Appendix 1

# Corporate Finance

## Treasury Management Strategy 2022/23

Strategic Board Meeting: 16th June 2022

Date: 7th June 2022

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**Treasury Management Strategy (TMS) 2022/23**

## 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 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.

1.6 The key changes from the 2021/22 TMS include updated criteria and limits for call accounts and investments in individual money market funds. New governance arrangements agreed with the PFCC in respect of the process by which external borrowing is approved are covered in section 3. A proposal for a strategic pooled fund is included but will be outside of agreed investment criteria until specifically agreed. The report has also been updated based on the latest Capital Programme reflecting content from the newly issued CIPFA codes referred to in paragraph 1.3.

## 2.0 Local Context

2.1 On the 31st March 2022 the PFCC held £18.1m of investments with no external borrowings (31st March 2021, £18.8m). These investments are set out in further detail in Annexe A.

2.2 The current treasury performance is reported on a monthly basis to the PFCC's Chief Financial Officer (and copied into the Chief Finance Officer for the Chief Constable), summarising the previous month performance as well as setting out a plan for the following month. Any deviations to this plan, with explanations for any key variances, are then followed up in the next report.

2.3 The current medium-term Capital Programme is the significant driver for both the cashflow 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 3rd February 2022 includes projects that have already been fully approved as well as schemes that are still subject to a full business case prior to approval. The current economic climate following the impact of the COVID-19 pandemic particularly with regard to delays with projects and shortage of materials, has resulted in increased amounts of capital expenditure slippage and a capital programme which is volatile and subject to further change.

2.5 The tables below demonstrate a capital programme which will provide significant challenges from 2022/23 onwards, with expenditure exceeding funding available and the PFCC needing to apply revenue reserves to meet these costs. Over the course of the following five-year period the financing requirement will total £85m, representing 63% of total capital expenditure forecast over the six years including 2021/22, with the external borrowing element of this equating to £74.6m by the end of 2026/27 (as shown in Table 4). The latest information available for the capital programme including the financing requirement element, as well as the resources available are shown in Tables 1 and 2 below.

**Table 1 – Capital Investment Programme**

**CAPITAL PROGRAMME - 2022/23 BUDGET SETTING**
**EXPENDITURE & FINANCING SUMMARY**

| | 2021/22 £000 | 2022/23 £000 | 2023/24 £000 | 2024/25 £000 | 2025/26 £000 | 2026/27 £000 | TOTAL £000 |
|---|---|---|---|---|---|---|---|
| ***Capital Expenditure*** | | | | | | | |
| ANPR (Automatic Number Plate Recognition) | 145 | 233 | 145 | 145 | 0 | 0 | 668 |
| Estates Business as Usual | 1,888 | 2,365 | 1,000 | 1,000 | 1,000 | 1,000 | 8,253 |
| Estates Strategy | 7,182 | 5,493 | 15,114 | 21,500 | 19,000 | 900 | 69,188 |
| IT Services (Information Technology) | 2,565 | 5,051 | 5,958 | 11,509 | 8,973 | 2,816 | 36,871 |
| OPC (Operational Policing) | 229 | 501 | 51 | 0 | 92 | 0 | 872 |
| Other | 365 | 590 | 237 | 270 | 250 | 250 | 1,962 |
| SCD (Serious Crime Directorate) | 157 | 93 | 30 | 0 | 0 | 0 | 280 |
| Transport | 1,513 | 3,564 | 2,200 | 2,200 | 2,240 | 2,500 | 14,216 |
| | **14,043** | **17,889** | **24,735** | **36,624** | **31,555** | **7,466** | **132,311** |
| ***Financing Sources to be Applied*** | | | | | | | |
| Capital receipts | (5,416) | (4,420) | (4,600) | (2,250) | (16,559) | (4,566) | (37,811) |
| Grants & contributions | (307) | (32) | 0 | 0 | 0 | 0 | (339) |
| Revenue funding | 0 | (5,579) | (1,131) | (1,131) | (1,000) | (1,000) | (9,842) |
| Financing requirement | (8,320) | (7,858) | (19,004) | (33,242) | (13,996) | (1,900) | (84,319) |
| | **(14,043)** | **(17,889)** | **(24,735)** | **(36,624)** | **(31,555)** | **(7,466)** | **(132,311)** |
| **Total Unfinanced Expenditure** | - | - | - | - | - | - | 0 |

### Table 2 – Capital Resources Summary

**CAPITAL PROGRAMME - 2022/23 BUDGET SETTING**
**CAPITAL RESOURCES SUMMARY**

| | 2021/22 £000 | 2022/23 £000 | 2023/24 £000 | 2024/25 £000 | 2025/26 £000 | 2026/27 £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| **Capital receipts** | | | | | | | |
| *Opening balance* | 0 | (1,770) | 0 | 0 | 0 | (4,566) | 0 |
| Received | (7,186) | (2,650) | (4,600) | (2,250) | (21,125) | 0 | (37,811) |
| Applied for financing | 5,416 | 4,420 | 4,600 | 2,250 | 16,559 | 4,566 | 37,811 |
| ***Closing balance*** | **(1,770)** | **0** | **0** | **0** | **(4,566)** | **0** | **0** |
| **Grants and contributions** | | | | | | | |
| *Opening balance* | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Received | (307) | (32) | 0 | 0 | 0 | 0 | (339) |
| Applied for financing | 307 | 32 | 0 | 0 | 0 | 0 | 339 |
| ***Closing balance*** | **0** | **0** | **0** | **0** | **0** | **0** | **0** |
| **Revenue funding** | | | | | | | |
| *Opening balance* | (606) | (4,379) | (100) | (100) | (100) | (100) | (606) |
| Received | (3,773) | (1,300) | (1,131) | (1,131) | (1,000) | (1,000) | (9,336) |
| Applied for financing | 0 | 5,579 | 1,131 | 1,131 | 1,000 | 1,000 | 9,842 |
| ***Closing balance*** | **(4,379)** | **(100)** | **(100)** | **(100)** | **(100)** | **(100)** | **(100)** |
| **Totals** | | | | | | | |
| *Opening balance* | (606) | (6,149) | (100) | (100) | (100) | (4,666) | (606) |
| Received | (11,266) | (3,982) | (5,731) | (3,381) | (22,125) | (1,000) | (47,485) |
| Applied for financing | 5,723 | 10,031 | 5,731 | 3,381 | 17,559 | 5,566 | 47,991 |
| ***Closing balance*** | **(6,149)** | **(100)** | **(100)** | **(100)** | **(4,666)** | **(100)** | **(100)** |

2.6 Included within the above figures are just under £38m of forecast capital receipts as the PFCC continues to rationalise its asset base and dispose of surplus assets. As at the 31st March 2022 six disposals were achieved in the financial year (totalling £4.8m). Additional overage income relating to Brentwood Police Station was also received totalling £0.4m. Whilst in the past this income has been largely sufficient to fund the capital programme, from 2021/22 onwards it is no longer the case that these funds will bridge the deficits in the PFCC's capital programme.

