Annex 1

POLICE AND CRIME COMMISSIONER FOR HUMBERSIDE

Treasury Management Strategy Statement

2012/13

(Including Minimum Revenue Provision Policy and Annual Investment Strategy)

1. Introduction

1.1 Background

The Financial Management Code of Practice (FMCP) sets out that the Police and Crime Commissioner (PCC) is directly responsible for loans, investments and for borrowing as he holds the Police Fund. The Chief Constable is not allowed to borrow money. The FMCP issued by the Home Office also makes it clear that the Prudential Code for Capital Finance in Local Authorities and the Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes, both issued by CIPFA, continue to apply to the police service. The PCC needs to have regard to the Prudential Code in terms of affordability of financial plans when developing the MTFS which should be aligned to the Police and Crime Plans.

The PCC is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation, which will continue to be undertaken by the Force Finance Team under a separate Service Level Agreement, is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the PCC's low risk appetite, providing adequate liquidity initially before considering investment return.

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

CIPFA defines treasury management as:

"The management of investments and cash flows, 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. "

1.2 Reporting requirements

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

A Treasury Manaement Strategy Statement (including Prudential Indicators)
This covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A Mid Year Treasury Management Report – This will update the PCC with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is effective and whether any policies require revision.

An Annual Treasury Report – This provides details of Treasury Management activity during the year and compliance with agreed prudential and treasury indicators.

1.3 Treasury Management Strategy for 2012/13

This report suggests that the original strategy for 2012/13 should be maintained. It covers two main areas:

Capital Issues

- capital plans and the prudential indicators;
- Minimum Revenue Provision (MRP) policy statement

Treasury management Issues

- the treasury position at the start of the financial year;
- treasury indicators which will 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, the CIPFA Treasury Management Code and guidance from the Department for Communities and Local Governmenmt (CLG) on MRP and investments.

2. Capital Prudential Indicators 2012/13 – 2014/15

2.1 Capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to provide an overview and an opportunity to assess and confirm capital expenditure plans.

2.2 Capital Expenditure. This prudential Indicator is a summary of the capital expenditure plans agreed previously, and those agreed by the Police Authority as part of the 2012/13 budget cycle. The capital expenditure forecasts set out below reflect those shown in the Medium Term Financial Strategy approved by the Authority on 14 February 2012 (see Appendix 6 for details of the projects within the programme used to determine the 2012/13 Prudential Indicators).

Capital Expenditure	**2012/13 Estimate £'m**	**2013/14 Estimate £'m**	**2014/15 Estimate £'m**
Total	**19.374**	**7.873**	**9.457**

The table below summarises the above capital expenditure plans and how these plans were to be financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure	**2012/13 Estimate £'m**	**2013/14 Estimate £'m**	**2014/15 Estimate £'m**
Total capital	19.374	7.873	9.457
Financed by:			
Capital grants	1.800	1.600	1.700
Net financing need for the year	**17.574**	**6.273**	**7.757**

2.3 Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the underlying borrowing need. Any of the capital expenditure shown above, which has not immediately been paid for, will increase the CFR.

Following accounting changes the CFR includes any other long term liabilities (e.g. finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the borrowing requirement, these types of scheme include a borrowing facility and so separate borrowing for these schemes is not required. The estimate within the CFR in connection with the helicopter lease was £1.081m. This lease will be transferred as part of the arrangements for the National Police Air Service (NPAS).

	2012/13 Estimate £'m	2013/14 Estimate £'m	2014/15 Estimate £'m
Capital Financing Requirement			
Total CFR	**61.603**	**65.912**	**71.232**
Movement in CFR	**16.025**	**4.309**	**5.320**

Net financing need for the year (above)	17.574	6.273	7.757
Less MRP/VRP and other financing movements	1.549	1.964	2.437
Movement in CFR	**16.025**	**4.309**	**5.320**

2.4 MRP Policy Statement

The PCC will be required to pay off an element of the accumulated Police Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP) and it is also allowed to undertake additional voluntary payments (voluntary revenue provision - VRP).

