. However, there are some caveats to this guidance where multiple amounts of the same asset equates to a total value over £10,000 (capitalisation 'by aggregation').

2.2 For further details of the PFCC's capitalisation approach reference should be made to the accounting policies section of the 2019/20 Essex/PFCC Group Statement of Accounts, as well as the financial regulations, both of which are available to view on the PFCC's website.

2.3 For 2020/21 and the subsequent five year period the PFCC is planning to spend a total of £110m on capital investment, including £19m in 2021/22. This is summarised in Table 1 below.

Table 1 – Prudential Indicator: Estimates of Capital Expenditure

CAPITAL PROGRAMME - 2021/22 BUDGET SETTING POSITION EXPENDITURE & FINANCING SUMMARY	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000	TOTAL £000
Capital Expenditure							
ANPR	190	280	145	145	145	1,000	1,905
Body Armour	308	370	238	238	238	-	1,391
Estates Business as Usual	1,411	4,338	11,460	12,000	10,000	-	39,209
Estates Strategy	8,114	5,521	8,813	8,029	500	-	30,977
I.T. Services	4,148	5,396	4,298	3,209	3,583	79	20,713
OPC	211	613	25	65	65	240	1,218
Other	-	-	22	-	-	-	22
SCD	453	61	2,217	2,230	2,200	2,200	9,361
Transport	2,487	2,501	-	30	-	250	5,267
	17,320	**19,079**	**27,218**	**25,945**	**16,731**	**3,769**	**110,064**

2.4 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.

2.5 The main element of spend relates to Estates, with £31m of spend relating to work to improve existing assets and a further £39m relating to the Estates Strategy. Together these elements equate to over 50% of the overall spend across the term. The principal objective of the Estates Strategy is to streamline the PFCC's property assets in line with policing demand in the 21st century. A key part of this project is to significantly redevelop and modernise the Force HQ site in Chelmsford. The other main area of spend relates to I.T. Services with nearly £21m of spend forecast over the six years, relating to a wide range of national and locally led projects with the overriding objective to provide more efficient digital solutions for all aspects of operational policing and their support services going forward.

2.6 All capital expenditure must be financed, either from external sources (such as grants and contributions), the PFCC's own resources (revenue reserves or capital receipts) or debt (borrowing or leasing). The planned financing of the expenditure set out in Table 1 is as follows:-

Table 2 – Capital Financing

CAPITAL PROGRAMME - 2021/22 BUDGET SETTING POSITION FINANCING SUMMARY	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000	TOTAL £000
Financing Source							
Capital receipts	(6,989)	(5,620)	(8,725)	(11,528)	(4,954)	(1,517)	(39,334)
Grants & contributions	(381)	(554)	(277)	(277)	(277)	(252)	(2,018)
Revenue funding	(426)	(3,046)	(2,233)	(1,000)	(1,000)	(1,000)	(8,705)
Borrowing	(9,525)	(9,859)	(15,983)	(13,140)	(10,500)	(1,000)	(60,007)
	(17,320)	**(19,079)**	**(27,218)**	**(25,945)**	**(16,731)**	**(3,769)**	**(110,064)**

2.7 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance.

2.8 The PFCC'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/loan fund repayments, and capital receipts where used to replace debt. The CFR is expected to increase to a value in excess of £24m by the end of 2021/22. Based on the above figures for expenditure and financing, the PFCC's estimated CFR is as follows:

Table 3 – Prudential Indicator: Estimates of Capital Financing Requirement

CAPITAL PROGRAMME - 2021/22 BUDGET SETTING POSITION

Capital Financing Requirement (CFR) SUMMARY

	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000
Opening CFR	**6,065**	**15,090**	**24,212**	**39,210**	**50,816**	**59,453**
Capital Expenditure	17,321	19,080	27,218	25,945	16,731	3,769
Financing Applied	(7,796)	(9,220)	(11,235)	(12,805)	(6,231)	(2,769)
Minimum Revenue Provision	(500)	(738)	(985)	(1,534)	(1,863)	(2,125)
Closing CFR	**15,090**	**24,212**	**39,210**	**50,816**	**59,453**	**58,327**

2.9 **Asset Management**: To ensure that capital assets continue to be of long-term use, the PFCC has an asset management strategy in place. This is known as the Estates Strategy, the latest copy of which can be found on the PFCC website.