2.7 Therefore, with the capital resources position now in deficit there is a forecast capital financing requirement (CFR) of £23.89m by the end of 2022/23, with £19.325m relating to unfinanced capital expenditure from 2020/21 onwards, in addition to the £4.565m pre-2008 element. From 2022/23 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 – CFR and MRP Summary**

CAPITAL PROGRAMME - 2022/23 BUDGET SETTING
CFR & MRP SUMMARY

| | 2021/22 £000 | 2022/23 £000 | 2023/24 £000 | 2024/25 £000 | 2025/26 £000 | 2026/27 £000 | TOTAL £000 |
|---|---|---|---|---|---|---|---|
| **Opening CFR** | **9,097** | **16,828** | **23,890** | **41,901** | **73,335** | **83,425** | **9,097** |
| ***Capital Expenditure*** | | | | | | | |
| Approved projects - long-life | 9,070 | 5,308 | 39 | 0 | 0 | 0 | 14,417 |
| Approved projects - short-life | 4,954 | 4,002 | 86 | 68 | 92 | 0 | 9,201 |
| Subject to Approval projects - long-life | 0 | 2,550 | 16,075 | 22,500 | 20,000 | 1,900 | 63,025 |
| Subject to Approval projects - short-life | 19 | 6,029 | 8,535 | 14,056 | 11,463 | 5,566 | 45,668 |
| | **14,043** | **17,889** | **24,735** | **36,624** | **31,555** | **7,466** | **132,311** |
| ***Financing Sources to be Applied*** | | | | | | | |
| Capital receipts | (5,416) | (4,420) | (4,600) | (2,250) | (16,559) | (4,566) | (37,811) |
| Grants & contributions | (307) | (32) | 0 | 0 | 0 | 0 | (339) |
| Revenue funding | 0 | (5,579) | (1,131) | (1,131) | (1,000) | (1,000) | (9,842) |
| | **(5,723)** | **(10,031)** | **(5,731)** | **(3,381)** | **(17,559)** | **(5,566)** | **(47,991)** |
| ***Minimum Revenue Provision*** | | | | | | | |
| Historic unfinanced borrowing | (500) | (500) | (500) | (500) | (500) | (500) | (3,000) |
| Current projects - long-life | (88) | (296) | (493) | (896) | (1,458) | (1,808) | (5,039) |
| Current projects - short-life | 0 | 0 | 0 | (413) | (1,947) | (1,947) | (4,308) |
| | **(588)** | **(796)** | **(993)** | **(1,808)** | **(3,906)** | **(4,255)** | **(12,347)** |
| **Closing CFR** | **16,828** | **23,890** | **41,901** | **73,335** | **83,425** | **81,070** | **81,070** |

| FINANCING COSTS | 2021/22 £000 | 2022/23 £000 | 2023/24 £000 | 2024/25 £000 | 2025/26 £000 | 2026/27 £000 | TOTAL £000 |
|---|---|---|---|---|---|---|---|
| Minimum Revenue Provision (MRP) | 588 | 796 | 993 | 1,808 | 3,906 | 4,255 | 12,347 |
| Borrowing Costs (based on 1%) | - | 69 | 160 | 317 | 367 | 355 | 1,268 |
| **Total revenue impact of borrowing** | **588** | **866** | **1,152** | **2,125** | **4,273** | **4,611** | **13,615** |

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. The PFCC's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. However, because the PFCC has an increasing CFR over the medium-term due to the capital programme, with investments also forecast to decrease over this period, internal borrowing will no longer be feasible and the amount of required external borrowing will therefore increase.

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 2022/23. This is demonstrated by Table 4 showing an expected requirement for external borrowing for 2022/23 of £11.8m, which is lower than the highest forecast CFR value of £73.3m (2024/25) 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.

2.11 The model assumes a flat working capital surplus of £3m from 2021/22, £1m from 2022/23 onwards reducing to £0.1m in 2025/26 and £0.7m for 2026/27, with cash balances maintained annually at a minimum of £10m, with slight increases in 2026 and 2027. 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).

**Table 4 – Liability Benchmark Summary**

**CAPITAL PROGRAMME 2022/23 BUDGET SETTING**
**BALANCE SHEET SUMMARY & FORECAST**

| | 31st March 2021 £000 | 31st March 2022 £000 | 31st March 2023 £000 | 31st March 2024 £000 | 31st March 2025 £000 | 31st March 2026 £000 | 31st March 2027 £000 |
|---|---|---|---|---|---|---|---|
| Loans: Capital Financing Requirement | 9,100 | 16,800 | 23,900 | 41,900 | 73,300 | 83,400 | 82,000 |
| Loans: External Borrowing (existing) | - | - | - | - | - | - | - |
| **Internal financing** | **9,100** | **16,800** | **23,900** | **41,900** | **73,300** | **83,400** | **82,000** |
| Less: Usable Reserves | (25,452) | (26,000) | (21,100) | (19,000) | (18,000) | (17,200) | (17,200) |
| Less: Working Capital | 4,552 | (3,000) | (1,000) | (1,000) | (1,000) | (100) | (700) |
| **Investments/(new external borrowing)** | **11,800** | **12,200** | **(1,800)** | **(21,900)** | **(54,300)** | **(66,100)** | **(64,100)** |
| Net borrowing requirement | **(11,800)** | **(12,200)** | **1,800** | **21,900** | **54,300** | **66,100** | **64,100** |
| Minimum short-term cash requirement | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,300 | 10,500 |
| **Liability Benchmark** | **(1,800)** | **(2,200)** | **11,800** | **31,900** | **64,300** | **76,400** | **74,600** |

**ASSUMPTIONS FOR BALANCE SHEET SUMMARY & FORECAST**

| | 31st March 2021 £000 | 31st March 2022 £000 | 31st March 2023 £000 | 31st March 2024 £000 | 31st March 2025 £000 | 31st March 2026 £000 | 31st March 2027 £000 |
|---|---|---|---|---|---|---|---|
| Debt-funded capital expenditure | 5,352 | (6,964) | 2,796 | 993 | 1,808 | 5,106 | 3,855 |
| Minimum revenue provision (MRP) | (500) | (588) | (796) | (993) | (1,808) | (3,906) | (4,255) |
| Change in Usable Reserves | (5,629) | (548) | 4,900 | 2,100 | 1,000 | 800 | - |
| Change in Working Capital | 3,035 | 7,700 | 7,100 | 18,000 | 31,400 | 10,100 | (1,400) |
| **Net Cash Outflow/(Inflow)** | **2,258** | **(400)** | **14,000** | **20,100** | **32,400** | **12,100** | **(1,800)** |