CLG Regulations have been issued which require the PCC to approve **an MRP Policy** in advance of each year. A variety of options are available so long as there is a prudent provision.

The PCC is recommended to approve the following MRP Statement:-

- For the proportion of the capital expenditure that was incurred before 1 April 2008 the MRP policy will be that the MRP will follow the practice outlined in former CLG regulations which provided for an approximate 4% reduction in the borrowing need (CFR) each year.
- For all other expenditure the MRP policy will be the Asset Life Method where MRP will be based on the estimated life of the assets, in accordance with the proposed regulations, with the amount charged being reasonably commensurate with the estimated useful life applicable to the nature of the expenditure, using either the equal instalment or annuity method of calculation (this option will also be applied for any expenditure capitalised under a Capitalisation Direction).

2.5 The Use of the PCC's Resources and the Investment Position

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. Resources will be supplemented each year from new sources (e.g. asset sales etc.) or as cash balances used temporarily to fund capital are replenished by new borrowing.

The financial projections are based on the assumption that a minimum working capital balance of £5m will be maintained. This is modelled within the MTFS to inform investment planning and borrowing decisions. This arrangement is supplemented by a detailed two year cashflow forecast considered at the monthly Investment Review meetings

2.6 Affordability Prudential Indicators

The previous sections cover 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 were agreed by the Police Authority and are submitted for approval.

Actual and estimates of the 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.

%	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %
Total	1.50	1.92	2.31

The estimates of financing costs include current commitments and the proposals in the budget report and MTFS approved by the Police Authority.

Estimates of the incremental impact of capital investment decisions on Council tax. This indicator identifies the revenue costs associated with proposed changes to the capital programme approved within the budget report and MTFS compared to the existing approved commitments and current plans. The assumptions are based on the approved budget, but will invariably include some estimates, such as the level of Government support, which are not published over the same period as that covered by the MTFS.

Incremental impact of capital investment decisions on the Band D Council Tax

£	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £
Council tax - Band D	3.63	2.99	2.38

3. Treasury Management Strategy

3.1 The capital expenditure plans set out in Section 2 provide details of the service activity approved by the Police Authority in March 2012 which was used to determine the prudential indicators for 2012/13. The treasury management function will ensure that the PCC's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the projected debt positions and the annual investment strategy.

3.2 Current Portfolio Position

The treasury portfolio forward projections at Match 2012 are summarised below. The table shows the estimated external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2012/13 Estimate £'m	**2013/14 Estimate £'m**	**2014/15 Estimate £'m**
External Debt			
Debt at 1 April	17.294	34.626	39.369
Expected change in Debt	17.332	4.743	6.150
Other long-term liabilities (OLTL)	0.957	0.834	0.556
Expected change in OLTL	-0.123	-0.278	-0.278
Estimated debt at 31 March	**35.460**	**39.925**	**45.797**
The Capital Financing Requirement	**61.603**	**65.912**	**71.223**
Under/(over) borrowing	**26.143**	**25.987**	**25.426**
Estimated Total Investments at 31 March			
Investments	**5.000**	**5.000**	**5.000**
Investment change	-	-	-
Net Debt	**30.460**	**34.925**	**40.797**

Within the prudential indicators there are a number of key indicators to ensure that the PCC will operate treasury management activities within well defined limits. One of these is to ensure that its total debt, net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2012/13 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Deputy Chief Executive and Treasurer reports that the Police Authority has complied with this prudential indicator in the year to date and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report and MTFS.

3.3 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary.

This is the limit beyond which external debt is not normally expected to exceed.

Operational boundary £m	2013/14 Estimate £'m	2014/15 Estimate £'m
Debt	72.714	74.707
Other long term liabilities	0.834	0.556
Total	73.548	75.263

The Authorised Limit for external debt.

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

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 authorities' plans, or those of a specific PCC, although this power has not been exercised.

