



2019/20 Treasury Management Strategy Statement

Incorporating
Minimum Revenue Provision Policy Statement and
Annual Investment Strategy

Approved 25 March 2019

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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 security of capital, 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, when it is prudent and economic, any debt previously drawn may be restructured to meet PCC risk or cost objectives.

The contribution the treasury management function makes to the group is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

“The management of the local authority’s borrowing, 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 PCC 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

Revised reporting is required for the 2019/20 reporting cycle due to revisions of the Ministry of Housing, Communities & Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA

Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.

This group has not engaged in any commercial investments and has no non-treasury investments.

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019/20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of this capital strategy is to ensure that the PCC fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

The strategy can be found at this link (add when approved and published).

1.2.2 Treasury Management reporting

The PCC is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

- 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 is primarily a progress report and will update on 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 is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.
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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 2019/20

The strategy for 2019/20 covers two main areas:

Capital issues

- the capital expenditure plans and associated 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, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

In accordance with the CIPFA Code and MHCLG 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 and the Joint Audit Committee members are periodically reviewed with training arranged as required.

1.5 Treasury management consultants

The PCC uses Link 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. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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 CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2019/20 – 2022/23 AND MRP STATEMENT

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 2022/23 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.

The following table summarises the four year capital and investment programme approved by the PCC:

Capital & Investment Plans	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000	Total £000
Information Technology	5,073	500	500	1,000	7,073
Fleet	4,199	3,582	3,451	3,372	14,604
Estates Strategy	5,298	3,535	2,585	2,000	13,418
Emergency Services Network	-	965	965	-	1,930
Video Enabled Justice	-	-	-	-	-
Digital Policing	-	-	-	-	-
Enterprise Resource Planning	2,100	-	-	-	2,100
Operational Investments	2,665	788	498	273	4,224
Total MTFS Capital & Investment Programme	19,335	9,370	7,999	6,645	43,349

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 how the 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.

Funding	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000	Total £000
Home Office Capital Grant	925	925	925	925	3,700
Revenue Contribution	3,220	3,700	3,000	3,700	13,620
Capital Receipts	4,825	2,300	4,000	0	11,125

Reserves	10,365	2,445	74	2,020	14,904
Total Capital and Investment Programme	19,335	9,370	7,999	6,645	43,349

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 indebtedness and 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 indebtedness in line with each assets life, and so changes the economic consumption of capital as they are used.

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 by the PFI, PPP lease provider and so the PCC is not required to separately borrow for these schemes. The PCC currently has £14m of such schemes within the CFR.

The PCC is asked to approve the CFR projections below:

	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Capital Financing Requirement						
Total CFR	18,367	17,411	16,755	16,207	15,396	14,135
Movement in CFR	(923)	(948)	(656)	(548)	(811)	(1,261)
Movement in CFR represented by						
Net financing need for the year (above)	0	0	0	0	0	0
Less MRP	(923)	(948)	(656)	(548)	(811)	(1,261)
Movement in CFR	(923)	(948)	(656)	(548)	(811)	(1,261)

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.

The PCC is required to make a prudent 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, the PCC is also 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 and is not planning to make any VRP in the foreseeable future.

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 for approval. In our case this is the PCC.

This statutory guidance (first released in 2008/09 and revised in February 2018) also gave 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 revised MHCLG MRP Guidance (released on 14th February 2018) has widened the scope to include non-financial/non-treasury investments and to limit the scope of some of the recent MRP policy approaches. These changes will not have any impact on the PCC's MRP calculations or current approach.

The PCC approves an **MRP Statement** in advance of each year. The 2019/20 statement was approved on 8 February 2019 in the Council Tax Precept and Revenue and Capital 2019/20 report:

<https://www.sussex-pcc.gov.uk/about/transparency/pcc-decisions/decisions/0022019-approval-of-the-council-tax-precept-and-revenue-and-capital-budgets-201920/>

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 2022/23

	2017/18 Actual £'000	2018/9 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Prudential Borrowing						
Cumulative Debt Outstanding at 31 March	4,500	4,500	4,500	4,500	4,500	4,500
MRP - Debt Outstanding	130	130	130	130	130	130
MRP - PFI	771	793	500	389	651	1,100
MRP - Finance Lease	23	25	26	28	30	32
Total MRP	924	948	656	547	811	1,262

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	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Reserves	54,257	40,833	25,453	24,135	23,975	19,367
Capital receipts	0	0	0	0	0	0
Provisions	3,150	3,150	3,150	3,150	3,150	3,150
Total core funds	57,407	43,983	28,603	27,285	27,125	22,517
Working capital	(1,400)	(5,331)	(108)	1,051	1,051	5,497
Under/(over) borrowing	1,193	1,348	1,505	1,664	1,824	1,986
Expected investments	57,200	40,000	30,000	30,000	30,000	30,000

The reduction in reserves and capital receipts to 2022/23 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.