2.10 **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. Repayments of capital grants, loans and investments also generate capital receipts. The PFCC is forecasting to receive in excess of £38m over the medium-term period, with £5.6m of receipts expected in 2021/22.

Table 4 – Capital receipts receivable

CAPITAL PROGRAMME - 2021/22 BUDGET SETTING POSITION CAPITAL RECEIPTS SUMMARY	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000
Opening balance	(1,088)	-	-	-	(6,472)	(1,517)
Received	(5,901)	(5,620)	(8,725)	(18,000)	-	-
Applied for financing	6,989	5,620	8,725	11,528	4,954	1,517
Closing balance	**-**	**-**	**-**	**(6,472)**	**(1,517)**	**-**

2.11 The government have issued statutory guidance on the flexible use of capital receipts, which has now been extended up until 31st March 2022. This enables the PFCC to use capital receipts in year to finance individual projects that would otherwise be a charge to the revenue account. However, at the current point in time the PFCC does not anticipate taking advantage of this financing option on the basis that all capital receipts need to be retained for subsequent years capital expenditure. It is therefore unlikely that the PFCC will be in a position to take advantage of this approach before this flexibility is withdrawn at the end of 2021/22.

3.0 Treasury Management

3.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the PFCC's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The PFCC is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

3.2 When borrowing the PFCC must demonstrate compliance with the Prudential Code making sure that it is affordable, prudent and sustainable. To meet this requirement the PFCC 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 PFCC therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.10%) and long-term fixed rate loans where the future cost is known but higher (currently 1.5% to 2.5%).

3.3 Projected levels of the PFCC's total outstanding debt are shown below, compared with the capital financing requirement.

Table 5 – Prudential Indicator – Gross Debt and the Capital Financing Requirement

2021/22 BUDGET SETTING POSITION GROSS DEBT AND THE CAPITAL FINANCING REQUIREMENT							
	31st March 2020 £000	31st March 2021 £000	31st March 2022 £000	31st March 2023 £000	31st March 2024 £000	31st March 2025 £000	31st March 2026 £000
Gross Debt (external borrowing)	-	-	17,463	33,162	45,669	55,206	54,081
Capital Financing Requirement	6,065	15,090	24,212	39,210	50,816	59,453	58,327

3.4 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the PFCC's total external debt for the upcoming year should be lower than its highest forecast CFR in the preceding year, the current year and the next two years. Table 5 above shows that the PFCC expects to comply with this requirement during 2021/22 e.g. a forecast external borrowing requirement of £17.5m in 2021/22 to be £17.5m which is lower than the highest forecast CFR value of £50.8m (2023/24) across the specified four year period.

3.5 **Affordable borrowing limit**: The PFCC 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.

Table 6 – Prudential Indicator – Authorised limit and operational boundary for external debt

2021/22 BUDGET SETTING POSITION AUTHORISED LIMIT AND OPERATIONAL BOUNDARY				
	2020/21	2021/22	2022/23	2023/24
Authorised limit - total external debt	£25m	£25m	£40m	£50m
Operational Boundary - total external debt	£20m	£20m	£30m	£40m

3.6 **Treasury investment strategy**: Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

3.7 The PFCC's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the PFCC may request its money back at short notice.

Table 7 – Treasury management investments

2021/22 BUDGET SETTING POSITION TREASURY INVESTMENTS					
	31/3/20 actual	31/3/21 forecast	31/3/22 forecast	31/3/23 forecast	31/3/24 forecast
Short-term investments	£16m	£15m	£10m	£10m	£10m
Long-term investments	£0m	£0m	£0m	£0m	£0m