Authorised limit £m	2013/14 Estimate £'m	2014/15 Estimate £'m
Debt	74.714	76.707
Other long term liabilities	0.834	0.556
Total	75.548	77.263

3.4 Prospects for Interest Rates

Sector have been appointed as treasury management advisors until 31 March 2013 and part of their service is to assist with the formulation of views on interest rates. Sector's latest forecast updated on 20 November 2012 is as follows:

	NOW	Dec 12	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16
	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.75
3 month LIBID	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.60	0.60	0.70	0.80	1.10	1.40	1.70	1.90
6 month LIBID	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.50	1.60	1.90	2.20
12 month LIBID	0.90	1.00	1.00	1.00	1.00	1.00	1.10	1.10	1.20	1.30	1.30	1.30	1.80	2.10	2.40
5 year PWLB	1.60	1.50	1.50	1.50	1.60	1.60	1.70	1.70	1.80	2.00	2.20	2.30	2.50	2.70	2.90
10 year PWLB	2.50	2.50	2.50	2.50	2.60	2.60	2.70	2.70	2.80	3.00	3.20	3.30	3.50	3.70	3.90
25 year PWLB	3.80	3.70	3.80	3.80	3.80	3.80	3.90	3.90	4.00	4.10	4.30	4.40	4.60	4.80	5.00
50 year PWLB	3.90	3.90	4.00	4.00	4.00	4.00	4.10	4.10	4.20	4.30	4.50	4.60	4.80	5.00	5.20

3.5 Borrowing Strategy

The Police Authority maintained an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cash flow was used as a temporary measure. This strategy was and remains prudent as investment returns are low and counterparty risk is high.

Against this background and the risks within the economic forecast, a cautious approach has been adopted with the 2012/13 treasury operations.

In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Deputy Chief Executive, together with Force finance officers and in conjunction with the treasury advisers, have and will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

A pragmatic approach will be taken and any decisions will be reported to the PCC at the first available opportunity.

The PCC's borrowing strategy will consider new borrowing in light of the following:

- *Internal borrowing, taking into account working capital requirements, by running down cash balances and foregoing interest earned at historically low rates will continue to be the cheapest form of borrowing. However, this needs to take into account the overall forecast for long term borrowing rates to increase over the next few years. The short term advantage of internal borrowing against potential long term costs as a result of long term rates being likely to be higher in future years needs to be carefully considered*
- *Temporary borrowing from the money markets or other local authorities is likely to provide short term low cost borrowing opportunities*
- *The relative attractiveness of PWLB variable rate loans*
- *Availability of short dated borrowing from non PWLB sources at lower than prevailing PWLB rates.*
- *Availability of long-term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available)*
- *PWLB borrowing for periods where rates incorporating the discounts available as a result of eligibility for the certainty rate (rates discounted by 20bps) are considered to be advantageous in the light of changing economic conditions*
- *Borrowing to assist in balancing the debt maturity profile*

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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. The proposed limits aim to ensure that they will not impair the opportunities to reduce costs and 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; and
- Maturity structure of borrowing. These gross limits are set to reduce exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The limits detailed below have been determined using forecasts of the potential level of debt and the potential sums available for investment based on latest assumptions of the need to borrow for capital purposes and cashflow forecasts. Investments of less than a year are regarded as variable rate in this calculation and therefore, given the limitation of investments to 364 days, all investments fall into this category.

	2012/13 £'m	**2013/14 £'m**	**2014/15 £'m**
Interest rate Exposures			
	Upper £	**Upper £**	**Upper £**
Limits on fixed interest rates based on net debt	40.000	43.000	50.000
Limits on variable interest rates based on net debt	52.500	46.500	45.000
Maturity Structure of fixed interest rate borrowing 2012/13			
		Lower	**Upper**
Under 12 months		0%	50%
12 months to 2 years		0%	75%
2 years to 5 years		0%	80%
5 years to 10 years		0%	80%
10 years and above		0%	100%

3.6 Policy on Borrowing in Advance of Need

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

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

3.7 Debt Rescheduling

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

The reasons for any rescheduling to take place will include:

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

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances by repaying 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 Annual Investment Strategy

3.8.1 Investment Policy

The investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). Investment priorities will be security first, liquidity second, then return.