	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Financing costs / Net revenue stream	0.67%	0.78%	0.73%	0.73%	0.71%	0.70%

The estimates of financing costs include current commitments and investment proposals in the approved budget report for 2019/20. The apparent % decrease in

financing costs is due to the increasing forecast for net revenue streams due to increasing precept income assumptions. Financing costs remain stable over the period.

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 and the PCC's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The overall treasury management portfolio as at 31 March 2018 and for the position as at 31 January 2019 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	actual 31/03/2018 £000	actual 31/03/2018 %	current 31/01/2019 £000	current 31/01/2019 %
Treasury investments				
Banks	45,093	79%	39,093	72%
Money Market Funds	12,200	21%	15,000	28%
Total managed in house	57,293	100%	54,093	100%
Total managed externally	0	0%	0	0%
Total treasury investments	57,293	100%	54,093	100%
Treasury external borrowing				
PWLB	4,500	100%	4,500	100%
Total external borrowing	4,500	100%	4,500	100%
Net treasury investments / (borrowing)	52,793	0	49,593	0

The PCC's debt portfolio position at 31 March 2018, with forward projections are summarised below. The table shows the gross actual external debt against the underlying capital borrowing need (the CFR), highlighting any over or under borrowing.

	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
External Debt						
Debt at 1 April	4,500	4,500	4,500	4,500	4,500	4,500
Expected change in Debt	0	0	0	0	0	0
Other long-term liabilities (OLTL)	15,052	14,259	13,760	13,371	12,720	11,621
Actual gross debt at 31 March	19,552	18,759	18,260	17,871	17,220	16,121
The Capital Financing Requirement (CFR)	18,359	17,411	16,755	16,207	15,396	14,135
Under / (over) borrowing	(1,193)	(1,348)	(1,505)	(1,664)	(1,824)	(1,986)
	6.50%	7.74%	8.98%	10.27%	11.85%	14.05%

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 or speculative purposes.

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

The Chief Finance Officer confirms the PCC 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.

The Chief Finance Officer reports that the PCC complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans and proposed revisions to the capital programme contained in the approved 2019/20 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 and the ability to fund under-borrowing by other cash resources.