2.12 Table 4 demonstrates that the Liability Benchmark increases markedly from 2022/23 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 £1.8m external borrowing required by the end of 2022/23 to reduce the burden on the PFCC's internal cash balances. Extrapolating this requirement forward to the end of 2026/27 shows an expected total amount of £64.1m of forecast external debt to fund capital expenditure during this period. The remaining element of the CFR debt burden over and above the £64.1m value will therefore be funded by internal borrowing. 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. By 2026/27 due to inflationary reasons, this minimum balance has increased to £10.5m. Therefore, whilst external debt is forecast to be £1.8m by the end of 2022/23 this will actually be a net balance comprised of £11.8m external borrowings and £10m investments. The revised total of external debt across the medium-term is therefore actually forecast to be £74.6m (reflecting the £64.1m + £10.5m contingency).

2.13 Whilst the 'Liability benchmark (mid-year)' figures (or 'peak to trough') have now been removed from Table 4 as they do not provide meaningful information in respect of borrowing requirements for the period concerned, the figures usually highlight that the PFCC typically has large surpluses of cash during the middle half of each financial year, due to its cashflow profile whereby the timings of grants and council tax precept income are received during the first half of each year.

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, with costs increasing from £0.5m in 2021/22 to £4.2m in 2026/27 (Table 4, assumptions). 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, however the PFCC will continue to monitor the current market position following on from the two recent interest rate rises, to ensure these estimates remain accurate and are not understated. Please refer to the Borrowing Strategy (section 3) for further detail on these costs.

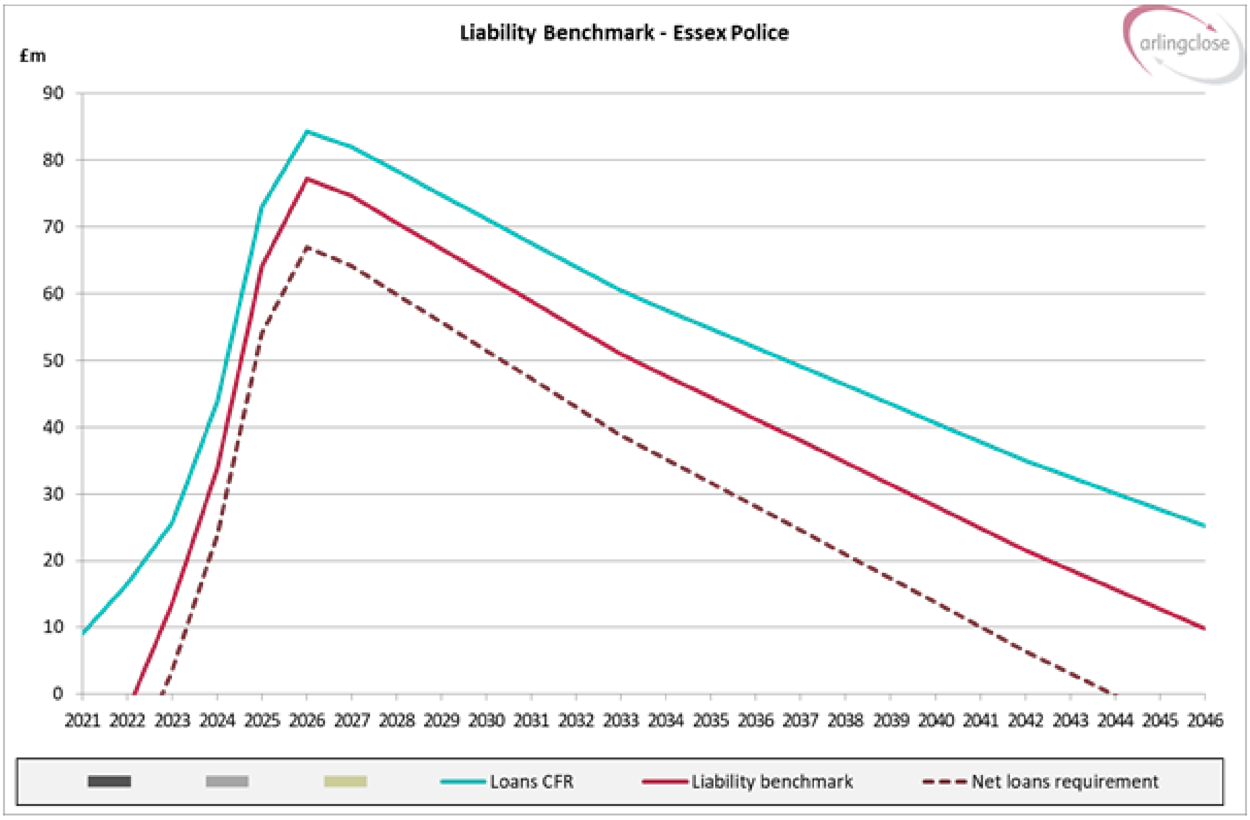
2.15 Following on from the medium-term forecasts within Table 4, a long-term liability benchmark has been created in Table 5 below, which forecasts the PFCC's need to borrow over a 50 year period. This assumes the following from 2026/27 onwards:

- 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 over £80m around 2026. 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.

2.17 Whilst the trend described in 2.16 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 2026/27 in accordance with the 2021 Prudential Code.

**Table 5 – Liability Benchmark Chart**




## 3.0 <u>Borrowing Strategy</u>

3.1 The PFCC currently has no external borrowing but, as per paragraph 2.12, expects to borrow circa £75m between 2022/23 and 2026/27 based on the current capital programme projections, which will be sourced in accordance with the PFCC's authorised limit of (external) borrowing and agreed governance arrangements. In 2022/23 the requirement is expected to be just under £14m.

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 exercise via a 'cost of carry' and breakeven analysis. Its output may determine whether the PFCC borrows additional sums at long-term fixed rates in 2022/23 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 via the Public Works Loan Board (PWLB). However, with PWLB rates starting to increase recently, the PFCC will actively 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. Following the revised Prudential Code and Treasury Management Code guidance issued in 2021, PWLB loans are no longer available to the PFCC to buy commercial investment assets primarily for yield. As these assets are not currently within the PFCC's proposed investment strategy there is no expected impact of this guidance change.