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, clearly-stipulated minimum acceptable credit quality criteria for counterparties to be included on the lending list are set out below. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agengy. Using the Sector ratings service banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

The PCC, his officers and Force Finance officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end officers of the OPCC and Force Finance Unit will engage with the advisors to maintain a monitor on market

pricing such as “Credit Default Swaps” and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Sector in producing its colour codings which show the varying degreees of creditworthiness.

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

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

Investment instruments identified for use in the financial year are listed in appendix 3 under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the PCC’s Treasury Management Practices document.

3.8.2 Creditworthiness policy

This creditworthiness service provided by Sector applies. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties*. These colour codes are used by the PCC to determine the duration for investments. Counterparties within the following durational bands will therefore be used:

- Blue 1 year (only applies to nationalised or semi-nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used
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**The methodology is set out in the Sector Guide to Establishing Credit Policies*

The Sector creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency’s ratings.

Typically the minimum credit ratings criteria to be used will be a short term rating (Fitch or equivalents) of Short Term rating F1, Long Term rating A-, Viability ratings of BB+, and a Support rating of 3. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored monthly at Investment Review meetings. The OPCC and Force Finance Unit Staff are alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the minimum criteria agreed, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the OPCC and Force Finance Unit Staff will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the PCC's lending list.

Sole reliance will not be placed on the use of this external service. Market data and market information, information on government support for banks and the credit ratings of that government support will also be used.

The spread of investments on a Sector basis between banks, building societies and other institutions will be determined at monthly Investment Review meetings to ensure that the concentration of investments with individual counterparties takes into account safeguards already built into this creditworthiness service together with the overall level of monies invested.

3.8.3 Country limits

The PCC will only allow the use approved UK counterparties.

3.9 Annual Investment Strategy

3.9.1 Investment Strategy

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

Investment returns expectations. Bank Rate is now forecast to remain unchanged at 0.5% before strating to rise from quarter 4 of 2014 to quarter 1 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2012/ 2013 0.50%
- 2013/ 2014 0.50%
- 2014/ 2015 0.75%

Whilst some forecasters are expecting that the Bank rate could be cut to near zero, the Governor of the Bank of England has made comments that this would not happen as it would make conditions in the economy worse due to the adverse effect on savings rates, pensions etc. There is potential for upside risk due to a number of issues, particularly concerns around rising UK inflation and forecasts remain vulnerable to factors affecting the Eurozone.

Investment earnings rates for returns on investments placed for periods up to three months during each financial year for the next five years are as follows:

2013/14	0.50%
2014/15	0.60%
2015/16	1.50%
2016/17	2.25%
2017/18	3.25%
2018/19	4.50%

Invesment treasury indicator and limit

Limits refer to total principal funds invested for greater than 364 days. These limits are set with regard to 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 PCC's position is that moneys will not be lent for periods longer than 364 days.

For its cash flow generated balances, business reserve accounts, notice accounts, money market funds and short-dated term deposits will be used in order to benefit from the compounding of interest.

4. Icelandic Bank Investments

The Police Authority has received regular reports on the action being taken to recover monies invested with the UK subsidiaries of the Icelandic banks, Heritable Bank (£5.57m) and Kaupthing Singer and Friedlander (KSF) (£1m) which collapsed in October 2008.

The Police Authority's audited financial statements for 2011/12 included updated calculations in line with the LAAP 88 bulletin issued earlier this year.

The latest estimates of recovery are for 88p/£ in respect of Heritable Bank and for 81p - 88p/£ in respect of KSF.

5. Investment Risk Benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

- Security - seeking to minimise all security risk to avoid any losses within the portfolio
- Liquidity - seeking to maintain liquid short term deposits of at least £5m available with immediate access.
- Yield - seeking to achieve yields on investments at rates above the 7-day LIBID rate

6. End of year investment report

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

7. Policy on the use of external service providers

Sector are used as 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 our external service providers.

The PCC 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 terms of Sector's appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

8. Scheme of delegation

Please see appendix 4.

