The Police and Crime Commissioner for Sussex

2017/18 Treasury Management Strategy Statement

Incorporating
Minimum Revenue Provision Policy Statement and
Annual Investment Strategy

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1 INTRODUCTION

1.1 Background

The Police and Crime Commissioner for Sussex (PCC) is required to set a balanced budget each financial year, which means that planned spending matches available funding. A key part of the treasury management function is to ensure that cash flow supporting the budget is adequately planned, with cash being available to meet commitments when it is needed. Surplus monies are invested at low risk, with due consideration to liquidity and rate of return.

The second main function of treasury management is the funding of the PCC's capital plans. These capital plans provide a guide to the borrowing need (if any), monitoring longer term cash flow to ensure that the PCC can meet capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet PCC risk or cost objectives.

CIPFA defines treasury management as:

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

The PCC's Chief Financial Officer is the financial adviser to the Police and Crime Commissioner as required under the Police Reform and Social Responsibility Act 2011 and has statutory responsibility to manage his/her financial affairs as set out in sections 112 and 114 of the Local Government Finance Act 1988, and the Accounts and Audit Regulations 2015.

For Treasury Management this includes:

- ensuring regularity, propriety and Value for Money (VfM) in the use of public funds;
- advising the PCC on the robustness of the estimates and the adequacy of financial reserves;
- securing the treasury management function, including loans and investments;
- advising, in consultation with the Chief Executive on the safeguarding of assets, including risk management and insurance

1.2 Reporting requirements

The PCC is required to receive and approve 3 main reports each year:

1) **A Treasury Management Strategy including prudential and treasury indicators** (this report) This covers:
   - the capital plans, including prudential indicators;
   - a minimum revenue provision (MRP) policy showing how residual capital expenditure is charged to revenue over time;

- the treasury management strategy which shows how the investments and borrowings are to be organised, including treasury indicators; and
- an investment strategy stating the parameters on how investments are to be managed.

2) A mid year treasury management report
This will provide an update of progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting objectives or whether any policies require revision.

3) An annual treasury report
This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the PCC. This role is undertaken by the Joint Audit Committee.

1.3 Treasury Management Strategy Statement (TMSS) for 2017/18

The strategy for 2017/18 covers two main areas:

Capital issues
- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues
- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the PCC;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Communities & Local Government (CLG) MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

In accordance with the CIPFA Code and CLG Guidance, a revised Treasury Management Strategy Statement can be approved by the Police and Crime Commissioner and implemented at any time during the financial year.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that individuals with responsibility for treasury management receive adequate training in treasury management. This especially applies to those responsible for scrutiny.

The training needs of treasury management officers are periodically reviewed with training arranged as required.

1.5 Treasury management consultants

The PCC uses Capita Asset Services - Treasury Solutions as its external treasury management advisors.

The PCC recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon external advisors.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The PCC will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE PRUDENTIAL INDICATORS 2017/18 – 2019/20

The PCC's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist understanding and confirm capital expenditure plans are affordable. A full table of prudential code indicators to 2019-20 is included in Appendix 5.7.

2.1 Capital expenditure

This prudential indicator is a summary of the PCC's capital expenditure plans, both those agreed previously, and those forming part of the current budget cycle.

Approved capital expenditure forecasts

Capital expenditure	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Estates Strategy	0	20,876	8,819	8,020	5,750
IT Strategy	1,365	5,604	5,352	1,283	1,256
Vehicles	2,752	3,526	3,460	3,239	3,067
Operational Investments	0	6,385	831	362	292
Major Change Initiatives	0	533	0	0	0
Total Capital & Investments	**4,117**	**36,924**	**18,462**	**12,904**	**10,365**

Other long term liabilities: The above table excludes other long term liabilities, such as PFI and leasing arrangements which themselves already include borrowing instruments.

The table below summarises the how capital expenditure plans are being financed, either by capital or revenue resources. Any shortfall of resources (Net financing need) results in a potential requirement to borrow.

Capital expenditure	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Total	**4,117**	**36,924**	**18,462**	**12,904**	**10,365**
Financed by:					
Capital Grants	2,258	1,068	906	906	906
Capital Reserves & Receipts	1,720	33,339	15,531	9,973	7,342
External Funding	139	0	0	0	0
Revenue Contribution	0	2,517	2,025	2,025	2,117
Net financing need	**0**	**0**	**0**	**0**	**0**

2.2 The PCC's borrowing need (the Capital Financing Requirement)

This prudential indicator is the PCC's Capital Financing Requirement (CFR). The CFR is the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the PCC's underlying borrowing need. Any new capital expenditure which has not immediately been paid for will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the PCC's borrowing requirement, these types of scheme include a borrowing facility and so the PCC is not required to separately borrow for these schemes. The PCC currently has £16m of such schemes within the CFR.

The PCC is asked to approve the CFR projections below:

	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Capital Financing Requirement					
Total CFR	**19,749**	**19,282**	**18,359**	**17,411**	**16,755**
Movement in CFR	**(296)**	**(467)**	**(923)**	**(948)**	**(656)**
Movement in CFR represented by					
Net financing need for the year (above)	0	0	0	0	0
Less MRP	(296)	(467)	(923)	(948)	(656)
Movement in CFR	**(296)**	**(467)**	**(923)**	**(948)**	**(656)**

2.3 Minimum Revenue Provision (MRP) policy statement

The PCC is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the MRP).

Minimum Revenue Provision (MRP) is therefore an annual charge made to the revenue account which reflects the minimum amount set aside to pay off capital expenditure.

All local authorities (including PCC's) are required to make a prudent amount of MRP provision in addition to any interest payable on outstanding loans in line with Regulations 27 and 28 in the Local Authorities (Capital Finance and Accounting)(England) Regulations 2003 [SI3146, as amended].

In addition, local authorities (including PCC's) are able to make additional voluntary payments, known as Voluntary Revenue Provision or VRP. The PCC for Sussex has not made any VRP payments to date.

In guidance issued under section 21(1A) of the Local Government Act 2003, the Secretary of State recommends that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to the full council or equivalent level.

This statutory guidance (first released in 2008/09 and revised in 2012) also gave Authorities the flexibility of using one of four options, to calculate a prudent level of MRP.

The four MRP options available are:

- Option 1: Regulatory Method (also known as the Existing practice method)
- Option 2: CFR Method
- **Option 3: Asset Life Method**
- Option 4: Depreciation Method

Options 1 and 2 were intended only for Government-supported borrowing and these options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

Options 3 and 4 were meant to be used for all self-financed borrowing.

The Asset Life method has been adopted by the PCC. This method provides for debt repayment over the life of the asset that has been funded from the borrowing.

