

**OFFICE OF THE POLICE AND CRIME COMMISSIONER
FOR HUMBERSIDE
DECISION RECORD**

Decision Record Number: **9/2013**

Title: **TREASURY MANAGEMENT STRATEGY STATEMENT**

Executive Summary:

The PCC has the responsibility for Treasury Management. Treasury Management activities are governed by a range of legislation and guidance. The proposed Treasury Management Strategy Statement for 2013/14, including the Minimum Revenue Provision (MRP) Policy and Annual Investment Strategy, meet the legislative requirements of the Local Government Act 2003, CIPFA codes and CLG guidance.

Decision:

That the Treasury Management Strategy Statement Management for 2013/14 be approved.

Background Report: Open

Police and Crime Commissioner for Humberside

I confirm I have considered whether or not I have any personal or prejudicial interest in this matter and take the proposed decision in compliance with my code of conduct.

Any such interests are recorded below.

The above decision has my approval.

Signature

Matthew Crowe

Date 27.03.13

**POLICE AND CRIME COMMISSIONER
FOR HUMBERSIDE**

DECISION RECORD: SUPPORTING REPORT FOR DECISION

Title: TREASURY MANAGEMENT STRATEGY STATEMENT 2013/14

Date: 27 March 2013

1. Purpose:

The purpose of the report is to secure approval to the Treasury Management Strategy Statement for 2013/14.

2. Issue:

The PCC has responsibility for Treasury Management. To discharge this responsibility you must agree a Treasury Management Strategy Statement (TMSS) for 2013/14 in order to comply with the CIPFA Prudential Code for Capital Finance in Local Authorities. The CIPFA Code of Practice on Treasury Management must also be adhered to together with CLG guidance.

3. Recommendations:

- Approve the Treasury Management Strategy Statement for 2013/14.

4. Background:

The Prudential Code for Capital Finance in Local Authorities underpins the system of capital finance. It enables self determination of the funding for capital investment programmes. The Code provides a framework to ensure that when strategic planning, asset management and investment decisions are made, they are affordable, prudent and sustainable. It ensures that treasury management operates in accordance with good professional practice including recording decisions and promoting accountability.

On 22 November 2012 you approved an updated TMSS for 2012/13 together with a Treasury Management Practices Statement (TMPS). These documents mirrored the arrangements approved by the Police Authority in March 2012.

The proposed TMSS for 3013/14 is attached at Annex 1.

The Financial Management Code of Practice confirms that you are responsible for loans, investments and for borrowing money as you hold the Police Fund. The Chief Constable is not able to borrow money.

The proposed Treasury Management Policy Statement is detailed below:

- *Treasury management activities are defined 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'

- *The PCC regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.*

- *The PCC acknowledges that effective treasury management will provide support towards the achievement of his business and service objectives. There is therefore a commitment to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.*

The Treasury Management Strategy Statement includes details of prudential indicators to assess affordability of investment plans. A policy for making Minimum Revenue Provision (MRP), how capital will be charged to revenue, is also included together with parameters on how investments will be made and managed.

No amendments to the approved TMPS are recommended at this time.

5. Options:

The Prudential Code has to be adopted within formal policy documents to enable borrowing to be undertaken in accordance with the Local Government Act 2003. You must have regard to this and CLG guidance in relation to local government investments. As a result, you are required to agree a treasury management policy. You are also required have an approved strategy, including prudential indicators and treasury management practices in place.

6. Risks/Implications:

The TMSS and TMPS provide detailed information in relation to risks associated with treasury management activity. It is acknowledged that risk cannot be entirely eliminated. However, the Statement and the approved

procedures are intended mitigate the risks involved and limit exposure to unforeseen and unbudgeted financial consequences.

7. Financial Comments:

You must adopt the Prudential Code to provide the basis for making funding decisions in connection with the capital programme. The proposals detail the action necessary to ensure there is a clear framework within which treasury management activity takes place. This covers both borrowing and lending.

The financial implications of treasury management have been factored into your precept proposal, the budget for 2013/14 and Medium Term Financial Strategy (MTFS) 2013/14–2017/18 and the calculations used in developing the prudential indicators reflect the information contained within those documents. Budget monitoring reports will take account of variations from original assumptions.