3.6 Variable-rate loans leave the PFCC exposed to the risk of interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators set out elsewhere in this report. Because it is the PFCC's policy to not use financial derivatives to manage or 'hedge' this interest rate risk, the PFCC will therefore ensure that the majority of its debt portfolio is based on fixed-term rates. Net exposure to interest rates will be monitored and managed to ensure a change in interest rates does not lead to an unbudgeted burden. The PFCC plans to undertake the majority of its underlying net borrowing on a fixed rate basis but short-term variable rates will be considered.

3.7 The PFCC may seek to arrange starting loans during 2022/23, 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 the cost of carry in the intervening period.

3.8 The PFCC may also use short-term loans to cover unplanned cash flow shortages and liquidity, in addition to its existing bank overdraft facilities.

3.9 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)
- 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 LGPS)
- Capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

3.10 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

3.11 **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.

Proposed borrowing approach 2022/23

3.12 In all likelihood the PFCC will look to use either local authorities or the PWLB for its external borrowing requirement in 2022/23. 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 1%, equating to the current UK base rate (for comparison purposes the 1 year rate is now closer to between 1.5%-2%) However, with further rate increases expected the viability of both short-term and long-term borrowing will be regularly reviewed, particularly with local authorities expected to continue to be lower than PWLB rates for all periods.

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 (MTFS), which can support the request for borrowing. The PFCC's 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. The maximum limits for specific types of external borrowing approach for 2022/23 are presented in Table 6 below.

**Table 6 – External Borrowing 2022/23**

| Borrowing approach | Maximum limit 2022/23 (note 1) |
|---|---|
| PWLB (non-LOBO's) | £25m |
| Any institution approved for investments | £25m |
| Any other bank or building society authorised to operate in the UK | £25m |
| Any other UK public sector body | £25m |
| UK public and private sector pension funds (except Essex Local Government Pension Scheme) | £5m |
| Capital market bond investors | £5m |
| UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues | £5m (subject to specific approval from OPFCC) |

3.16 Going forward the PFCC will look at expanding its debt structure across subsequent years, in order that the most viable financing plan is adopted which fully utilises the other available avenues of borrowing set out in paragraphs 3.9/3.10. The PFCC will also look to restructure debt where appropriate, repaying loans before maturity and either paying a premium or receiving a discount based on current interest rates at that point in time. This will be actioned where it is expected to lead to an overall cost saving or reduction in risk. Debt restructuring is currently allowed by the PWLB and other lenders may be prepared to negotiate on similar terms.

Proposed approval process for external borrowing

3.17 The PFCC is legally obliged to set affordable limits for external debt expected to be required during the year. Two limits are required – an 'authorised limit' which cannot be exceeded, and an 'operational boundary' which acts as a warning level should debt approach the 'authorised limit'. The limits for 2022/23 are included in the Capital Strategy (a separate annexe to the main TMS report) and are based on the financial information set out elsewhere within the TMS, most notably the medium-term Capital Programme.

3.18 However, whilst external borrowing will be restricted to the thresholds agreed for these limits (notably the 'authorised limit'), there will also be additional approval processes implemented depending on the value of the proposed borrowing. This will allow the PFCC closer oversight of when deals are proposed, particularly in relation to any higher value/longer-term element.

3.19 Based on the current structure whereby treasury management performance is reported to the PFCC on a quarterly basis to the Performance and Resources Scrutiny Board (PRSB) it is proposed that these reports will now include updated estimates for external borrowing in terms of a range of values expected for the following quarter, which would be subject to a decision report sign-off by the PFCC. As this would mean the paper would be subject to a formal approved decision, it is therefore proposed that treasury management reporting is moved to the PFCC Strategic Board going forward, rather than PRSB.

3.20 The new governance process will ensure that all external borrowing, long-term (greater than one year) and short-term (less than one year), is subject to further approval in addition to the estimated figures approved as part of the TMS itself.

3.21 In addition to the decision report process, individual instances of external borrowing which are either long-term, or short-term where exceeding £5m in value or one month in duration, will also be approved by the PFCC in advance. The details of how this process works will be agreed with the PFCC office once the first quarterly reporting paper has been submitted for 2022/23.

3.22 In respect of any short-term borrowing which does not exceed £5m in value or one month in duration, this will be retrospectively notified to the PFCC's Head of Finance at the earliest opportunity. This borrowing will typically be required to cover cashflow-related deficits, and is not classed as structured borrowing to support capital expenditure. Included in this category will also be the use of the PFCC's bank overdraft position, where a £1m authorised limit is currently in place.

## 4.0 <u>Investment Strategy</u>

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 summer months following the receipt of the annual Police Officer Pension top up grant from the Home Office (HO). In 2022/23 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 and other income). Thereafter, cash balances will initially increase following the HO grant receipt, but then reduce over the subsequent months, ultimately falling into a deficit position during early 2023, without the assistance of externally borrowed funds.

4.2 The CIPFA Code requires the PFCC 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 LIBOR, 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 Against the backdrop of the global recovery from the COVID-19 pandemic, the economy has entered a challenging phase with the UK encountering higher inflation driven by the combination of resurgent demand and a supply bottleneck in goods and shortage in the labour market. The latter has prompted concern about wage driven inflation leading central banks to tighten policies to ensure that inflation expectations remain anchored. The Bank of England increased the base rate from 0.25% in December 2021 to 0.50% in February 2022, and by May 2022 this has subsequently increased to 1%. The current forecast for interest rates is that they are expected to continue to rise and remain weighted to the upside for the remainder of

2022, becoming more balanced over time. With the recent base rate increase investment returns are expected to improve in 2022/23 compared to the negative rates the PFCC received on many of its investments, including from money market funds and the Debt Management Deposit Facilities (DMADF), during the first three quarters in 2021/22.

4.5 The Treasury Management Strategy for investments will continue to prioritise liquidity for the PFCC's cash flow whilst seeking to maximise returns with 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.

4.6 Whilst the PFCC is not planning to radically change its investment approach at the current time. However, should economic conditions allow, it is proposed to actively investigate and invest in a strategic pooled fund to achieve some longer-term returns for the PFCC, and take advantage of the increasing interest rate environment. This diversification into higher yielding asset classes, will encompass an amount of money ring-fenced for longer-term investment into a pooled fund on the understanding that such an investment approach will 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 paragraphs 4.17 to 4.19 for further information on this.

4.7 Under the 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 2022/23 the PFCC may invest its surplus funds with any of the counterparty types in Table 7 below, subject to the limits shown. Some changes to limits have been enacted for 2022/23 which attempt to make treasury management processes and related investments more manageable and pragmatic, whilst not increasing the risk profile for the PFCC. The amendments made look to resolve the issues which have arisen during 2021/22 where investment breaches have been recorded within quarterly treasury management/cashflow reports submitted to the PFCC. These changes are set out in paragraphs 4.9 and 4.10.