The PCC approves **an MRP Statement** in advance of each year. The 2017/18 statement was approved on 9 February 2017 in the Council Tax Precept and Revenue and Capital 2017/18 report:

https://www.sussex-pcc.gov.uk/wp-content/uploads/2017/02/2017-18-PCC-Budget-and-Precept-Decision-Paper-APPROVED-09.02.2017.pdf

The annual MRP statement indicates how the PCC intends to discharge their duty to make a prudent amount of MRP in the forthcoming financial year. A prudent provision is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The PCC approves the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Based on CFR** – MRP will be based on the CFR (option 2)

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);

This option provides for a reduction in the borrowing need over approximately the asset's life.

Repayments included in annual PFI or finance leases are applied as MRP.

The MRP statement to 2019/20

	2015/16 £'000	2016/17 £'000	2017/18 £'000	2018/19 £'000	2019/20 £'000
Prudential Borrowing	0	0	0	0	0
Cumulative External Debt Outstanding at 31 March	4,500	4,500	4,500	4,500	4,500
MRP - Debt Outstanding	130	130	130	130	130
MRP - PFI	146	315	771	793	500
MRP - Finance Lease	20	22	23	25	26
Total MRP	**296**	**467**	**924**	**948**	**656**

2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an

ongoing impact on investments, unless resources are supplemented each year from new sources (asset sales etc.).

Estimates of the year end balances and anticipated cash flow balances

Year End Resource	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Reserves	65,933	64,040	54,658	36,480	33,137
Capital receipts	8,870	0	0	0	0
Provisions*	4,240	4,240	4,240	4,240	4,240
Total core funds	**79,043**	**68,280**	**58,898**	**40,720**	**37,377**
Working capital	(4,665)	10,679	9,909	(2,068)	(8,882)
Under/(over) borrowing	888	1,041	1,193	1,348	1,505
Expected investments	**75,266**	**80,000**	**70,000**	**40,000**	**30,000**

* Provisions relate to estimated insurance injury and damage compensation claims which are based on an annual actuarial review and therefore are likely to change

The reduction in reserves and capital receipts to 2019/20 reflects the programme of committed investments agreed by the PCC, which includes the Estates Strategy.

2.5 Affordability prudential indicators

The previous sections set out the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the PCC's overall finances. The following indicators are approved by the PCC:

2.6 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Financing costs / Net revenue stream	0.45%	0.69%	0.81%	0.81%	0.82%

The estimates of financing costs include current commitments and investment proposals in the approved budget report for 2017/18. The apparent increase is due to the forecast falling net revenue streams due to reductions in government funding. Financing costs remain relatively stable over the period.

2.7 Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme compared to the PCC's existing approved commitments and current plans. The assumptions are based on the budget but will invariably include some estimates, such as the level of Government support, which are not published over a three year period. The current capital and investment programme includes both revenue and capital elements of investment projects, which are funded primarily by capital grants, capital receipts, capital and investment reserve transfers and external funding. The only impact on the net revenue budget is via a revenue contribution of approximately £2m which is incorporated into the balanced budget for the year and does not therefore impact on council tax. In addition the PCC does not assume an annual increase in the precept.

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the PCC. The treasury management function ensures that the PCC's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current debt portfolio

The PCC's debt portfolio position at 31 March 2016, with forward projections are summarised below. The table shows the actual gross debt against the underlying capital borrowing need (the CFR), highlighting any over or under borrowing.

	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
External Debt					
Debt at 1 April	4,500	4,500	4,500	4,500	4,500
Expected change in Debt	0	0	0	0	0
Other long-term liabilities (OLTL)	16,137	15,823	15,052	14,259	13,760
Actual gross debt at 31 March	**20,637**	**20,323**	**19,552**	**18,759**	**18,260**
The Capital Financing Requirement (CFR)	**19,749**	**19,282**	**18,358**	**17,411**	**16,755**
Under / (over) borrowing	**(888)**	**(1,041)**	**(1,194)**	**(1,348)**	**(1,505)**
	4.50%	**5.40%**	**6.50%**	**7.74%**	**8.98%**

As a key indicator the PCC needs to ensure that gross debt does not, except in the short term or exceptional circumstances, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

Current borrowing exceeds the CFR with the majority relating to other long term liabilities, principally a PFI contract repayment. In addition there is a long term PWLB loan of £4.5m.

The Chief Finance Officer confirms the Police and Crime Commissioner is not borrowing for revenue purposes. It is not currently cost effective to repay the PWLB loan debt or the financing contained within the PFI agreement.

This view takes into account current commitments, existing plans and proposed revisions to the capital programme contained in the 2017/18 budget report.

This is subject to regular review and will be considered when economic circumstances make it viable to repay the PWLB loan.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the estimate of what we expect to achieve within the authorised limit. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

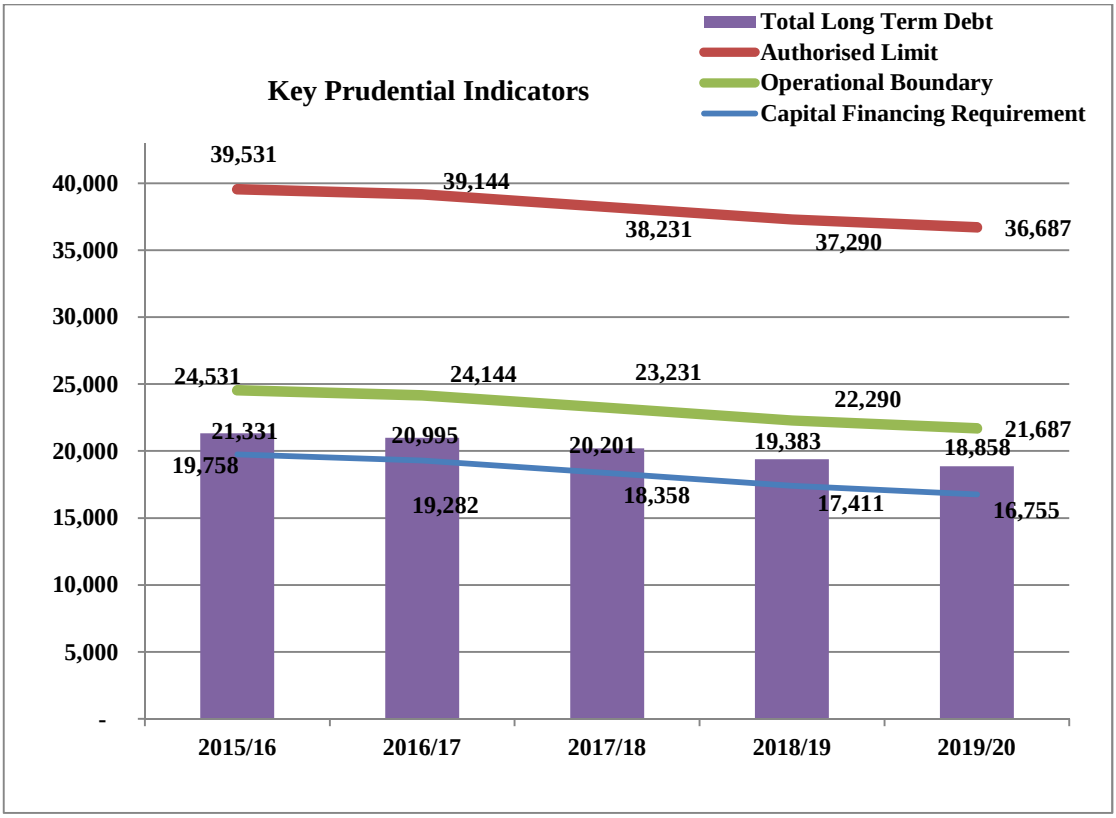
Operational boundary	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Debt	4,500	4,500	4,500	4,500
PFI long term liability	15,823	15,052	14,259	13,760
Finance lease liability	672	649	624	598
Additional external debt	3,149	3,030	2,907	2,829
Total Operational Boundary	**24,144**	**23,231**	**22,290**	**21,687**
CFR	19,282	18,358	17,411	16,755