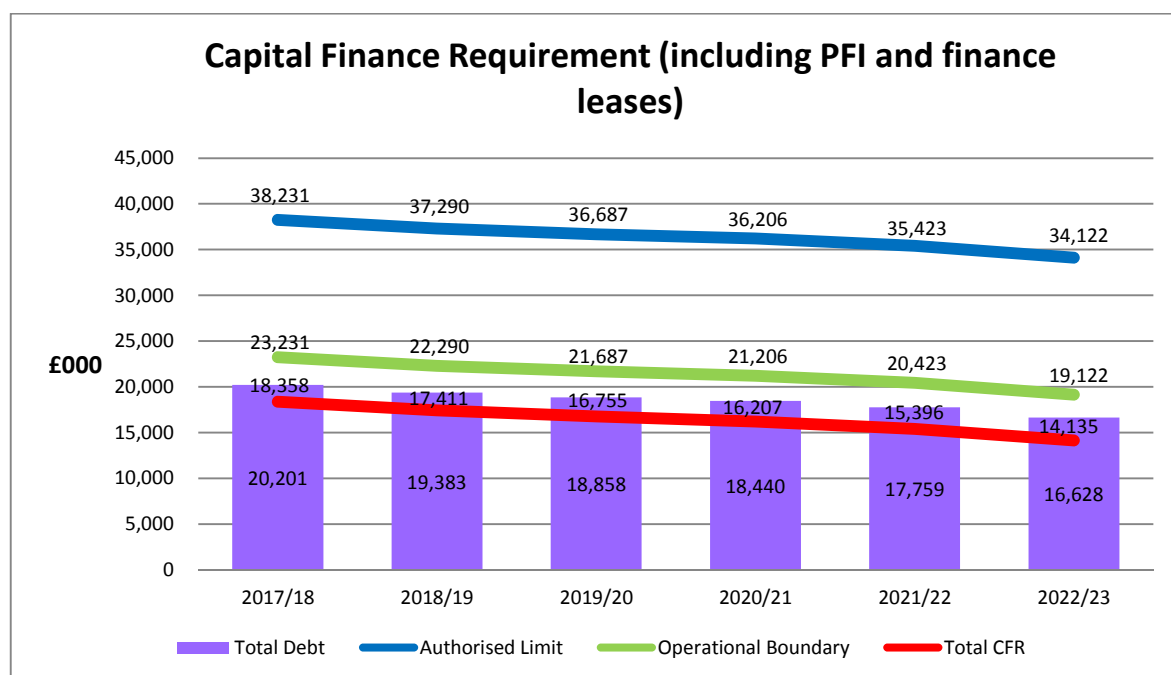
Operational boundary	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Debt	4,500	4,500	4,500	4,500	4,500	4,500
PFI long term liability	15,052	14,259	13,760	13,371	12,720	11,621
Finance lease liability	649	624	598	569	539	507
Additional external debt	3,030	2,907	2,829	2,766	2,664	2,494
Total Operational Boundary	23,231	22,290	21,687	21,206	20,423	19,122
CFR	18,358	17,411	16,755	16,207	15,396	14,135

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a legal 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	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
Debt	4,500	4,500	4,500	4,500	4,500	4,500
PFI long term liability	15,052	14,259	13,760	13,371	12,720	11,621
Finance lease liability	649	624	598	569	539	507
Additional external debt	3,030	2,907	2,829	2,766	2,664	2,494
Additional debt contingency	15,000	15,000	15,000	15,000	15,000	15,000
Authorised Limit	38,231	37,290	36,687	36,206	35,423	34,122

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



3.3 Prospects for interest rates

The PCC has appointed Link 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.

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.70%	0.80%	1.00%	1.10%	1.20%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.80%	0.90%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.00%	1.10%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
10yr PWLB Rate	2.20%	2.30%	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.00%
25yr PWLB Rate	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%

A more detailed interest rate forecast and economic outlook for the years ahead from Link Asset Services are set out in appendices 5.1 and 5.2. 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 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 2019/20 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 2019/20 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 FCA 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 PCC's debt portfolio, whilst difficult in the current market environment, will continue to be actively reviewed throughout 2019/20. 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.
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The following treasury indicators and limits are approved by the PCC:

	2019/20	2020/21	2021/22	2022/23
Interest rate exposures	Upper	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	74%	72%	70%	65%
Limits on variable interest rates based on net debt	18%	18%	17%	16%
Limits on fixed interest rates:				
· Debt only	100%	100%	100%	100%
· Investments only	100%	100%	100%	100%
Limits on variable interest rates				
· Debt only	25%	25%	25%	25%
· Investments only	85%	85%	85%	85%
Maturity structure of fixed interest rate borrowing 2019/20				
		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 2019/20				
		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 may 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 possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes 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 – management of risk

The PCC's investment policy has regard to the following:

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

The PCC's investment priorities will be security first, liquidity second, then yield (return).

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
 2. **Other information:** ratings will not be the sole determinant of the quality of an institution; 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 achieve this consideration 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.
 3. **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.
 4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 5.3 under the categories of 'specified' and 'non-specified' investments.
 - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
 - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.
 5. **Non-specified investments limit.** The PCC has determined that it will limit the maximum total exposure to non-specified investments as being 25% of the total investment portfolio (see paragraph 4.2).
 6. **Lending limits** (amounts and maturity) for each counterparty will be set through applying the criteria in paragraph 4.2.
-

7. **Transaction limits** are set for each type of investment in appendix 5.4.
8. The PCC will set a limit for the amount of its investments which are invested for **longer than 365 days** (see paragraph 4.5).
9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating** (see paragraph 4.2).
10. This PCC has engaged **external consultants** (see paragraph 1.5) to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
11. All investments will be denominated in **sterling**.
12. As a result of the change in accounting standards for 2018/19 under **IFRS 9**, the PCC will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. [In November 2018 the Ministry of Housing, Communities and Local Government (MHCLG), concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.]