**Table 7 – Investment limits 2022/23**

| Treasury investment counterparties and limits 2022/23 | 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 | £2m | Unlimited |
| Secured investments - Non-UK (between A and AAA) fixed term-duration | 6 mths | £2m | Unlimited |
| Lloyds Bank plc (operational bank account) where at least A* | 1 year | £2m | 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 | £2m | Unlimited |
| Banks, Building societies and registered providers - Non-UK unsecured (between A and AAA) fixed term duration | 6 mths | £2m | 50% |
| Banks, Building societies and registered providers - unsecured (between A and AAA) with same day access e.g. call accounts | n/a | £5m | Unlimited |
| Money market funds (minimum AAA rated) | n/a | £5m | 50% |
| Strategic pooled funds | Separate approval to be sought from PFCC office | | |
| No published credit ratings (non-government) | n/a | n/a | n/a |
| Other investments | n/a | n/a | n/a |

<u>Notes on investment limits</u>:

*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.

4.9 Based on issues encountered during 2021/22, the investment limits have been amended to take account of these issues and provide a more workable set of parameters going forward and reduce/eliminate breaches being reported in future treasury management reports being submitted to the PFCC. This includes the removal of % based thresholds which can be difficult to manage, with maximum monetary values now solely being used. In respect of call accounts, where balances can be accessed the same working day, it is proposed to increase the daily limit from 'the higher of 5% or £1m' to 'the higher of 5% or £5m'. As it is the monetary value which is typically the higher amount, this will mean the force can invest more amounts in its call accounts, thus increasing liquidity options but continuing to maintain a low risk profile due to these funds being instantly accessible. Where the PFCC has exposure to one counterparty in respect of both fixed-term/notice and callable deposits (e.g. Barclays) the PFCC will deduct any fixed-term limit value (e.g. the higher risk element) from the call account investment held, to ensure balances remain proportionate for exposure risk to individual counterparties.

4.10 In respect of money market funds (MMF's) which are set out in more detail in paragraph 4.16, the PFCC currently has five funds in which investments can be placed, which fluctuate in terms of interest rates and returns being offered. Whilst the 50% overall threshold for MMF's will continue to be adhered to, it is proposed to remove the 10% 'per fund' threshold, and replace this with a monetary value per fund of £5m. Whilst offering a more pragmatic solution in respect of daily treasury management processes and avoiding further breaches being recorded, this would also allow more funds to be placed into higher-yielding funds, whilst not exposing the PFCC to any further risk in this sector. As MMF's also have same day access like call accounts, funds could be withdrawn at short-notice should any credit ratings change. The 10% per fund guideline would still be deemed to be good practice as it offers a diversified range of investments in these funds, however it would not necessitate a formal threshold as adopted in the previous strategy.

<u>Types of investments</u>

4.11 **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 unlimited investments may be made for up to 50 years.

4.12 **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 rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

4.13 **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.

4.14 **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.

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

4.16 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide 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. Whilst it is expected that this position has now improved, it is proposed to retain the 50% sector limit for 2022/23. Therefore, whilst the investment guidance for MMF's 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, generally in the region of 10% of total investments held at any time.

3) Assuming condition 1) is initially met, investments in each MMF are limited to £5m 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.

4.17 **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, they are typically used as a long-term investment instrument.

4.18 Based on an assessment of the PFCC's investment objectives going forward it is proposed to place a ringfenced amount of monies within a strategic pooled fund. A 'per fund' limit of £5m is proposed, with the total sector limit for these type of investments also set at £5m with such limits allowing the PFCC to enter this market without being over-exposed, thereby ensuring that the related risks and structure of these instruments can be understood in more detail, prior to further investments being made. However, based on current market conditions it is not proposed that the PFCC will actively proceed with this option during 2022/23, and instead a proposal will be included as part of the 2023/24 TMS, once compliance with the new CIPFA Prudential Code has been satisfied.

4.19 Should this proposal be subsequently approved this would therefore mean that an additional £5m of external borrowing would be required to provide the surplus funds for these investments. This external borrowing would be *in addition to* the values set out in Table 4. Additional funds would be required because the force would need to keep £10m as liquid cash to meet short-term cashflow commitments, rather than draw down on a strategic pooled fund which has been set-up as a long-term investment vehicle. Under current CIPFA guidance it is understood that it is acceptable to externally borrow for the purpose of investing in strategic pooled funds, however based on prudence it is proposed that additional assurance is obtained to verify this understanding. Also, the PFCC will need to ensure that investment returns override the financing costs of the borrowing and whilst investment incomewill increase, £5m will be tied up for a minimum of three years at least, before the PFCC will see the returns expected from such an investment.

4.20 **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.

4.21 **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

4.22 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.

4.23 **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. In respect of exposure to counterparties where the PFCC holds multiple types of investment, please see paragraph 4.9.

4.24 **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.

4.25 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.

4.26 **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 MTFS.

## 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 | (£200,000) |
| Upper limit on one year revenue impact of a 1% fall in interest rates | £200,000 |

5.3 The above figures reflect the potential impact of a rise or decrease in the current base rate of 1% to either 2% or 0%. 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 potentially 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 4.21 and 4.22.

| | Target |
|---|---|
| Minimum credit rating<br>*(excluding operational bank account but only where short-term cashflow requirements demand this, or whilst actively seeking other banking arrangements – see Table 7, para 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. Whilst it can be seen that the net overdraft facility is currently £1m, it is proposed to investigate options in respect of increasing this up to £3m, on the basis this deficit not exceed 2-3 working days, thus assisting with cashflow management. Should this be agreed this change will reported to the PFCC as part of the quarterly reporting process. It should also be noted that the PFCC treats the bank overdraft facility as part of its short-term borrowing in respect of approval/governance processes.

| | 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 significant amounts of fixed-term investments beyond 365 days in the immediate future, however a £5m limit has been applied for strategic pooled funds investment.

| | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|
| Limit on principal invested beyond one year (non-government) | £5m | £5m | £5m |

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 2022/23 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 Other Items

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 (MiFID):** 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 2021/22 financial year these monies have been co-mingled into the PFCC's bank accounts with interest calculated and added to any repayments to third parties. This element of interest received is netted off the total investment income for the purposes of the annual statutory Statement of Accounts.

## 7.0 Financial implications

7.1 The budget for investment income in 2022/23 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 2022/23 is £0.069m based on an anticipation that the PFCC will have an external borrowing requirement during the upcoming year.