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the PCC. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all PCCs' plans, or those of a specific PCC, although this power has not yet been exercised.
2. The following table illustrates the authorised limits approved by the PCC with a breakdown of how they were composed:

Authorised limit	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Debt	4,500	4,500	4,500	4,500
PFI long term liability	15,823	15,052	14,259	13,760
Finance lease liability	672	649	624	598
Additional external debt	3,149	3,030	2,907	2,829
Additional debt contingency	15,000	15,000	15,000	15,000
Authorised Limit	**39,144**	**38,231**	**37,290**	**36,687**

The following graph illustrates the prudential indicator projections of CFR and borrowing:


Key Prudential Indicators
Total Long Term Debt
Authorised Limit
Operational Boundary
Capital Financing Requirement
40,000
35,000
30,000
25,000
20,000
15,000
10,000
5,000
-
39,531
39,144
38,231
37,290
36,687
24,531
24,144
23,231
22,290
21,687
21,331
20,995
20,201
19,383
18,858
19,758
19,282
18,358
17,411
16,755
2015/16
2016/17
2017/18
2018/19
2019/20

3.3 Prospects for interest rates

The PCC has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the PCC to formulate a view on interest rates. The following table gives their forecast of interest rates.

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

Appendix 5.2 provides Capita Asset Services' economic outlook for the years ahead. This advice is used in assessing borrowing and investment decisions.

3.4 Borrowing strategy

The PCC is currently maintaining a marginal 'over-borrowed' position. This means that the capital borrowing need (the Capital Financing Requirement) has been fully funded with loan debt. Repayment of a part of the PCC's debt is reviewed on a regular basis.

Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and consider changing circumstances against borrowing requirements.

The PCC's policy towards external borrowing in 2017/18 is:

- No new Prudential Borrowing in line with the Capital Programme and Prudential Indicators
- At any one time short-term borrowing up to a maximum of £15m can be borrowed to cover cash flow shortages

There is no counterparty risk associated with borrowing, except that associated with money laundering. Therefore the approved institutions for short-term borrowing will be:

- Borrowing from other local authorities
- Borrowing from the money markets (any FSA approved institution)
- Borrowing from any company wholly owned by the UK Government

The PWLB allows local authorities to repay loans early and either pay a premium or obtain a discount according to a formula based on current interest rates. Rescheduling opportunities within the Police & Crime Commissioner's debt portfolio, whilst difficult in the current market environment, will continue to be actively reviewed throughout 2017/18. The rationale for rescheduling would be one or more of the following:

- Savings in risk adjusted interest costs
- Rebalancing the interest rate structure of the debt portfolio
- Changing the maturity profile of the debt portfolio

All borrowing, rescheduling and repayment activity will be reported to the PCC for approval in advance.

3.5 Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the PCC's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The following treasury indicators and limits are approved by the PCC:

	2017/18	**2018/19**	**2019/20**
Interest rate exposures	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	31%	55%	74%
Limits on variable interest rates based on net debt	8%	14%	18%
Limits on fixed interest rates: • Debt only • Investments only	 • 100% • 100%	 • 100% • 100%	 • 100% • 100%
Limits on variable interest rates • Debt only • Investments only	 • 25% • 85%	 • 25% • 85%	 • 25% • 85%
Maturity structure of fixed interest rate borrowing 2017/18			
		Lower	**Upper**
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 to 5 years		0%	100%
5 to 10 years		0%	100%
Over 10 years		0%	100%
Maturity structure of variable interest rate borrowing 2017/18 *			
		Lower	**Upper**
Under 12 months		0%	0%
12 months to 2 years		0%	0%
2 to 5 years		0%	0%
5 to 10 years		0%	0%
Over 10 years		0%	0%

-

3.6 Policy on borrowing in advance of need

The PCC will not borrow in advance of need purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the PCC can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.7 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the PCC, at the earliest meeting following its action.

3.8 Municipal Bond Agency

It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This may provide future opportunity for the PCC to consider use of this new source of borrowing as and when appropriate.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The PCC's investment policy has regard to the DCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The PCC's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the DCLG and CIPFA, and in order to minimise the risk to investments, the PCC applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution as it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the PCC will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The aim of the strategy is to generate a list of highly creditworthy counterparties which will enable diversification whilst providing security of investment and minimising risk

Investment instruments identified for use in the financial year are listed in Appendix 5.3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the PCC's treasury management practices – schedules.

It should be noted that possible regulatory changes, currently proposed, may impact on the operations of the investment function. The Market in Financial Instruments Directive (MIFID II), is likely to see the PCC classed as a Retail counterparty in the money markets, with an option to opt up to Professional counterparty. As the 'Retail' category would severely limit the PCC's choice of investment options it is likely that the opt up to 'Professional' status will be required. Once the draft regulations are finalised this policy will be re-affirmed.

4.2 Creditworthiness policy

The primary principle governing the PCC's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the PCC will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These

procedures also apply to the PCC's prudential indicators covering the maximum principal sums invested.