9. Role of the section 151 officer

Please see appendix 5

Appendices

1. Interest rate forecasts 2012/2015
2. Economic background
3. Treasury Management practice TMP1 – Credit and Counter Pary Risk Management - Specified and non specified investments and limits
4. Treasury management scheme of delegation
5. The treasury management role of the section 151 officer
6. Detailed capital programme (as at March 2012)

	NOW	Dec 12	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15	Jun 15	Sep 15	Dec 15	Mar 16
	%	%	%	%	%	%	%	%	%	%	%	%	%		
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.75
3 month LIBID	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.60	0.60	0.70	0.80	1.10	1.40	1.70	1.90
6 month LIBID	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.30	1.60	1.90	2.20
12 month LIBID	0.90	1.00	1.00	1.00	1.00	1.00	1.10	1.10	1.20	1.50	1.30	1.30	1.80	2.10	2.40
5 year PWLB	1.60	1.50	1.50	1.50	1.60	1.60	1.70	1.70	1.80	2.00	2.20	2.30	2.50	2.70	2.90
10 year PWLB	2.50	2.50	2.50	2.50	2.60	2.60	2.70	2.70	2.80	3.00	3.20	3.30	3.50	3.70	3.90
25 year PWLB	3.80	3.70	3.80	3.80	3.80	3.80	3.90	3.90	4.00	4.10	4.30	4.40	4.60	4.80	5.00
50 year PWLB	3.90	3.90	4.00	4.00	4.00	4.00	4.10	4.10	4.20	4.30	4.50	4.60	4.80	5.00	5.20

APPENDIX 2
Economic Background

4.1 In the August Inflation Report, the Bank changed its position significantly in as much as it markedly downgraded its forecasts for the strength and speed of recovery in GDP growth whereas previously it had consistently been forecasting a strong recovery to over 3% p.a. In its November Report, the Bank has continued this shift towards pessimism in the speed and strength of recovery; it is now only forecasting growth at around 1% in 2013 and 2% in 2014.

It is still looking for a rebound in growth over the next two years based on the following factors:

1. The impact of a further increase of £50bn of quantitative easing (QE) in July 2012, taking the total from £325bn to £375bn (purchases of gilts to be completed in November 2012).

2. The transfer of £35bn from the Bank's Asset Purchase Facility to the Treasury (representing coupon payments to the Bank by the Treasury on gilts held by the Bank). This is equivalent to a further round of QE of £35bn.

3. The introduction of the Funding for Lending scheme launched by the Bank and the Government on 13 July which will make available at least £80bn of cheap funding for banks so as to support lending to the "real economy", i.e. households and companies. This initiative is anticipated to counter the increase in funding rates over the last year caused by the increasing stresses in the Eurozone impacting on the cost and availability of funds to banks. The full effect of this scheme is still to fully impact the economy.

However, there is still some concern that even this reduction in the Bank's forecasts for recovery could turn out to be optimistic. Another way of looking at the last four years since the recession bottomed out in 2008 in the UK is that despite radical action by the Bank to cut Bank Rate to 0.5% (reached in March 2009) and £375bn of QE, the Bank has failed to stimulate a consistently strongrecovery in economic growth. In fact, the current situation is:-

- The return to positive growth of 1% in Q3 after three quarters of negative growth is likely to be only a blip to wash out the negative figure in the previous quarter. Q4 could well see a return to negative growth. Year on year growth to Q3 was 0%.

- Growth is still 4.5% below the peak in economic activity achieved prior to the start of the 2008 recession.

- The recovery in the UK is the worst and slowest of any G7 country apart from Italy (G7 = US, Japan, Germany, France, Canada, Italy, UK).

- The period since 2008 is the worst and slowest recovery from recession of any of the five UK recessions since 1930.

- The increase in forecasts for CPI inflation to between 2.5 and 3.0% during 2013 will erode consumer spending power and so depress consumer expenditure. According to these forecasts, CPI is not likely to come down to

the 2% target now until two years ahead but significant risks remain to the upside.