7.2 If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different. It should also be noted that there have been two interest rate rises since the 2022/23 budget setting position was drafted, and some variations are therefore expected, especially for the investment income budget which now appears understated.

## 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 |

**Annexe A**

## Investment position at 31st March 2021

| | 31/03/2021 £000 | Start date | Maturity date | Approx. Rate % |
|---|---|---|---|---|
| **Call/notice accounts** | | | | |
| Santander UK PLC | 2,260 | | | 0.40% |
| Barclays Bank FIBCA | 1,000 | | | 0.05% |
| Barclays Bank PLC | 1,500 | | | 0.01% |
| **Total** | **4,760** | | | |
| | | | | |
| **Money market funds** | | | | |
| Blackrock | 1,000 | | | 0.01% |
| Insight | 1,000 | | | 0.00% |
| Aberdeen | 1,500 | | | 0.01% |
| Federated | 1,500 | | | 0.01% |
| Aviva | 1,500 | | | 0.01% |
| **Total** | **6,500** | | | |
| | | | | |
| **Fixed term deposits** | | | | |
| Bank of England- DMO | 6,500 | 29/03/2021 | 01/04/2021 | 0.015% |
| **Total** | **6,500** | | | |
| | | | | |
| **Other** | | | | |
| Lloyds current account | 1,040 | | | 0.10% |
| | **1,040** | | | |
| | | | | |
| **Total treasury investments** | **18,800** | | | |

## Investment position at 31st March 2022

| | 31/03/2022<br>£000 | Start date | Maturity date | Approx. Rate<br>% |
|---|---|---|---|---|
| **Call/notice accounts** | | | | |
| Santander UK PLC | 2,260 | | | 0.02% |
| Barclays Bank FIBCA | 1,000 | | | 0.00% |
| Barclays Bank PLC | 1,500 | | | 0.05% |
| **Total** | **4,760** | | | |
| | | | | |
| **Money market funds** | | | | |
| Blackrock | 2,800 | | | 0.01% |
| Insight | 500 | | | 0.13% |
| Aberdeen | 0 | | | 0.11% |
| Federated | 0 | | | 0.08% |
| Aviva | 0 | | | 0.08% |
| **Total** | **3,300** | | | |
| | | | | |
| **Fixed term deposits / Treasury Bills** | | | | |
| Bank of England DMO | 4,999 | 22/11/2021 | 23/05/2022 | 0.05% |
| Thurrock Council | 5,000 | 15/10/2021 | 19/04/2022 | 0.10% |
| **Total** | **9,999** | | | |
| | | | | |
| **Other** | | | | |
| Lloyds current account | 48 | | | 0.00% |
| | **48** | | | |
| | | | | |
| **Total treasury investments** | **18,107** | | | |

Appendix 2

# Corporate Finance

## Investment Strategy 2022/23

Strategic Board Meeting: 16th June 2022

Date: 7th June 2022

Authors: Arfanara Naidu / Matthew Tokley

## Investment Strategy 2022/23

### 1.0 Introduction

1.1. Local authorities (including police forces) invest their money for three 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**)
- 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 it does not set out any detail or proposed approach in respect of these latter two types of investment. This approach is unchanged from the 2021/22 Investment Strategy.

1.4. The PFCC will continue to concentrate on treasury management investments during 2022/23.

### 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 (CIPFA).

2.2. The balance of treasury management investments is expected to fluctuate between £0m and £50m during 2022/23, depending on the period of the 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 2022/23 for treasury management investments are covered in a separate document, the Treasury Management Strategy (TMS).

## 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 anticipated that the PFCC will enter into any service loans during 2022/23 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 anticipated that the PFCC will undertake any service investments relating to shares during 2022/23 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 equivalent to, or is 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 anticipated that the PFCC will undertake any commercial property investments during 2022/23 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. **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. The PFCC is currently considering borrowing for the purposes of investing in a strategic pooled fund. Should this proposal progress, the PFCC will seek further guidance to ensure compliance. However, it should be noted that any such borrowing will fundamentally be for the purposes of capital expenditure, whilst still allowing the PFCC to pursue investment opportunities and an income yield over the medium-term. Further details of this proposal are set out in the Treasury Management Strategy.

## 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 PFCC's Chief Financial Officer, both in respect of retrospective performance and forward-looking plans. The Head of Corporate Accounting 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 and cashflow performance update report has also been submitted for scrutiny. All the above papers will be submitted to boards administered by the PFCC, with final approval/sign-off by the PFCC in each instance.

## 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 2022/23, no separate indicators are included in this report and all related aspects of risk management for treasury activity, and associated indicators, are included instead within the separate TMS.

Appendix 3

# Corporate Finance

## Capital Strategy 2022/23

Strategic Board Meeting: 16th June 2022

Date: 7th June 2022

Author: Matthew Tokley

## Capital Strategy 2022/23

### 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 such as vehicles (where the threshold is lower) and 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 in the most recently published version of the Essex/PFCC Group Statement of Accounts, as well as the financial regulations, both of which are available to view on the PFCC's website (see below link)

https://www.essex.pfcc.police.uk/statement-of-accounts

2.3 For 2021/22 and the subsequent five year period the PFCC is planning to spend a total of £132m on capital investment, including £20m in 2022/23. This is summarised in Table 1 below. It should be noted that due to the Capital Strategy being based on 2022/23 budget setting information the 2021/22 outturn position is not reflected within the figures in the subsequent tables. However, as the majority of the £2m reduction represented in the actual outturn for 2021/22 has slipped into subsequent financial years, there is no overall material differential to the figures presented.

**Table 1 – Prudential Indicator: Estimates of Capital Expenditure**

| CAPITAL PROGRAMME - 2022/23 BUDGET SETTING EXPENDITURE SUMMARY | 2021/22 £000 | 2022/23 £000 | 2023/24 £000 | 2024/25 £000 | 2025/26 £000 | 2026/27 £000 | TOTAL £000 |
|---|---|---|---|---|---|---|---|
| ***Capital Expenditure*** | | | | | | | |
| ANPR | 145 | 233 | 145 | 145 | 0 | 0 | 668 |
| Estates Business as Usual | 1,888 | 2,365 | 1,000 | 1,000 | 1,000 | 1,000 | 8,253 |
| Estates Strategy | 7,182 | 5,493 | 15,114 | 21,500 | 19,000 | 900 | 69,188 |
| I.T. Services | 2,565 | 5,051 | 5,958 | 11,509 | 8,973 | 2,816 | 36,871 |
| OPC | 229 | 501 | 51 | 0 | 92 | 0 | 872 |
| Other | 365 | 590 | 237 | 270 | 250 | 250 | 1,962 |
| SCD | 157 | 93 | 30 | 0 | 0 | 0 | 280 |
| Transport | 1,513 | 3,564 | 2,200 | 2,200 | 2,240 | 2,500 | 14,216 |
| | **14,043** | **17,889** | **24,735** | **36,624** | **31,555** | **7,466** | **132,311** |

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 £8m of forecast spend relating to work to improve existing assets and a further £69m 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, and a consultation process is currently underway which will inform the way forward for this. The other main area of spend relates to I.T. Services with nearly £37m 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, and to fully utilise Sharepoint and Office 365 technology across the force.