The Chief Finance Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to PCC for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the PCC may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Capita Asset Services our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. A negative rating watch applying to a given counterparty at the minimum PCC criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) are:

- **Banks 1** - good credit quality **–** the PCC will only use banks which:
    i. are UK banks; and/or
    ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AA- or equivalent from at least one of the credit rating agencies
    iii. have a minimum credit rating of F1 Short Term and A- Long Term Fitch or equivalent from at least one of the credit rating agencies
    iv. Investments will include term deposits, call accounts, notice accounts and CD's (Certificates of Deposit).
- **Banks 2** – Part nationalised UK banks – Royal Bank of Scotland Group. This bank can be included if it continues to be part nationalised or meets the ratings in Banks 1 above.
- **Banks 3** – Nat West Bank – The PCC's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- **Bank subsidiary and treasury operation** – The PCC will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- **Building societies** – The PCC will use all societies which meet the ratings for Banks 1 outlined above.
- **Money market funds** – AA- – CNAV (Constant Net Asset Value) money market funds asset over £1bn limited to £10m or 0.5% of the fund's net asset size (per fund).
- **Money market funds** – AA- – Government backed CNAV money market funds limited to the lower or £10m or 2% of the fund's net asset size (per fund).
- **UK Government** – including gilts, Treasury Bills and the Debt Management Account Deposit Facility (DMADF)
- **Local Authorities**, parish councils and PCC's
- **Corporate Bonds and Pooled Funds** – Corporate Bonds and Collective Investment Schemes (Pooled Funds) will be considered as investment tools,

enabling the PCC to diversify the investment portfolio away from the banking sector and provide the potential for enhanced returns. Inclusion is on the explicit understanding that approval is required from the Police and Crime Commissioner before use of such investments.

- **Longer-term Investments (greater than one year)** – Longer-term deposits up to a maximum of two years, with **UK domiciled banks** and/or **multilateral development banks** (five years for **local authorities** and other **PCC's**) can be placed with explicit approval from the Police and Crime Commissioner in consultation with the Chief Finance Officer. The PCC has placed a maximum limit for principal sums invested for over one year as £17.5m.

A limit of 25% will be applied to the use of non-specified investments.

Country and sector considerations - Due care will be taken to consider the country, group and sector exposure of the PCC's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above.

Sector limits will be monitored regularly for appropriateness.

In addition specific limits over and above individual counterparty limits, for which specified investments may be placed up to, will be designated as follows:

- Maximum amount **per banking group**: **£20m**
- Maximum amount invested in **UK Building Societies**: **£10m**
- Maximum % invested in **UK domiciled institutions**: **100%**
- Maximum total investments for **non-UK countries**: **£40m**
- Maximum amount invested per **individual non-UK country**: **£10m**
- Maximum total amount invested **for over one year**: **£20m**

The full criteria proposed for specified and non-specified investments are shown in Appendix 5.3 for approval.

4.3 Credit Rating Methodology

The main rating agencies (Fitch, Moody's and Standard & Poor's) have provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies began removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this represented a change in the use of Fitch and Moody's ratings. We will continue to utilise Credit Default Swap (CDS) price information as an overlay to ratings in our new methodology.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also meant that sovereign ratings became of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest

sovereign rating to their criteria, the new regulatory environment has broken the link between sovereign support and domestic financial institutions. The requirement for a UK sovereign rating of AA- was removed.

It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution, merely a reassessment of their methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks received lower credit ratings as a result of these changes, this does not mean that they were suddenly less credit worthy than they were previously. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now.

Use of additional information other than credit ratings. Additional requirements under the Code require the PCC to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments. The full criteria for Specified and Non-Specified investments including time and monetary limits for institutions on the PCC's counterparty list are detailed in Appendix 5.3.

4.4 Country limits

The PCC has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- (or equivalent) from at least one of the three credit rating agencies. The list of countries that qualify using this credit criteria as the time of writing this report are shown in Appendix 5.6. This list will be added to, or deducted from, by the Chief Finance Officer should ratings change in accordance with this policy.

4.5 Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations. The Bank base interest Rate is forecast to remain unchanged at 0.25% until quarter 2 of 2019 and not to rise above 0.75% by quarter 1 of 2020. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.25%
- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next four years are as follows:

2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

The overall balance of risks to these forecasts is currently likely to be slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and/or forecasts for increases in inflation rise, there could be an upside risk where Bank Rate increases occur earlier and/or at a quicker pace.

Investment treasury indicator and limit - total principal funds invested for greater than 364 days. These limits are set with regard to the PCC's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The treasury indicator limits approved by the PCC are as follows: -

Maximum principal sums invested > 364 days			
	2017/18	**2018/19**	**2019/20**
Principal sums invested > 364 days	£17.5m	£10.0m	£7.5m
Maximum % investment longer than 1 year	25%	25%	25%

For its cash flow generated balances, the PCC will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

Approved brokers – Investments arranged via the London money market will be made through approved brokers. The proposed list of approved brokers for 2017-18 comprises:

- King and Shaxson Limited
- Martin Brokers Group Limited
- Capita Asset Services Trustee Arrangement (via Pooled Trust Account)
- ICAP Securities Limited
- Tullett Prebon Group Limited

4.6 Icelandic bank investments with Heritable Bank

Prior to the inception of Police and Crime Commissioners, the Sussex Police Authority had three deposits with Heritable Bank totalling £6.8m when Heritable was taken into administration in October 2008 following the failure of its Icelandic parent company, Landsbanki. An original claim of £6.84m was submitted to the administrators Ernst &

Young in November 2008, which included interest accrued at the date of Heritable entering administration (£44,828).

Total repayments received to date amount to £6.4m representing 94% of the total claim against investments in Heritable Bank. This may be the extent of recovery, although the final position has yet to be confirmed by the Administrators.

A 20% loan impairment of £1.36m was recognised in the 2008/09 accounts as a prudent forecast of potential loss. £994,000 of this provision was released during 2013/14 to reflect repayment amounts received in excess of expectation at the time of impairment. The remaining impairment of £366,00 reflects the Principal Value of the investment not yet recovered. This offsets the unrecovered element of the original investment so the overall carrying value of the Heritable bank investment in the accounts of the PCC is £Nil.

The current position with regard to Heritable investments is as follows:

	£'000
Original Investment	6,800
Dividends received between 2009 and 2014	(6,434)
Dividends received during 2015/16	(273)
Balance not yet recovered (excluding 2008-09 impairment)	**93**
Loan impairment recognised in 2008-09 accounts (20%)	(1,360)
Loan impairment released in 2013-14 accounts	994
Loan impairment released in 2015-16 accounts	273
Position at 31 March 2016	**0**

These amounts are recognised in full in the accounts in respect of the value of the deposits, including reversal of the remaining impairment value and is charged to the Comprehensive Income and Expenditure Statement.

4.7 End of year investment report

At the end of the financial year, the PCC will report on its investment activity as part of its Annual Treasury Report.