3.8 The above table demonstrates that it is not currently proposed to invest in strategic pooled funds within 2021/22 and the subsequent medium-term, but this option will continue to be reviewed. The short-term investments reflect the fact that whilst the PFCC will fall into an external borrowing position with effect from 2021/22 the PFCC will still look to maintain a minimum balance of £10m for liquidity and short-term cashflow purposes. This means the gross debt figures expected are actually £10m higher across the medium-term, equating to the PFCC's liability benchmark position. This higher debt requirement has been incorporated into the calculation for the operational boundary and authorised limit figures included in Table 6.

3.9 Further details of the PFCC's investments and borrowings are included within the Treasury Management Strategy 2021/22 document.

3.10 **Risk management**: The effective management and control of risk are prime objectives of the PFCC's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

4.0 Governance

4.1 **Capital Programme**: Budget holders submit new bids for capital projects on an annual basis each summer for potential inclusion in the following year's budget setting process. These are known as stage 1 outline bids, and effectively ringfence funding for the project concerned, assuming it is signed off during the budget setting process. The next stage for each of these bids is a full stage 2 business case which is then submitted to the PFCC for approval, prior to the green light being given to the project starting. A governance framework has been put in place to support this process, and in accordance with financial regulations this ensures 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 reviewing capital and revenue budget monitoring reports as well as scrutinising the MTFS documents.

- The PFCC Strategic Board which is responsible for recommending the approval of the capital strategy and the five year capital programme (2021/22 to 2025/26), changes to the programme within financial regulations and for the approval of final business cases (stage 2). Subsequent decision sheets submitted are signed off, representing the formal approval stage.

- The Police, Fire and Crime Panel, who are ultimately responsible for signing off and approving the capital programme and MTFS as part of the formal budget setting approval process (the 2021/22-2025/26 programme was approved on the 4th February 2021).

4.2 Further governance is in place 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 of the capital programme and meets on a quarterly basis to review progress on projects and assess current forecasts compared to the budgeted programme. Whilst not a decision making board, the attendees include the main capital budget holders, representatives of Corporate Finance and the PFCC, and contribute to an effective oversight/scrutiny process for the Capital Programme, as well as ensuring value for money;

- The Estates Change Board and I.T. Technology Prioritisation and Digital Transformation Boards which have overall responsibility for the strategic review of their projects;

- The Strategic Change and Co-ordination Board which provides an initial strategic review for all projects which do not relate to Estates or I.T; and

- Specific Project boards with key stakeholders which are set up to manage and progress projects and identify risks which could affect the project or PFCC.

4.3 **Treasury processes**: Decisions on treasury management investment and borrowing are made daily by Corporate Finance staff in accordance with a fortnightly plan which is shared with the PFCC's Head of Finance. Any decision making in respect of treasury management processes will always be consistent with the parameters and criteria of the Treasury Management Strategy for that year, and approval for any proposed deviations from that strategy will need to be signed off by the PFCC in advance. A more detailed proposal for reporting to the PFCC on cashflow related workstreams, as well as investments and borrowing, is currently in the process of being implemented, with an aim that it is introduced with effect from the start of the 2021/22 financial year.

5.0 Liabilities

5.1 In addition to the debt referred to earlier in this paper, the PFCC is committed to future payments to cover its pension fund deficit for Police Officer and Police Staff schemes (valued at £3,000m as at the 31st March 2020). The PFCC has also set aside significant funds in provisions and reserves for various purposes, as referred to in the PFCC Statement of Accounts (the latest version of which, the 2019/20 accounts, can be found on the PFCC website). The PFCC is also at risk of having to pay for some of its contingent liabilities (again referred to in the 2019/20 Statement of Accounts) and some funds have been set aside for these during 2020/21 based on best estimates of potential liabilities.