The PCC will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.

The above criteria are updated from last year in respect of IFRS 9.

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 Link Asset Services our treasury advisors, 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 the longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. A negative rating watch applying to 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; and
 - 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: and
 - 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 ring-fenced operations. This bank can be included provided 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 (MMFs)** – AAA **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 (MMFs)** – AAA Government backed **CNAV** money market funds limited to the lower of £10m or 2% of the fund's net asset size (per fund).
 - **Money Market Funds (MMFs)** – AAA **LVNAV** (Low Volatility Net Asset Value) money market funds limited to the lower of £10m or 2% of the fund's net asset size (per fund).
 - **Money Market Funds (MMFs)** – AAA **VNAV** (Variable Net Asset Value) money market funds limited to the lower of £10m or 2% of the fund's net asset size (per fund).
 - **Ultra-Short Dated Bond Funds with a credit rating of at least 1.25** – AAA funds limited to the lower of £10m or 2% of the fund's net asset size (per fund).
 - **Ultra-Short Dated Bond Funds with a credit rating of at least 1.50** – AAA funds limited to the lower of £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
 - **Supranational institutions**
-

- **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 PCC 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 PCC in consultation with the Chief Finance Officer. The PCC has placed a maximum limit for principal sums invested for over one year as £20m.

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 rating element of our own credit assessment process focuses on the Short and Long Term ratings of an institution.

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.

UK banks – ring fencing. The largest UK banks (those with more than £25bn of retail and/or Small and Medium-sized Enterprise (SME) deposits) are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst

smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The PCC will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.4 Other limits

Due care will be taken to consider the exposure of the PCC’s total investment portfolio to non-specified investments, countries, groups and sectors.

- a) **Non-specified investment limit.** The PCC has determined that it will limit the maximum total exposure to non-specified investments as being 25% of the total investment portfolio.
- b) **Country limit.** The PCC has determined that it will only use approved counterparties from the UK and 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 5.4. 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). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations.

On the assumption that the UK and EU agree a Brexit deal in spring 2019 or soon after, then Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.50%
- 2021/22 2.00%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

	Now
2018/19	0.75%
2019/20	1.00%
2020/21	1.25%
2021/22	1.75%
2022/23	2.00%
2023/24	2.25%
Later years	2.50%

The overall balance of risks to economic growth in the UK is probably neutral.

The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Investment treasury indicator and limit - total principal funds invested for greater than 365 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 > 365 days				
	2019/20	2020/21	2021/22	2022/23
Principal sums invested > 365 days	£7.5m	£7.5m	£7.5m	£7.5m
Maximum % investment longer than 1 year	25%	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 2019/20 comprises:

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

4.6 Investment risk benchmarking

This PCC will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID.

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 2022/23
 - 5.8. Treasury Management Practice Notes (TMP's)
 - 5.9. Glossary
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5.1 APPENDIX: Interest Rate Forecasts 2019 – 2022

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

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.70%	0.80%	1.00%	1.10%	1.20%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.80%	0.90%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.00%	1.10%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
10yr PWLB Rate	2.20%	2.30%	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.00%
25yr PWLB Rate	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
Bank Rate													
Link Asset Services	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%
Capital Economics	0.75%	0.75%	1.00%	1.25%	1.50%	1.75%	1.75%	1.75%	-	-	-	-	-
5yr PWLB Rate													
Link Asset Services	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
Capital Economics	1.80%	1.90%	2.00%	2.20%	2.50%	2.50%	2.60%	2.60%	0.00%	0.00%	0.00%	0.00%	0.00%
10yr PWLB Rate													
Link Asset Services	2.20%	2.30%	2.40%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.00%
Capital Economics	2.20%	2.30%	2.40%	2.60%	2.80%	2.80%	2.80%	2.80%	-	-	-	-	-
25yr PWLB Rate													
Link Asset Services	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%
Capital Economics	2.70%	2.80%	3.00%	3.10%	3.30%	3.20%	3.20%	3.10%	-	-	-	-	-
50yr PWLB Rate													
Link Asset Services	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
Capital Economics	2.60%	2.70%	2.80%	2.90%	3.20%	3.20%	3.20%	3.10%	-	-	-	-	-

5.2 APPENDIX: Economic Background

THE UK ECONOMY

2018 was a year which started with weak growth of only 0.1% in quarter 1. However, quarter 2 rebounded to 0.4% in quarter 2 followed by quarter 3 being exceptionally strong at +0.6%. Quarter 4 though, was depressed by the cumulative weight of Brexit uncertainty and came in at only +0.2%. Growth is likely to continue being weak until the Brexit fog clears.