5 APPENDICES

5.1. Interest rate forecasts

5.2. Economic background

5.3. Treasury management practice 1 – credit and counterparty risk management

5.4. Approved countries for investments

5.5. Treasury management scheme of delegation

5.6. The treasury management role of the section 151 officer

5.7. Prudential Code Indicators to 2019/20

5.8. Treasury Management Practice Notes (TMP's)

5.9. Glossary

5.1 APPENDIX: Interest Rate Forecasts 2017 – 2020

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Capita Asset Services Interest Rate View														
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Bank Rate View	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%	-
3 Month LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%	0.90%
6 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%	1.00%
12 Month LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.40%
5yr PWLB Rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%	-
10yr PWLB Rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	-
25yr PWLB Rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	-
50yr PWLB Rate	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	-
Bank Rate														
Capita Asset Services	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%	-
Capital Economics	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%
5yr PWLB Rate														
Capita Asset Services	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%	-
Capital Economics	1.40%	1.60%	1.80%	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.70%	2.80%	2.90%	3.00%	3.20%
10yr PWLB Rate														
Capita Asset Services	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	-
Capital Economics	2.20%	2.30%	2.40%	2.55%	2.60%	2.70%	2.70%	2.80%	2.90%	3.10%	3.20%	3.30%	3.40%	3.60%
25yr PWLB Rate														
Capita Asset Services	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	-
Capital Economics	2.75%	2.90%	3.05%	3.15%	3.25%	3.25%	3.35%	3.45%	3.55%	3.65%	3.75%	3.95%	4.05%	4.15%
50yr PWLB Rate														
Capita Asset Services	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	-
Capital Economics	2.70%	2.80%	2.90%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.60%	3.70%	3.80%	3.90%	4.10%

5.2 APPENDIX: Economic Background

THE UK ECONOMY

UK GDP growth rates of 2.2% in 2013, 2.9% in 2014 and 1.8% in 2015 were some of the strongest growth rates among G7 countries. Growth is expected to strengthen in 2016 and the Bank of England forecast for growth in 2016 as a whole is 2.2%. It is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and in 2017, albeit at a slower pace than in the first half of 2016.

The **referendum vote for Brexit** in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The **Monetary Policy Committee (MPC)** cut the Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. This meeting also gave rise to a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing made available for banks to use to lend to businesses and individuals.

The **MPC meetings of 3 November and 15 December** left the Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations.

The latest MPC decision included a forward view that Bank Rate could go either up or down depending on how economic data evolves in the coming months. The view of our advisers remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019. However, we would not, as yet, discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards, though we think this is unlikely. We would also point out that forecasting as far ahead as mid 2019 is highly uncertain as there are many economic factors and political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, consumers have very much stayed in a 'business as usual' mode with no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly consistent three months leading up to October, retail sales in quarter 4 grew reasonably strongly, increasing by 1.2% and added 0.1% to GDP growth. In addition, the GfK consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, by December it had fallen back to -7 indicating a return to pessimism about future prospects among consumers,

probably based mainly around concerns about rising inflation eroding purchasing power.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

Capital Economics' GDP forecasts are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

The Chancellor has said he will do 'whatever is needed' i.e. to **promote growth**; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR (Public Sector Borrowing Requirement) deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

The other key factor in forecasts for Bank Rate is **inflation** where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as at the MPC meeting date – 15.12.16).This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

It is clear that **consumer disposable income** will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend in 2016 and reached 1.6% in December. However, prices paid by factories for inputs are rising very strongly although producer output prices are still lagging well behind.

Gilt yields, and consequently PWLB rates, have risen sharply since hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The

year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and hit a new peak on the way up again of 1.55% on 15 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

Employment had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October. The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. **House prices** have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

THE GLOBAL ECONOMY

The Eurozone (EZ): In the Eurozone, the European Central Bank (ECB) commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central banks in countries around the world which are currently struggling to combat low growth, are running out of options to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

There are also significant specific political and other risks within the EZ: -

- **Greece** continues to cause stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way.

- **Spain** had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. Late on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.
- The under capitalisation of **Italian banks** poses a major risk. Some **German banks** are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. National governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to borrow additional capital in financial markets due to their vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.
- **4 December Italian constitutional referendum** on reforming the Senate and reducing its powers; this was also a confidence vote on Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in. A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%. These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems.
- **Dutch general election 15.3.17**; a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU – Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.
- **French presidential election;** first round 13 April; second round 7 May 2017.
- **French National Assembly election June 2017.**
- **German Federal election August – 22 October 2017.** This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.
- The core EU, (note, not just the Eurozone currency area), principle of **free movement of people** within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.

Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it

remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

USA: The American economy had sharp swings in the quarterly **growth rate** during 2015 leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, quarter 3 at 3.5% signalled a rebound to strong growth. The Federal bank embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation. This is going to require the central bank to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Federal bank therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

The result of the **presidential election** in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election had a profound effect on the **bond market and bond yields** rose sharply in the week after his election. Time will tell if this is a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

In the first week since the US election, there was a major shift in investor sentiment away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which could be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

China: Economic growth in China has been slowing down and reducing economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to

consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

Economic growth in Japan is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

Emerging countries: There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that $340bn of emerging market corporate debt will fall due for repayment in the final two months of 2016 and in 2017 – a 40% increase on the figure for the last three years.

Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Capita Asset Services Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Federal bank rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of

progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation and reduce high levels of debt in some countries.
- Major national polls in the Eurozone.
- A resurgence of the Eurozone sovereign debt crisis with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a large influx of immigrants or terrorist threats.
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and increases in inflation being weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for **upside risks to current forecasts** for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.
- A rise in US Treasury yields as a result of Federal funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Federal funds rate causing fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major shift from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates:

- **Investment returns** are likely to remain low during 2017/18 and beyond.

- **Borrowing interest rates** displayed a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt.

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

5.3 APPENDIX: Treasury Management Practice (TMP1) Credit and Counterparty Risk Management

The DCLG issued Investment Guidance in 2010, and this forms the structure of the PCC's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for PCCs to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this PCC to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sector Guidance Notes. This PCC has adopted the Code and will apply its principles to all investment activity. In accordance with the Code, the Chief Finance Officer has produced its treasury management practices (TMPs). This part, TMP1, covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the PCC will use. These are high security (i.e. high credit rating, although this is defined by the PCC, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the PCC is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the PCC has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council, community council, fire authority, local authority pension fund or another PCC.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AA- or equivalent from Fitch, Moody's or Standard and Poor's rating agencies.

5. A body that is considered of a high credit quality (such as a bank or building society. For category 5 this covers bodies with a minimum short term rating of F1/P-1/A-1 respectively as rated by Fitch, Moody's or Standard and Poor's rating agencies.