5.2 Decisions on incurring new discretional liabilities are taken by Heads of Department in consultation with the Chief Finance Officer of the Chief Constable, and the Head of Finance for the PFCC. 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.

6.0 Revenue Budget Implications

6.1 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 PFCC (the amount funded from Council Tax and general government grants). The ratios for the previous, current and subsequent three years is shown in Table 8 at the bottom of this section.

6.2 **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue implications of expenditure incurred in the next few years will extend up to 40 years into the future. The Head of Finance is satisfied that the proposed capital programme is prudent, affordable and sustainable based on a detailed examination of the capital programme and the proposed financing plan, during the 2021/22 budget setting process.

Table 8 – Prudential Indicator: Proportion of financing costs to net revenue stream

CAPITAL PROGRAMME - 2021/22 BUDGET SETTING POSITION Financing costs proportion of net revenue stream	2019/20 actual £000	2020/21 forecast £000	2021/22 budget £000	2022/23 budget £000	2023/24 budget £000
Minimum Revenue Provision (MRP)	500	738	985	1,863	2,125
Interest payable	1	2	63	119	125
Interest receivable	(182)	(20)	(20)	(10)	(10)
Net financing costs	**319**	**720**	**1,028**	**1,971**	**2,240**
Net budget requirement	297,586	314,700	330,300	336,100	341,900
Proportion of net revenue stream	**0.11%**	**0.23%**	**0.31%**	**0.59%**	**0.66%**

7.0 Minimum Revenue Provision (MRP) Policy Statement

7.1 Where the PFCC 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 MHCLG guidance) most recently issued in 2018.

7.2 The broad aim of the MHCLG 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.

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

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

7.5 For capital expenditure incurred after the 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset (in equal instalments), starting in the year after the asset becomes operational e.g. capital expenditure incurred during 2021/22 will not be subject to an MRP charge until 2022/23.

7.6 The useful lives (as per paragraph 7.5) of the related assets for capital expenditure incurred after 31st March 2008 will be determined by reference to the PFCC's Property, Plant and Equipment accounting policy in the most recently published (2019/20) Statement of

Accounts. This lists the different asset lives as follows:-

- Buildings 20-60 Years
- Vehicles 3-8 Years
- Plant, IT & Equipment 3-30 Years
- Marine Vessels 10-25 Years

7.7 Purchase of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years (Option 3 of the MHCLG guidance in England and Wales.

7.8 If applicable, for any capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the PFCC 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.

7.9 Based upon the PFCC's latest estimate of its Capital Financing Requirement on 31st March 2021, the budget for MRP has been set as follows:

CAPITAL PROGRAMME - 2021/22 BUDGET SETTING POSITION

CFR and MRP estimates

	31/03/21 Estimated CFR £m	2021/22 Estimated MRP £m
Capital expenditure before 01/04/2008	5.6	0.5
Capital expenditure after 31/03/2008	9.5	0.2
Total	**15.1**	**0.7**

7.10 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 PFCC.

7.11 Whilst the guideline MRP for the pre-April 2008 expenditure is 4% (e.g. £224k per annum based on the forecast £5.6m of pre-2008 debt at the end of 2020/21) 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 PFCC'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.

7.12 Whilst there will be unfunded capital expenditure in 2020/21 which will require borrowing, there will not be any related MRP costs arising until 2021/22 (as per the explanation in paragraph 7.5). Where possible the OPFC will look to make additional MRP voluntary overpayments in respect of its post-April 2008 unfunded expenditure to limit the revenue impact on future financial years.

8.0 Knowledge and Skills

8.1 The PFCC and Chief Constable employs professionally qualified and experienced staff in senior positions, with responsibility for making capital expenditure, borrowing and investment decisions.

8.2 Where staff do not have the knowledge and skills required, use is made of external advisors and consultants that are specialists in their field. The PFCC currently employs Arlingclose Limited as treasury management advisors. This approach is more cost effective than employing such staff directly and ensures that the PFCC has access to knowledge and skills commensurate with its risk appetite.