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).

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 assets (known as capital receipts) may be used to replace debt finance. The planned financing plan in Table 1 (including any forecast debt) is set out in Table 2.

**Table 2 – Capital Financing**

| CAPITAL PROGRAMME - 2022/23 BUDGET SETTING FINANCING SUMMARY | 2021/22 £000 | 2022/23 £000 | 2023/24 £000 | 2024/25 £000 | 2025/26 £000 | 2026/27 £000 | TOTAL £000 |
|---|---|---|---|---|---|---|---|
| ***Financing Source*** | | | | | | | |
| Capital receipts | (5,416) | (4,420) | (4,600) | (2,250) | (16,559) | (4,566) | (37,811) |
| Grants & contributions | (307) | (32) | 0 | 0 | 0 | 0 | (339) |
| Revenue funding | 0 | (5,579) | (1,131) | (1,131) | (1,000) | (1,000) | (9,842) |
| Financing requirement | (8,320) | (7,858) | (19,004) | (33,242) | (13,996) | (1,900) | (84,319) |
| | **(14,043)** | **(17,889)** | **(24,735)** | **(36,624)** | **(31,555)** | **(7,466)** | **(132,311)** |

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 £25m by the end of 2022/23. The PFCC's estimated CFR is as follows:

**Table 3 – Prudential Indicator: Estimates of Capital Financing Requirement**

| CAPITAL PROGRAMME - 2022/23 BUDGET SETTING CAPITAL FINANCING REQUIREMENT (CFR) SUMMARY | 2021/22 £000 | 2022/23 £000 | 2023/24 £000 | 2024/25 £000 | 2025/26 £000 | 2026/27 £000 | TOTAL £000 |
|---|---|---|---|---|---|---|---|
| **Opening CFR** | **9,097** | **16,828** | **23,890** | **41,901** | **73,335** | **83,425** | **9,097** |
| Capital Expenditure | 14,043 | 17,889 | 24,735 | 36,624 | 31,555 | 7,466 | **132,311** |
| Financing Applied | (5,723) | (10,031) | (5,731) | (3,381) | (17,559) | (5,566) | **(47,991)** |
| Minimum Revenue Provision | (588) | (796) | (993) | (1,808) | (3,906) | (4,255) | **(12,347)** |
| **Closing CFR** | **16,828** | **23,890** | **41,901** | **73,335** | **83,425** | **81,070** | **81,070** |

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 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 £37m over the medium-term period, with £3.1m of receipts expected in 2022/23. Whilst the actual figure for 2021/22 was lower (£5.3m) the corresponding slippage in the capital programme meant there was no material impact on financing. The additional receipts not received have slipped into subsequent years and thus do not impact the overall position in this strategy.

**Table 4 – Capital receipts receivable**

| CAPITAL PROGRAMME - 2022/23 BUDGET SETTING POSITION CAPITAL RECEIPTS SUMMARY | 2021/22 £000 | 2022/23 £000 | 2023/24 £000 | 2024/25 £000 | 2025/26 £000 | 2026/27 £000 | TOTAL £000 |
|---|---|---|---|---|---|---|---|
| ***Opening balance*** | 0 | (1,770) | 0 | 0 | 0 | (4,566) | **0** |
| Received | (7,186) | (2,650) | (4,600) | (2,250) | (21,125) | 0 | (37,811) |
| Applied for financing | 5,416 | 4,420 | 4,600 | 2,250 | 16,559 | 4,566 | 37,811 |
| ***Closing balance*** | **(1,770)** | **0** | **0** | **0** | **(4,566)** | **0** | **0** |

2.11 The government has issued statutory guidance on the flexible use of capital receipts, which has now been extended for a further three years up until 31st March 2025. 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 2024/25.

## 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 (aka 'internal 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 short-term loans (currently available at around 1%) and longer-term fixed rate loans which whilst providing budgetary stability are typically more expensive (currently available between 2% to 4%).

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

### Table 5 – Prudential Indicator – Gross Debt and the CFR

| CAPITAL PROGRAMME - 2022/23 BUDGET SETTING POSITION<br>GROSS DEBT AND THE CFR | | | | | | |
|---|---|---|---|---|---|---|
| | 2021/22<br>£000 | 2022/23<br>£000 | 2023/24<br>£000 | 2024/25<br>£000 | 2025/26<br>£000 | 2026/27<br>£000 |
| Gross Debt<br>(external borrowing) | 0 | 11,800 | 31,900 | 64,300 | 76,400 | 74,600 |
| CFR<br>(capital financing requirement) | 16,828 | 23,890 | 41,901 | 73,335 | 83,425 | 81,070 |

3.4 Statutory guidance recommends that the PFCC's total external debt should remain below the CFR, expect in the short-term where required. Table 5 above shows that the PFCC expects to comply with this requirement in the medium-term.

3.5 **Liability benchmark**: To estimate the PFCC's actual external debt over the medium-term period, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £10m at each year-end, for liquidity purposes and compliance with MiFID II legislation. Because the PFCC uses this tool to estimate it's external borrowing requirements these figures are the same as those set out in Table 5 above. The detail of these calculations are presented within the PFCC's TMS.

3.6 **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*

| CAPITAL STRATEGY 2022/23<br>AUTHORISED LIMIT AND OPERATIONAL BOUNDARY | | | | |
|---|---|---|---|---|
| | 2021/22 | 2022/23 | 2023/24 | 2024/25 |
| Authorised Limit<br>(Total External Debt) | £25m | £30m | £50m | £75m |
| Operational Boundary<br>(Total External Debt) | £20m | £20m | £40m | £65m |

*Whilst the PFCC has set the above limits in accordance with its external debt expectations over the medium-term and to comply with the Prudential Code, additional arrangements have been introduced which requires additional approval for specific instances of external borrowing, based on the value and term involved. For further information please refer to Section 3 of the Treasury Management Strategy.

3.7 **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.