The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) are:

- **Banks 1**: good credit quality **–** the PCC will only use banks which:

  i. are UK banks; and/or

  ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AA- or equivalent from at least one of the credit rating agencies

  iii. have a minimum credit rating of F1 Short Term and A- Long Term Fitch o r

	Fitch	Moody's	Standard & Poors
Short Term	F1	P1	A-1
Long Term	A-	A3	A-

  valent from at least one of the credit rating agencies:

  iv. Investments will include term deposits, call accounts, notice accounts and CD's (Certificates of Deposit).

- **Banks 2** – Part nationalised UK banks – Royal Bank of Scotland Group. This bank can be included if it continues to be part nationalised or meets the ratings in Banks 1 above.
- **Banks 3** – Nat West Bank – The PCC's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- **Bank subsidiary and treasury operation** – The PCC will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- **Building societies** – The PCC will use all societies which meet the ratings for Banks 1 outlined above.
- **Money market funds** – AA- – CNAV (Constant Net Asset Value) money market funds asset over £1bn limited to £10m or 0.5% of the fund's net asset size (per fund).
- **Money market funds** – AA- – Government backed CNAV money market funds limited to the lower or £10m or 2% of the fund's net asset size (per fund).
- **UK Government** – including gilts, Treasury Bills and the Debt Management Account Deposit Facility (DMADF)
- **Local authorities**, parish councils and PCC's
- **Corporate Bonds and Pooled Funds** – Corporate Bonds and Collective Investment Schemes (Pooled Funds) will be considered as investment tools, enabling the PCC to diversify the investment portfolio away from the banking sector and provide the potential for enhanced returns. Inclusion is on the explicit understanding that approval is required from the Police and Crime Commissioner before use of such investments.
- **Longer-term Investments (greater than one year)** – Longer-term deposits up to a maximum of two years, with **UK domiciled banks** and/or **multilateral development**

banks (five years for **local authorities** and other **PCC's**) can be placed with explicit approval from the Police and Crime Commissioner in consultation with the Chief Finance Officer. The PCC has placed a maximum limit for principal sums invested for over one year as £15m.

Within these bodies, and in accordance with the Code, the PCC has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are as follows:

Specified investments - Time limits for specified investments (up to a maximum of 364 days) and the monetary limits per country/sector/banking group will be subject to explicit approval by the Police and Crime Commissioner, in consultation with the Chief Finance Officer, and will be continually reviewed in-year. Such approval will relate to the institution rather than the particular investment and will remain in force until revoked.

In addition specific limits over and above individual counterparty limits, for which specified investments may be placed up to, will be designated as follows:

- Maximum amount per **banking group: £20m**
- Maximum amount invested in **UK Building Societies: £10m**
- Maximum % invested in **UK domiciled institutions: 100%**
- Maximum total investments for **non-UK countries: £40m**
- Maximum amount invested per individual **non-UK country: £10m**
- Maximum total amount invested for **over one year: £20m**

Non-specified investments – Non-specified investments are any other type of investment (i.e. not defined as specified). Where the PCC's cash flow forecast has identified a core surplus of funds, approval may be given to some long-term investments (i.e. with a maturity of one year or longer). The PCC has placed a maximum limit for the total of principal sums invested in 2017/18 for over one year as £17.5m. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the PCC's counterparty list are as follows (these will cover both specified and non-specified investments):

Investments	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 higher quality	AA-	£20m	2 years
Banks 1 medium quality	A	£15m	364 days
Banks 1 lower quality	A-	£10m	6 months
Banks 2 – part nationalised (RBS/Nat West)	N/A	£20m per group	2 years
Banks 3 category – PCC's banker (not meeting Banks 1)	A-	£20m	3 months
Other institutions limit	A-	£10m	6 months

DMADF / Treasury Bills	AAA	Unlimited	6 months
Local authorities and PCC's	N/A	£10m	5 years
Investments Continued	**Fitch Long term Rating (or equivalent)**	**Money Limit**	**Time Limit**
CNAV Money market funds assets over £1bn	AA-	Lower of £10m or 0.5% of fund size per fund	Overnight
CNAV Government backed money market funds	AA-	Lower of £10m or 2% of fund size per fund	Overnight
Pooled funds (e.g. Investec short dated bond fund). The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. This PCC will seek specific guidance on the status of any fund it may consider using.		Further approval required	5 years
Corporate Bonds (e.g. Network rail and Tesco bonds). The PCC will seek further advice on the appropriateness of these categories as there is a higher risk of loss with this type of instrument.		**Further approval required**	**5 years**
Supranational bonds greater than 1 year to maturity **(a) Multilateral development bank bonds** - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and Development Bank etc.). **(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. National Rail, the Guaranteed Export Finance Company [GEFCO]) The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent		£5m per bank	2 years

gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.			
Investments Continued	**Fitch Long term Rating (or equivalent)**	**Money Limit**	**Time Limit**
Gilt edged securities with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.		Unlimited	5 years
Non-Specified Investment: Building societies not meeting the basic security requirements under the specified investments. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The PCC may use such building societies which have a minimum asset size of £1bn, but will restrict this type of investments to £5m.		£5m in total	1 year

The PCC will seek further advice on the appropriateness and associated risks with investments in the above categories.

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The PCC receives credit rating information (changes, rating watches and rating outlooks) from Capita Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Finance Officer, and if required new counterparties which meet the criteria will be added to the list.

5.4 APPENDIX: Approved countries for investments

The following list was correct as at 24 February 2017 and is included for illustrative purposes on the basis that ratings may change throughout the year and will therefore be reviewed on the day prior to investment.

AAA

- Australia
- Canada
- Denmark
- Germany
- Netherlands
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar
- UK

AA-

- Belgium

5.5 APPENDIX: Treasury management scheme of delegation

(i) Police and Crime Commissioner for Sussex

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual treasury management strategy statement (TMSS) including purdential and treasury indicators
- approval of MRP statement
- approval of the annual treasury report
- approval of the mid year treasury management report
- approval of any mid year amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- approval of the annual budgets
- is responsible for the legal contracting body who owns all the assets and liabilities, with the responsibility for the financial administration of their office and the Force, including all borrowing limits

(ii) Chief Finance Officer

- securing the treasury management function, including loans and investments
- approval of division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment

(iii) Joint Audit Committee responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body
- ensure effective scrutiny of the treasury management policy and procedures and make recommendations to the PCC

5.6 APPENDIX: The treasury management role of the section 151 officer

The S151 (responsible) officer represented by the Chief Finance Officer to the Police and Crime Commissioner for Sussex