The MPC has stated that future Bank Rate increases would be gradual and rise to a much lower equilibrium rate (where monetary policy is neither expansionary or contractionary), than before the crash; indeed they have given a figure for this of around 2.5% in ten years' time but have declined to give a medium term forecast. However, with so much uncertainty around Brexit, the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, the MPC could also raise Bank Rate in the same scenario if there was a boost to inflation from increases in import prices, devaluation of sterling, and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could provide fiscal stimulus to boost growth.

Inflation. The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.1% in December 2018. In the February Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead given a scenario of minimal increases in Bank Rate.

The **labour market** figures in November were particularly strong with an emphatic increase in total employment of 141,000 over the previous three months, unemployment at 4.0%, a 43 year low on the Independent Labour Organisation measure, and job vacancies hitting an all-time high, indicating that employers are having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation continued at its high point of 3.3%, (3 month average regular pay, excluding bonuses). This means that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.2%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, the Brexit deal put forward by the Conservative minority government was defeated on 15 January. Prime Minister May was then (mid-February) seeking some form of modification or clarification from the EU of the Irish border backstop issue. However, our central position is that the Government will endure, despite various setbacks, along the route to reaching an orderly Brexit though the risks are increasing that it may not be possible to get full agreement by the UK and EU before 29 March 2019, in which case this withdrawal date is likely to be pushed back to a new date. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

GLOBAL OUTLOOK

World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to an acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is now probably unlikely to make a start on raising rates in 2019.

KEY RISKS - central bank monetary policy measures

Looking back on more than ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), also reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy and of unemployment falling to such low levels, that the re-emergence of inflation is viewed as a significant risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we did, indeed, see a sharp fall in equity values in the last quarter of 2018 and into early 2019. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery by taking action that is too rapid and too strong, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.** It is particularly notable that, at its 30 January 2019 meeting, the Federated Bank dropped its previous words around expecting further increases in interest rates; it merely said it would be "patient".

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt, (currently about \$50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of its manufacturing exports e.g. cars. Current forward indicators for economic growth and inflation have now been on a downward trend for a significant period, which will make it

difficult for the ECB to make any start on increasing rates until 2020 at the earliest. Indeed, the issue now is rather whether the ECB will have to resort to new measures to boost liquidity in the economy in order to support growth. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. In its January meeting, it made a point of underlining that it will be fully reinvesting all maturing debt for an extended period of time past the date at which it starts raising the key ECB interest rates.

USA. President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2% (annualised rate) in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and an unemployment rate of 4.0%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in December. However, CPI inflation overall fell to 1.9% in December and looks to be on a falling trend to continue below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, which was the fifth increase in 2018 and the ninth in this cycle. However, they dropped any specific reference to expecting further increases at their January 30 meeting. The last increase in December compounded investor fears that the Fed could overdo the speed and level of increases in rates in 2019 and so cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world falling under the weight of fears around the Fed's actions, the trade war between the US and China and an expectation that world growth will slow. Since the more reassuring words of the Fed in January, equity values have recovered somewhat.

The tariff war between the US and China generated a lot of heat during 2018; it could significantly damage world growth if an agreement is not reached during the current three month truce declared by President Trump to hold off from further tariff increases.

China. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

Japan - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

Brexit timetable and process:

- March 2017: UK government notified the European Council of its intention to leave under the Treaty on European Union Article 50 on 29 March 2019.
- 25/11/18 EU27 leaders endorsed the withdrawal agreement
- Dec 2018 vote in the UK Parliament on the agreement was postponed
- 21/12/18 – 08/01/19 UK parliamentary recess
- 15/01/19 Brexit deal defeated in the Commons vote by a large margin
- 28/01/19 Further votes in the Commons
- 14/02/19 Further votes in the Commons
- 21/03/19 EU summit at which a Brexit option could be considered
- By 29/03/19 another vote (?) in UK parliament
- By 29/03/19 if the UK Parliament approves a deal, then ratification by the EU Parliament requires a simple majority
- By 29/03/19 if the UK and EU parliaments agree the deal, the EU Council needs to approve the deal; 20 countries representing 65% of the EU population must agree
- 29/03/19 Either the UK leaves the EU, or asks the EU for agreement to an extension of the Article 50 period if the UK Parliament has been unable to agree on a Brexit deal.
- 29/03/19: If an agreement is reached with the EU on the terms of Brexit, then this will be followed by a proposed **transition period ending around December 2020.**
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy may leave the single market and tariff free trade at different times during the transition period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.

LINK ASSET SERVICES FORWARD VIEW

2018 was a year which started with weak growth of only 0.1% in quarter 1. However, quarter 2 rebounded to 0.4% in quarter 2 followed by quarter 3 being exceptionally strong at +0.6%. Quarter 4 though, was depressed by the cumulative weight of Brexit uncertainty and came in at only +0.2%. Growth is likely to continue being weak until the Brexit fog clears.

The forecasts in Appendix 5.1 are based on a major assumption that Parliament and the EU agree an orderly Brexit, either by 29 March or soon after. At their 7 February meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary), than before the crash; indeed they have given a figure for this of around 2.5% in ten years' time but have declined to give a medium term forecast. However, with so much uncertainty around Brexit, the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they could also raise Bank Rate in the same scenario if there was a boost to inflation from increases in import prices, devaluation of sterling, and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could provide fiscal stimulus to boost growth.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. Since then, US 10 year bond yields have fallen back on fears that the Fed could be too aggressive in raising interest rates and was going to cause a recession. However, the Fed dropped any specific reference to expecting further rate increases at their January 30 meeting. Equity prices have been very volatile on alternating good and bad news during this period.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and 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 interest rate forecasts provided by Link Asset Services in Appendix 5.1 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU**. On this basis, while GDP growth is likely to be subdued in 2019 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement is likely to lead to a boost to the rate of growth in subsequent years which could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there was a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

However, there would appear to be a majority consensus in the Commons against any form of non-agreement exit so the chance of this occurring has now substantially diminished.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**, possibly **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March 2018 of a government which has made a lot of anti-austerity noise. The EU rejected the original proposed Italian budget and demanded cuts in government spending. The Italian government nominally complied with this rebuttal – but only by delaying into a later year the planned increases in expenditure. This particular can has therefore only been kicked down the road. The rating agencies have downgraded Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold Italian debt. Unsurprisingly, investors are becoming increasingly concerned by the actions of the Italian government and consequently, Italian bond yields have risen sharply – at a time when the government faces having to refinance large amounts of debt maturing in 2019.
- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD had a major internal debate as to whether it could continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she has continued as Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority EU governments**. Sweden, Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Italy, Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU. Elections to the EU parliament are due in May/June 2019.
- The increases in interest rates in the US during 2018, combined with a potential trade war between the USA and China, sparked major volatility in equity markets during the final quarter of 2018 and into 2019. Some

emerging market countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to investor flight from equities to safe havens, typically US treasuries, German bunds and UK gilts.

- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks**, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.
- **The Federated Bank causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Investment and borrowing rates

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018/19 and while they were on a rising trend during the first half of the year, they have fallen significantly since then. 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 the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

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

The MHCLG issued Investment Guidance in 2018, 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

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 or equivalent from at least one of the credit rating agencies:

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

- 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 (MMFs)** – AAA **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 (MMFs)** – AAA Government backed **CNAV** money market funds limited to the lower of £10m or 2% of the fund's net asset size (per fund).
 - **Money Market Funds (MMFs)** – AAA **LVNAV** (Low Volatility Net Asset Value) money market funds limited to the lower of £10m or 2% of the fund's net asset size (per fund).
 - **Money Market Funds (MMFs)** – AAA **VNAV** (Variable Net Asset Value) money market funds limited to the lower of £10m or 2% of the fund's net asset size (per fund).
 - **Ultra-Short Dated Bond Funds with a credit rating of at least 1.25** – AAA funds limited to the lower of £10m or 2% of the fund's net asset size (per fund).
 - **Ultra-Short Dated Bond Funds with a credit rating of at least 1.50** – AAA funds limited to the lower of £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