3.8 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 or other local authorities, 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 or money market 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**

CAPITAL STRATEGY 2022/23
TREASURY MANAGEMENT INVESTMENTS

| | 31/3/21 actual | 31/3/22 actual | 31/3/23 forecast | 31/3/24 forecast | 31/3/25 forecast |
|---|---|---|---|---|---|
| Short-term investments (periods less than one year) | £18m | £18m | £10m | £10m | £10m |
| Long-term investments (periods greater than one year) | £0m | £0m | £0m | £0m | £0m |

3.9 The above table demonstrates that it is not currently proposed to invest in longer-term investments such as strategic pooled funds within 2022/23 and the subsequent medium-term, but this option will continue to be reviewed. It is assumed that money market funds are short-term investments on the basis they have same-day access, and are primarily used for liquidity purposes. The short-term investment values in Table 7 reflect the fact that whilst the PFCC will fall into an external borrowing position during 2022/23 the PFCC will still look to maintain a minimum annual 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.

3.10 Further details of the PFCC's investments and borrowings are included within the Treasury Management Strategy 2022/23 document.

3.11 **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 (where applicable).

## 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 and scrutinising MTFS documents.

- The PFCC Strategic Board which is responsible for recommending the approval of the capital strategy and the five year capital programme (2022/23 to 2026/27), 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 2022/23-2026/27 programme was approved on the 3rd February 2022).

4.2 Work is currently underway to review the structure of business cases, and the associated governance process, with these changes potentially taking effect during 2022/23 The new templates have been produced in accordance with the HM Treasury guidance and will be consistent with the approach taken nationally across the public sector. Four templates are proposed (Stage's A – D) which will take the place of the existing Stage 1 and 2 business cases, and place more emphasis on scrutinising higher value and complex projects. New governance proposals include the plan to streamline lower value bids and wholly externally-funded projects, in respect of the oversight and approval routes they are currently required to follow. These changes are due to be presented to Chief Officers and the PFCC for approval before any such plans are formally adopted, with the new templates issued as part of the 2023/24 budget setting process.

4.3 Further governance is currently 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 and scrutinise progress on projects and hold the related stakeholders to account. 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 IT Technology Prioritisation/Digital Transformation Boards which have overall responsibility for the strategic review of Estates and IT projects respectively

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

- Specific Project boards with key stakeholders which are set up to manage and progress projects and identify risks which may impact the project/PFCC entity

4.4 **Treasury processes**: Decisions on treasury management investment and borrowing are made daily by Corporate Finance staff in accordance with a monthly plan which is shared with the PFCC's Chief Financial Officer. Furthermore, quarterly reports are also provided to the PFCC office which provide an analysis of cashflow and treasury performance over the preceding quarter, as well as a high level cashflow forecast for the remainder of the year. 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. Any such proposals will usually take the form of a recommendation within the quarterly Treasury Management performance reports.

## 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 £3,569m as at the 31st March 2021). It should be noted that the PFCC has an agreed position with the pension administrator regarding the future liability provision for pensions, with statutory arrangements in place for meeting these deficits. Therefore, the financial position of the PFCC remains sound with current pension liabilities met by current contributions, and future liabilities decreasing over the long-term. The PFCC has also set aside significant funds in provisions and reserves for various purposes, as referred to in the PFCC Statement of Accounts (see link earlier in this document) The PFCC is also at risk of having to pay for some of its contingent liabilities (again referred to in the Statement of Accounts) and some funds have been set aside for these during 2021/22 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 Officers of the Chief Constable, and 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 below.

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

CAPITAL STRATEGY 2022/23
FINANCING COSTS PROPORTION OF NET REVENUE STREAM

| | 2020/21 actual £000 | 2021/22 actual £000 | 2022/23 forecast £000 | 2023/24 forecast £000 | 2024/25 forecast £000 |
|---|---|---|---|---|---|
| Minimum Revenue Provision (MRP) | 500 | 588 | 788 | 1,145 | 1,990 |
| Interest payable | 0 | 0 | 78 | 169 | 315 |
| Interest receivable | (17) | (12) | (20) | (20) | (20) |
| **Net financing costs** | **483** | **576** | **846** | **1,294** | **2,285** |
| Net budget requirement | 314,700 | 330,310 | 352,200 | 365,900 | 372,100 |
| **Proportion of net revenue stream** | **0.15%** | **0.17%** | **0.24%** | **0.35%** | **0.61%** |

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, based on long-life spend relating to Estates projects. 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 2022/23 budget setting process. In particular, the MRP costs arising have been reviewed, and are in accordance with the MRP Policy Statement set out in Section 7.

## 7.0 Minimum Revenue Provision (MRP) Policy Statement

7.1 Where the PFCC does not have enough capital resources to finance its capital expenditure, the CFR will increase and the PFCC will be required to put aside resources to reduce the associated financing requirement 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 former 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 (as part of the Capital Strategy) 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 if applicable.

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 2022/23 will not be subject to an MRP charge until 2023/24.

7.6 Where former operating leases are brought onto the Balance Sheet on 1st April 2022 due to the adoption of the IFRS 16 Leases accounting standard (due to take effect from 2022/23), and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard. However, as at February 2022 a consultation has been launched by CIPFA which proposes to defer the implementation of this standard by twelve months to 1st April 2023 instead. This consultation will close in early March 2022 and, if the proposals are approved, this will mean that there will no impact on revenue for these charges until 2023/24.

7.7 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 (2020/21) 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 |

7.8 Purchase of freehold land will be charged over 50 years. MRP on expenditure not related to non-current 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).

7.9 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.

7.10 Based upon the PFCC's latest estimate of its Capital Financing Requirement on 31st March 2022, the budget for MRP for 2022/23 has been set as follows:

**Table 9 – CFR and MRP Estimates**

| CAPITAL PROGRAMME - 2022/23 BUDGET SETTING CFR AND MRP ESTIMATES | 31/3/22 Estimated CFR £m | 2022/23 Estimated MRP £m |
|---|---|---|
| Capital expenditure before 1st April 2008 | 5.065 | 0.500 |
| Capital expenditure after 31st March 2008 | 11.763 | 0.288 |
| **Total** | **16.828** | **0.788** |

7.11 The CFR arising from the period prior to 1st April 2008 relates to miscellaneous unfinanced capital expenditure relating to various assets no longer held by the PFCC.

7.12 Whilst the guideline MRP for the pre-April 2008 expenditure is 4% (e.g. £204k per annum based on the forecast £5.1m of pre-2008 debt forecast to be held at the end of 2021/22) 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.

7.13 Where possible the PFCC 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. However, it should be noted that these costs are not currently built into any element of the 2022/23 budget or within this strategy.

## 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. These staff hold relevant CCAB professional qualifications and are members of recognised accounting bodies such as CIPFA and ACCA. These staff also have a number of years' experience working in public sector treasury management and capital accounting roles.

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.