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

5.7 APPENDIX: Prudential Code Indicators to 2019/20

Impact of Capital Plans on Council Tax	**Base: ACTUAL 2015/16**	**Base: Estimate 2016/17**	**Base: Estimate 2017/18**	**Base: Estimate 2018/19**	**Base: Estimate 2019/20**
Impact on Council Tax Band D Equivalent £	143.91	148.91	153.91	153.91	153.91
Impact on Council Tax Band D Equivalent %	1.98%	3.47%	3.36%	0.00%	0.00%
Increase on Tax Base	2.00%	2.33%	1.54%	0.50%	0.50%
Financial	**ACTUAL 2015/16 £ '000s**	**Estimate 2016/17 £ '000s**	**Estimate 2017/18 £ '000s**	**Estimate 2018/19 £ '000s**	**Estimate 2019/20 £ '000s**
Capital Expenditure	4,117	33,896	18,462	12,904	10,366
Capital Financing Requirement	19,758	19,282	18,358	17,411	16,755
Authorised Borrowing Limit	39,531	39,144	38,231	37,290	36,687
Operational Boundary	24,531	24,144	23,231	22,290	21,687
Net Borrowing	(70,766)	(75,500)	(65,500)	(35,500)	(25,500)
Financing costs	1,295	2,000	2,400	2,400	2,400
Net revenue Stream	(290,889)	(291,025)	(295,608)	(296,211)	(292,305)
Financing costs/Net revenue Stream	0.45%	0.69%	0.81%	0.81%	0.82%
Closing Liabilities as at 31 March	**Actual 2015/16 £ '000s**	**Estimate 2016/17 £ '000s**	**Estimate 2017/18 £ '000s**	**Estimate 2018/19 £ '000s**	**Estimate 2019/20 £ '000s**
Long Term Borrowing	4,500	4,500	4,500	4,500	4,500
Long Term PFI Liability	16,137	15,823	15,052	14,259	13,760
Long Term Finance Lease Liability	694	672	649	624	598
Total Long Term Debt	**21,331**	**20,995**	**20,201**	**19,383**	**18,858**
15% x External Debt (Long term borrowing)	*3,200*	*3,149*	*3,030*	*2,907*	*2,829*
Operational borrowing limit	***24,531***	***24,144***	***23,231***	***22,290***	***21,687***
£15m additional	*15,000*	*15,000*	*15,000*	*15,000*	*15,000*
Authorised borrowing limit	***39,531***	***39,144***	***38,231***	***37,290***	***36,687***
Investments	(75,266)	(80,000)	(70,000)	(40,000)	(30,000)
Maximum investments at longer than 1 year	0	(20,000)	(17,500)	(10,000)	(7,500)
Maximum % investment longer than 1 year	0%	25%	25%	25%	25%
Borrowing (actual external borrowing)	4,500	4,500	4,500	4,500	4,500
Investments	(75,266)	(80,000)	(70,000)	(40,000)	(30,000)
Net Borrowing	**(70,766)**	**(75,500)**	**(65,500)**	**(35,500)**	**(25,500)**
Treasury Management	**ACTUAL 2015/16**	**Estimate 2016/17**	**Estimate 2017/18**	**Estimate 2018/19**	**Estimate 2019/20**
Compliance with CIPFA Code of Practice?	YES	YES	YES	YES	YES
Debt Maturity:					
15-20 Years	100%	44%	0%	0%	0%
10-15 Years	0%	56%	100%	100%	100%
Fixed Rate Debt as % Net Borrowing	30%	28%	31%	55%	74%
Variable Rate Debt as % Net Borrowing	0%	7%	8%	14%	18%
Maximum % Borrowing at Fixed Rates	100%	100%	100%	100%	100%
Maximum % Borrowing at Variable Rates	0%	25%	25%	25%	25%
Maximum % Investments at Fixed Rates	100%	100%	100%	100%	100%
Maximum % Investments at Variable Rates	85%	85%	85%	85%	85%
Maximum Allowable Principal Invested >1year	0%	25%	25%	25%	25%

5.8 APPENDIX: Treasury Management Practice Notes (TMP's)

Treasury Management Services

The PCC's Chief Finance Officer has responsibility for Treasury Management under the PCC's Scheme of Delegation to approve the arrangements for the Treasury Management function, including the day to day management, the production of the Treasury Management Strategy and supporting policies and procedures. For the purpose of the Treasury Management function, the Chief Finance Officer is the responsible officer.

The Chief Constable is responsible via delegation to the Corporate Finance team for providing an effective Treasury Management processing service covering capital and day-to-day revenue requirements, managing cash flows, borrowing and lending in a prudent and efficient manner, in line with the Treasury Management Strategy and Treasury Management Practices agreed with the PCC's Chief Finance Officer.

Treasury Management includes the following activities:-

- Monitor day-to-day cash flows, arrange short-term borrowing or investment as required;
- Arrange and monitor borrowings within best professional practices.
- Manage the funding of the capital programme through borrowing, leasing, capital receipts, use of grants and contributions and direct revenue finance.
- Manage debt, including re-scheduling and monitoring to achieve an even maturity profile.
- Manage the exposure to interest rate fluctuations and assessment of creditworthiness of counterparties.

The approved Chief Constable's Budget includes £14,000 for provision of Treasury Management processing services.

This service provided by the Chief Constable's finance team includes but has not been exclusively restricted to the following objectives:-

General Objectives

- Managing the PCC's cash flow, banking, money market and capital transactions
- Effective control of the risks associated with those activities, and pursuit of optimum performance consistent with those risks
- Provision of all such services to be carried out in accordance with CIPFA's Treasury Management Code of Practice and Prudential Code, the 2003 Local Government Act, DCLG MRP guidance, DCLG Investment guidance and the PCC's Treasury Management strategy and policy and investment strategy
- Ensure adequate treasury management resources and skills, and effective division of responsibilities within the treasury management team

Cash Management

- Ensure necessary working capital is available to enable operational requirements of the PCC and Force to be met
- Ensure all necessary procedures are in place to provide for efficient management of the PCC's cash flow
- Assist the PCC's management team in preparing future cash flow forecasts and advising on strategy

Banking

- Opening necessary bank accounts in accordance with the Scheme of Delegation and Financial Regulations of the PCC, including Petty Cash (Imprest) accounts as determined by the Chief Finance Officer
- Ensure banking and petty cash transactions are carried out with due authorisation
- Carry out necessary reconciliations and controls as required by the PCC including bank and cash reconciliations as appropriate
- Maintenance and provision of access to all necessary procedures and records

Investment

- Prudent recommendations for investment of surplus cash balances in line with the PCC's annual investment strategy
- Provision of an effective investment management service which meets the PCC's requirements in respect of growth, risk and liquidity
- Maintenance of comprehensive records in respect of all investment transactions
- Allocation of investment interest to the PCC based on surplus cash balances and investments

Debt Management

- Management of debt, including new arrangements, re-scheduling and monitoring to achieve an even maturity profile

Risk Management

- Effective management of risk on behalf of the PCC in the pursuit of optimum performance, consistent with the PCC's Treasury Management Strategy

Treasury Management Advice

- The PCC appoints external treasury management advisors. Payment for external advice in addition to the budget will be charged directly to the PCC cost centre.
- The Chief Constable's finance team will liaise with the PCC's external treasury management advisors (currently Capita Asset Management Services). Responsibility for treasury management decisions remains with the PCC and approval is required from the PCC's Chief Finance Officer of the approach to treasury management transactions, and to ensure that undue reliance is not placed upon our external service providers.
- The value of employing external providers of treasury management services is in order to acquire access to specialist skills and resources. Terms of their appointment and the methods by which their value will be assessed will be subject to regular review by the PCC's Chief Finance Officer.