- **Supranational institutions**
- **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 PCC 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 PCC 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 365 days) and the monetary limits per country/sector/banking group will be subject to explicit approval by the PCC 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 2019/20 for over one year as £20m. 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	Transaction limit	Time Limit
Banks 1 higher quality	AA-	£20m	£10m	2 years
Banks 1 medium quality	A	£15m	£10m	365 days
Banks 1 lower quality	A-	£10m	£10m	6 months

Banks 2 – part nationalised (RBS/Nat West)	N/A	£20m per group	£10m	2 years
Banks 3 category – PCC’s banker (not meeting Banks 1)	A-	£20m	£10m	1 day
Other institutions limit	A-	£10m	£10m	6 months
DMADF / Treasury Bills	AAA	Unlimited	£10m	6 months
<i>Investments Continued</i>	<i>Fitch Long term Rating (or equivalent)</i>	<i>Money Limit</i>	<i>Transaction limit</i>	<i>Time Limit</i>
Local authorities and PCC’s	N/A	£10m	£10m	5 years
CNAV Money market funds assets over £1bn	AAA	Lower of £10m or 0.5% of fund size per fund	£10m	Liquid
CNAV Government backed money market funds	AAA	Lower of £10m or 2% of fund size per fund	£10m	Liquid
LVNAV Money Market Funds (MMFs)	AAA	Lower of £10m or 2% of fund size per fund	£10m	Liquid
VNAV Money Market Funds (MMFs)	AAA	Lower of £10m or 2% of fund size per fund	£10m	Liquid
Ultra-Short Dated Bond Funds with a credit rating of at least 1.25	AAA	Lower of £10m or 2% of fund size per fund	£10m	Liquid
Ultra-Short Dated Bond Funds with a credit rating of at least 1.50	AAA	Lower of £10m or 2% of fund size per fund	£10m	Liquid
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

<p>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.</p>		Further approval required		5 years
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Non Specified Investment Category	Fitch Long term Rating (or equivalent)	Money Limit	Transaction limit	Time Limit
<p>Supranational bonds greater than 1 year to maturity</p> <p>(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.).</p> <p>(b) A financial institution that is guaranteed by the United Kingdom Government (e.g. National Rail, the Guaranteed Export Finance Company [GEFCO])</p> <p>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 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.</p>		£5m per bank	£5m	2 years
<p>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.</p>		Unlimited		5 years
<p>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.</p>		£5m in total	£5m	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 Link 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 12 February 2019 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
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

AA-

- Belgium
- Qatar

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 prudential 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 that an effective system of scrutiny is in place in respect of Treasury Management policy, strategy, policies and practices

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.

The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the most recent changes in both the Treasury Management and Prudential codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management) as follows:

- ensuring the preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe;
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the PCC has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- providing a list to the PCC and JAC stakeholders of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by the PCC
- ensuring that the PCC has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices including:
 - Risk management, including investment and risk management criteria for any material non-treasury investment portfolios;

- Performance measurement and management, including methodology and criteria for assessing the performance and success of non-treasury investments;
- Decision making, governance and organisation, including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
- Reporting and management information, including where and how often monitoring reports are taken;
- Training and qualifications, including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