Bank Rate

Some forecasters are predicting that the Bank could cut Bank Rate to near zero from 0.5% currently. However, Mervyn King, the Governor, has made some very strong comments that this would NOT happen as that would actually make conditions in the economy worse, not better, due to its adverse effects on savings rates, pension funds etc.

Eurozone

It is apparent that the troika of the EZ, ECB and IMF will need to agree to a longer timeframe for Greece to get its debt below 120% of GDP and, correspondingly, will have to provide even more financial support in the short term to tide Greece over as it struggles to hit austerity targets. The indications are currently that the troika is likely to provide this support. However, markets are still predicting an end game where Greece is eventually forced to exit (dubbed "Grexit") the Eurozone and to return to the drachma. Allied to the market's Greek concerns are the increased threats of contagion that an exit would cause. Portugal and Ireland are natural stepping stones in the process. However, once contagion fears start running, it could be very difficult to contain and stop them.

Greece, though, is not the only focus. Sovereign bond yields in both Spain and Italy rose sharply before the ECB stated it would provide unlimited support in buying government debt to countries that asked for a bailout. However, Spain is still prevaricating over asking for a bailout and surrendering its sovereignty to external oversight by the Eurozone paymasters.

UK economy

Mervyn King was downbeat at the press conference after the Inflation Report was published about the combination of stronger inflation and weaker growth facing the UK. He blamed the downturn in the global economy and viewed the recent reversal of the 25% devaluation of Sterling after the financial crash, to 20% recently, as being unhelpful to encouraging an export led recovery. (However, some commentators are now questioning whether Sterling devaluation is a positive for an economy which is focused on producing high value added specialised goods and services which may not be as price sensitive as UK exports in previous decades.) He also commented that the banks were keeping financially weak zombie firms on life support systems by allowing them to breach borrowing covenants so as to avoid debt write offs hitting bank balance sheets. This may mean that more viable firms with expansion plans are being starved of credit and that the potential for a more rapid recovery is being stifled. In addition, the Government is faced with a significant shortfall in reducing the annual budget deficit due to tax revenues not keeping pace with public expenditure increases, primarily benefits payments, and may therefore need to consider amending its financial plans. The housing market also looks as if it will continue to be weak for a long time yet and the construction industry is contracting.

In summary, our concerns around a slowdown in prospects for GDP growth in the western world are as follows:

US

- GDP growth is likely to remain weak at around 2% - but that is a lot better than the
- prospects for the UK and EU.
- Fed unlikely to increase the central interest rate until 2015.
- The fiscal cliff (budget deficit) urgently needs resolving despite the potential for political gridlock between a Republican House of Representatives and Democrat President and Senate
- The housing market is showing some signs of having turned a corner

EU

- Austerity programmes in various EZ countries are starting to show signs of having an effect in reducing growth rates in the "core" EZ countries.

UK

- The November 2012 Inflation Report has again pushed back the timing of a return to trend growth and the rate at which inflation will fall back towards the target rate of 2%.
- A fair proportion of UK GDP is dependent on overseas trade; the high correlation of UK growth to US and EU GDP growth means that the UK economy is likely to register weak growth in the next two years.
- Consumers likely to remain focused on paying down debt; inflation eroding disposable income, weak consumer sentiment and job fears will all act to keep consumer expenditure suppressed.
- Coalition government hampered in promoting growth by the need to tackle the budget deficit.
- Little sign of a coordinated strategy for the private sector to finance a major expansion infrastructure investment to boost UK growth.
- Alongside Eurozone concerns, there is potential for even more QE to keep gilt yields
- depressed during the next twelve months.

China

- Increasing concerns that efforts to stimulate the economy could fail to avoid a hard landing. There are now many parts of the economy flashing distress signals.

The UK, therefore, is continuing to sail through dangerous waters where event risk is, potentially, never far from occurring. The updated Sector forecast is based around an expectation that we are not heading into a disorderly break-up of the Eurozone, but rather a managed, albeit painful, resolutionof the current crisis. Under this assumed scenario, growth within the Eurozone will be depressed for the next couple of years and this would also lower UK growth as the EU is our biggest export market.