Training

- The CIPFA Code requires the responsible officer (Chief Finance Officer) to ensure that those with responsibility for treasury management receive adequate training in treasury management
- Training will be arranged as required with periodic review of training needs within the finance team members undertaking treasury management activities

Reporting

The Chief Constable's finance team is required to submit a range of reports and updates on an annual basis, providing all necessary financial information and records to the PCC's CFO to allow the statutory role to be carried out. Some reports are required to be adequately scrutinised by the Joint Audit Committee (JAC) before being approved by the PCC.

This is to include:

- **Capital plans** (including prudential indicators) in the annual budget report;
- Annual Minimum Revenue Provision **(MRP) policy** on how residual capital expenditure is charged to revenue over time
- **Annual Treasury Management Strategy** describing how the investments and borrowings are to be organised, including treasury indicators and an Investment Strategy detailing parameters on how investments are to be managed. (JAC)
- **Annual Treasury Management Report** providing details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy. (JAC)
- **Mid-year Treasury Management Report** to update the Joint Audit Committee and the PCC on progress of the capital position, amending prudential indicators as necessary, and

assessing whether the treasury strategy remains fit for purpose or whether any revision or amendment is required. (JAC)

- **Day to day reporting** including regular updates and local arrangements agreed by the CFO and Director of Finance in line with the Schemes of Delegation and Financial Regulations.

Indemnities and Insurance

The Chief Constable has responsibility via delegation to the Joint Insurance team for the insurance function in line with the strategy approved by the PCC on an annual basis. The Chief Constable shall indemnify and keep indemnified Sussex PCC against all losses, actions, claims, demands, proceedings, damages, costs, charges and expenses whatsoever in respect of, or in any way arising out of the provision of the TM services or any part of them or other work carried out pursuant to this Agreement including injury to, or death of, any person and loss of, or damage to, any property including also property belonging to Sussex PCC arising from any act of neglect or negligence on the part of Sussex Police staff except and to the extent that:

- It may arise out of the act error default or negligence of Sussex PCC its employees or agents (not being Sussex Police or its personnel) or by breach by Sussex PCC of any of its obligations under this arrangement, or
- It arises as a direct result that Sussex Police staff acted on the instructions of Sussex PCC

Save for death and personal injury, the liability of Sussex Police (whether in contract, tort or otherwise) for a breach of its obligations under this arrangement shall not exceed ten million pounds (£10,000,000) per occurrence.

Without limiting its responsibilities under this condition, Sussex Police shall ensure that the interest of Sussex PCC is noted on any contracts of insurance it effects which are relevant to the performance of its obligations under this arrangement.

Such contracts of insurance may include but not be limited to Fidelity Guarantee insurance.

5.9 APPENDIX: Glossary

Bill of Exchange

A financial instrument financing trade.

Callable Deposit

A deposit placed at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates before maturity. This decision is based upon how market rates have moved since the deal was agreed. If rates have fallen, the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.

Certificate of Deposit

Evidence of a deposit placed with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.

Capital Financing Requirement (CFR)

The capital financing requirement represents the underlying indebtedness for capital purposes.

Commercial Paper

Short-term obligations maturing between 2 and 270 days which is issued by a bank, corporation or other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.

Corporate Bond

Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies

Derivative

A contract with a value based on the performance of an underlying financial asset, index or other investment. e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock.

DMADF

Deposit Account offered by the Debt Management office, guaranteed by the UK government

Equity

Share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.

Floating Rate Notes

Bonds on which the rate of interest is established periodically with reference to short-term interest rates

Forward Deal

The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.

Forward Deposits

Same as a forward deal (see above).

Deposits with unrated deposit takers (banks and building societies) but with unconditional financial guarantee from HMG or credit rated parent institution: any maturity

Placing money with a bank or building society that has no credit rating, but it does have a guarantee from the UK government or its parent bank.

Unrated deposit takers (banks and building societies) which do not have an unconditional guarantee: any maturity

As above, but without any guarantee at all.

Gilt

Registered British government securities giving the investor an absolute commitment from the government to honour the debt represented by those securities.

Gilt Funds

Pooled fund investing in bonds guaranteed by the UK government.

Minimum Revenue Provision (MRP)

MRP is the minimum prudent amount needed to pay off capital expenditure for a given year.

Money Market Fund (MMF)

Well rated and highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments. It is very similar to a unit trust, however in a MMF, equities are replaced by cash instruments. Returns are typically around 1 month LIBID, and the average maturity is generally below 60 days.

Open Ended Investment Companies

A well-diversified pooled investment vehicle, with a single purchase price, rather than a bid/offer spread.

Other Bond Funds

Pooled funds invested in a wide range of bonds.

Private Finance Initiatives (PFI)

PFI schemes are service concession arrangements typically involve a private sector entity (the operator) constructing or upgrading assets used in the provision of a public service, and operating and maintaining those assets for a specified period of time. The operator is paid for its services over the period of the arrangement.

Public Works Loan Board (PWLB)

The PWLB is a statutory body operating within the United Kingdom Debt Management Office, an executive agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and to collect the repayments.

Reverse Gilt Repo

This is a transaction as seen from the point of view of the party which is buying the gilts. In this case, one party buys gilts from the other and, at the same time and as part of the same transaction, commits to resell equivalent gilts on a specified future date, or at call, at a specified price.

Sovereign Issues (Ex UK Gilts)

Bonds issued or guaranteed by nation states, but excluding UK government bonds.

Supranational Bonds

Bonds issued by supranational bodies which are entities formed by two or more central governments to promote economic development for the member countries e.g. European investment bank. These bonds – now known as Multilateral Development Bank bonds – behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts.

Term Deposit

A deposit held in a financial institution for a fixed term at a fixed rate.

Treasury Bill

Treasury bills are short-term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final *redemption* value.

Unfunded Capital Financing Requirement (Unfunded CFR)

Amount of CFR not funded by loans or other long-term liabilities.

Voluntary Revenue Provision (VRP)

VRP payments are voluntary payment amounts made to pay off capital spend.