5.7 APPENDIX: Prudential Code Indicators to 2022/23

	ACTUAL 2017/18	Estimate 2018/19	Estimate 2019/20	Estimate 2020/21	Estimate 2021/22	Estimate 2022/23
Impact of Capital Plans on Council Tax						
Impact on Council Tax (Band D Equivalent)	153.91	165.91	189.91	194.91	199.91	204.91
Precept Increase	3.36%	7.80%	14.47%	2.63%	2.57%	2.50%
Financial	ACTUAL 2017/18 £ '000s	Estimate 2018/19 £ '000s	Estimate 2019/20 £ '000s	Estimate 2020/21 £ '000s	Estimate 2021/22 £ '000s	Estimate 2022/23 £ '000s
Capital Expenditure (excluding leasing and PFI)	12,249	11,890	19,335	9,370	7,999	6,645
Capital Financing Requirement (Inc. PFI & Leases) at 31 March	18,358	17,411	16,755	16,207	15,396	14,135
Authorised Borrowing Limit (Actual Debt/Op' borrow limit + £15m)	38,231	37,290	36,687	36,206	35,423	34,122
Operational Boundary (total l/t borrowing + 15%)	23,231	22,290	21,687	21,206	20,423	19,122
Net Borrowing	(54,269)	(35,500)	(25,500)	(25,500)	(25,500)	(25,500)
Financing costs	2,021	2,400	2,400	2,400	2,400	2,400
Net revenue Stream (Taxation and Non-specific Grant Income)	(300,455)	(307,996)	(327,440)	(328,624)	(335,720)	(342,693)
Financing costs/Net revenue Stream	0.67%	0.78%	0.73%	0.73%	0.71%	0.70%
Closing Liabilities as at 31 March	ACTUAL 2017/18 £ '000s	Estimate 2018/19 £ '000s	Estimate 2019/20 £ '000s	Estimate 2020/21 £ '000s	Estimate 2021/22 £ '000s	Estimate 2022/23 £ '000s
Long Term Borrowing - Fixed Rate (PWL B Loan £4.5m)	4,500	4,500	4,500	4,500	4,500	4,500
Long Term PFI Liability - PFI	15,052	14,259	13,760	13,371	12,720	11,621
Long Term Finance Lease Liability - Brighton East	649	624	598	569	539	507
Total Long Term Debt	20,201	19,383	18,858	18,440	17,759	16,628
15% x External Debt (Total Long term borrowing)	3,030	2,907	2,829	2,766	2,664	2,494
Operational borrowing limit	23,231	22,290	21,687	21,206	20,423	19,122
£15m additional	15,000	15,000	15,000	15,000	15,000	15,000
Authorised borrowing limit	38,231	37,290	36,687	36,206	35,423	34,122
Investments	(58,769)	(40,000)	(30,000)	(30,000)	(30,000)	(30,000)
Maximum investments at longer than 1 year	(14,692)	(10,000)	(7,500)	(7,500)	(7,500)	(7,500)
Maximum % investment longer than 1 year	25%	25%	25%	25%	25%	25%
Borrowing (actual external borrowing)	4,500	4,500	4,500	4,500	4,500	4,500
Investments	(58,769)	(40,000)	(30,000)	(30,000)	(30,000)	(30,000)
Net Borrowing	(54,269)	(35,500)	(25,500)	(25,500)	(25,500)	(25,500)
Treasury Management	ACTUAL 2017/18	Estimate 2018/19	Estimate 2019/20	Estimate 2020/21	Estimate 2021/22	Estimate 2022/23
Compliance with CIPFA Code of Practice	YES	YES	YES	YES	YES	YES
Debt Maturity:						
10-15 Years	100%	100%	100%	100%	44%	0%
5-10 Years	0%	0%	0%	0%	56%	100%
Actual Debt at Fixed Rates as % Net Borrowing	37%	55%	74%	72%	70%	65%
Actual Debt at Variable Rates as % Net Borrowing	9%	14%	18%	18%	17%	16%
Maximum % Borrowing at Fixed Rates	100%	100%	100%	100%	100%	100%
Maximum % Borrowing at Variable Rates	25%	25%	25%	25%	25%	25%
Maximum % Investments at Fixed Rates	100%	100%	100%	100%	100%	100%
Maximum % Investments at Variable Rates	85%	85%	85%	85%	85%	85%
Maximum Allowable Principal Invested > 365 days	25%	25%	25%	25%	25%	25%
Maximum Actual Principal Invested > 365 days						

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.
- Performance measurement and management including methodology and criteria for assessing the performance and success of non-treasury investments.
- Effective decision making and governance arrangements to ensure appropriate due diligence is carried out to support investment decisions, including decisions relating to non-treasury investments.

The cost of providing internal Treasury Management processing services is provided within a memorandum of understanding between the PCC and Chief Constable's.

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, MHCLG MRP guidance, MHCLG Investment guidance, IFRS9 Financial Asset Accounting 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
- Risk management to consider investment and risk management criteria for any material non-treasury investment portfolios.

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 Link 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 scrutinised by the Joint Audit Committee (JAC) before being approved by the PCC.

This is to include:

- **Capital Strategy Report** providing high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services, the management of the associated risk and the implication for future financial sustainability
- **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, Public Liability insurance, Professional Indemnity insurance and Officials Indemnity 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.

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.