These developments have pushed back our expectations of the timing of the eventual start of increases in Bank Rate and the expected eventual rise in gilt yields and PWLB rates. However, if there were to be a major Eurozone disaster, then we would likely undertake further revisions to when Bank Rate and PWLB rates would be likely to start to increase.

Consequently, Sector has pushed back their forecast of the first rise in Bank Rate, from Q4 2014 to Q1 2015 as well as the pace of rises in gilt yields.

The PWLB forecasts at Appendix 1 are based around a balance of risks. Downside risks have already been covered.

However, Sector are flagging up the potential for upside risks, especially for longer term PWLB rates, as follows: -

- UK inflation being significantly higher than in the wider EU and US causing an increase in the inflation premium in gilt yields

- Reversal of QE; this could initially be allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held

- Reversal of Sterling's safe haven status on an improvement in financial stresses in the Eurozone

- Investors reverse de-risking by moving money from government bonds into shares in anticipation of a return to worldwide economic growth

- The possibility of a UK credit rating downgrade (Moody's has stated that it will review the UK's Aaa rating at the start of 2013).

They emphasised views expressed at the time of previous interest rate revisions about the unpredictability of PWLB rates and bond yields given exceptional levels of volatility being experienced which are highly correlated to political developments in the sovereign debt crisis. The forecast is based on the new 'Certainty Rate' (i.e. rates discounted by 20 bps) being accessible from 1 November 2012. The PCC will have access to this rate.

APPENDIX 3

Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management Specified and Non-Specified Investments and Limits

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	*** Minimum credit criteria / colour band**	**** Max % of total investments/ £ limit per institution**	**Max. maturity period**
DMADF – UK Government **DMADF – Treasury Bills**	**N/A**	**100%/** **No limit**	**up to 1 year**
Money market funds	AAA	100%/ £10m	Liquid
Local authorities	N/A	100%/ £15m	Up to I year
Term deposits with banks and building societies	Blue/Orange Red Green	£15m £10m £10m	Up to I year Up to 6 Months Up to 3 months

SPECIFIED INVESTMENTS:
(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	*** Minimum 'High' Credit Criteria**	**Use**
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies **	Green	In-house

Term deposits with nationalised banks and banks and building societies

	* Minimum Credit Criteria	Use	*** Max % of total investments	Max. maturity period
UK part nationalised banks	Blue Orange Red Green	In-house	100% 100% 100% 100%	12 months 12 months 6 months 3 months

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this PCC. To ensure that the PCC is protected from any adverse revenue impact, which may arise from these differences, the accounting implications of new transactions will be reviewed before they are undertaken.

APPENDIX 4 Treasury management scheme of delegation

(i) Responsibility of the PCC

- To receive and review reports on treasury management policies, practices and activities;
- To approve the annual strategy.
- To approve amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- To consider and approve the budget;
- To approve the division of responsibilities;
- To receive and review regular monitoring reports and to act on recommendations;
- To approve the selection of external service providers and agree terms of appointment.

(ii) Responsibility of the PCCCFO (Deputy Chief Executive and Treasurer)

- To review the treasury management policy and procedures and make recommendations to the PCC.

APPENDIX 5 The treasury management role of the section 151 officer

The PCCCFO/S151 officer will:

- recommend clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submit regular treasury management policy reports;
- submit budgets and budget variations;
- receive and review management information reports;
- review the performance of the treasury management function;
- ensure the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensure the adequacy of internal audit, and liaise with external audit on treasury management;
- recommend the appointment of external service providers.

APPENDIX 6 - Capital Programme

CAPITAL SCHEME	2011/12 £	2012/13 £	2013/14 £	2014/15 £	2015/16 £	2016/17 £
Building Improvements						
D Division Bridewell and DHQ						
- Land		-	-	-	-	-
- Building Works	10,295,100	6100306.00	609,911	-	-	-
- Fees	1,142,860	677,193	67,706	-	-	-
- Roof	1,385,520	-	-	-	-	-
- Sanitary	-	233,210	-	-	-	-
- Heating & Ventilation	-	949,005	-	-	-	-
- Electrical Installation	716,310	424,444	42,436	-	-	-
- Lift	55,200	32,709	3,270	-	-	-
- Communications Installation	298,990	177,167	17,713	-	-	-
- M&E Specialist Works	472,980	280,262	28,021	-	-	-
- Windows & Internal Doors	541,830	-	-	-	-	-
	14,908,790	**8,874,296**	**769,057**	-	-	-
Projects						
- Hessle PS-Additional NCC refurb/upgrade	**83,000**	-	-	-	-	-
Other Estates Strategy						
- HQ Extention (construction costs)			413,473	1,653,894		
- Scunthorpe Police Station				336,179	1,344,717	
- HQ Priory		87,028	87,028	696,226		
- Fees (for the above schemes)		90,156	90,156	721,246		
- Hessle PS	110,000	439,712			1,209,208	439,640
- Fees (Hessle PS)	-					
- Beverley PS	-		614,040	614,040		
- Grimsby PS	-	126,202		1,893,024	504,806	
- Queens Gardens Relocation - Works	-	3,140,000	790,000			
- Queens gardens Relocation - Fees	20,000					
- Riverside NPT	-	1,568,000				
- Bransholme PS - Works	-	341,091	511,637			
- Bransholme PS - Fees	23,560					
- Training Centre	112,000				896,000	112,000
- Derringham Street	-	1,004,976	111,664			
- Minor Capital Works	180,000	320,000	250,000	250,000		
Total Estates Strategy	**15,437,350**	**15,991,461**	**3,637,055**	**6,164,609**	**3,954,731**	**551,640**

CAPITAL SCHEME	2011/12 £	2012/13 £	2013/14 £	2014/15 £	2015/16 £	2016/17 £
(Cont'd) **COMMUNICATIONS UNIT**						
Telephony	30,000	30,000	30,000	30,000	30,000	30,000
CJX Line	37,000		0	0	0	
ISDX	200,000	187,000	0	0	0	750,000
ICCS	0	400,000	0	0	0	
ACD Recorders	0	200,000	0	0	200,000	200,000
Faxes and Mobiles	2,000	2,000	2,000	2,000	2,000	10,000
Custody CCTV	0	177,000	0	0	250,000	150,000
Secure Telephones	8,330	0	0	0	0	
Headset Replacement	0	0	40,000	0	0	
Equipment Rooms	43,180	20,000	20,000	20,000	20,000	20,000
Call Logging System	0	0	20,000	20,000	0	100,000
CCTV	0	150,000				
Airwave - Terminals	0	0	0	350,000	0	
Upgrade of CJX/PNN services	0	0	40,000	40,000	40,000	40,000
TOTAL COMMUNICATION	320,510	1,166,000	152,000	462,000	542,000	1,300,000
Communications equipment	23,550	76,450		0	0	1,500,000
COMPUTER UNIT						
Workstation Replacement	250,000	300,000	300,000	400,000	400,000	300,000
Server Replacement	0					
Network Infrastructure	1,794,940	1,300,000	3,000,000	1,500,000	1,500,000	1,850,000
Information Factory	0					
Nearline Hard Disk Storage	0					
Replacement of GPMS	0					
TOTAL COMPUTERS	2,044,940	1,600,000	3,300,000	1,900,000	1,900,000	2,150,000
PROCURE TO PAY PROJECT						
Computer software	82,560					
VEHICLES & EQUIPMENT						
Vehicle Replacement	656,570	510,000	754,000	900,000	840,000	840,000
IPLD Vehicles	0					
Vehicle Equipment	20,000	30,000	30,000	30,000	30,000	30,000
Major Equipment	180,000					
Liquid Petroleum Gas	0					
Printing Equipment	0					
TOTAL VEHICLES & EQUIP	856,570	540,000	784,000	930,000	870,000	870,000
TOTAL	**18,765,480**	**19,373,911**	**7,873,055**	**9,456,609**	**7,266,731**	**6,371,640**