8. Legal Comments:

The requirements of the Local Government Act 2003, the CIPFA Code and CLG guidance must be complied with. This is achieved by determining and approving the treasury management policies and strategies in place supported by the agreed practices and procedures approved in November 2012.

9. Equality Comments:

There are no equalities implications.

10. Next steps:

If the recommendations are accepted all treasury management activity will be undertaken in line with the agreed procedures and practices.

11. Background/Supporting Papers

Police Reform and Social Responsibility Act 2011

Policing Protocol Order 2011

Financial Management Code of Practice for Police

Decision Record 3/2012 and supporting documentation

**POLICE AND CRIME COMMISSIONER
FOR HUMBERSIDE**

**Treasury Management Strategy Statement
2013/14**

(Including Minimum Revenue Provision Policy and Annual
Investment Strategy)



1 INTRODUCTION

1.1 Background

The Police and Crime Commissioner (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 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.

A further key 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, 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."

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 Management Strategy Statement (including Prudential Indicators)

This covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision (MRP) 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 on the capital position, amending prudential indicators as necessary, and whether the treasury management activity is in line with the strategy and/or whether any policies require revision.

An Annual Treasury Report - This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.3 Treasury Management Strategy for 2013/14

The strategy for 2013/14 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;
- the Minimum Revenue Provision (MRP) strategy.

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, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that those with responsibility for treasury management receive adequate training in treasury management. The PCC has access to training and briefings on treasury management and the training needs of treasury management officers are regularly reviewed.

1.5 Treasury management consultants

The PCC uses Sector 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 our external service providers.

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 INDICATORS 2013/14 - 2015/16

The PCC's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist the PCC to maintain an overview of these spending plans and to confirm his capital programme.

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 this budget cycle. The PCC is asked to approve the capital expenditure forecasts:

	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Capital Expenditure				
Total	16,183	17,052	9,069	7,438

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

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need

	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Total	16,183	17,052	9,069	7,438
Financed by:				
Capital receipts	142			
Capital grants	1,800	1,600	1,700	1,700
Revenue	65			
Net financing need for the year	14,176	15,452	7,369	5,738

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

The second prudential indicator is the PCC's Capital Financing Requirement (CFR). The CFR put simply is 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 PCC's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

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

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

The PCC is asked to approve the CFR projections below:

	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Capital Financing Requirement				
Total CFR	45,267	58,027	71,753	75,760
Movement in CFR	12,760	13,726	4,007	1,837

Net financing need for the year (above)	14,176	15,452	7,369	5,738
Less MRP/VRP and other financing movements	-1,416	-1,726	-3,362	-3,901
Movement in CFR	12,760	13,728	4,007	1,837

2.3 Minimum revenue provision (MRP) policy statement

The PCC is 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), although additional voluntary payments if required (voluntary revenue provision - VRP) can be undertaken if required.

CLG regulations have been issued which require the PCC to approve an **MRP Statement** in advance of each year. A variety of options are provided to PCCs, so long as there is a prudent provision. The PCC is recommended to approve the following MRP Statement.

- For capital expenditure that was incurred before 1 April 2008, the MRP policy will be that the MRP will follow the practice outlined in the 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 the MRP will be based on the estimated life of the assets, in accordance with the regulations with the amounts 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).

2.4 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 for each resource and anticipated day to day cash flow balances are detailed below.

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 cash flow forecast considered at the monthly Investment Review Meetings.

2.5 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 PCC is asked to approve the following indicators:

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.

	2012/13 Estimate %	2013/14 Estimate %	2014/15 Estimate %	2015/16 Estimate %
Ratio of financing costs to net revenue income stream	1.18%	1.54%	2.79%	3.28%

The estimates of financing costs include current commitments and the proposals in the approved MTFS.

2.7 Incremental impact of capital investment decisions on Council tax.

This indicator identifies the revenue costs associated with proposed changes to the capital programme compared to the PCC's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over multi year periods.

	2012/13 Estimate £	2013/14 Estimate £	2014/15 Estimate £	2015/16 Estimate £
Incremental impact of capital investment decisions on the Band D Council tax				
Council tax - Band D	2.00	3.62	8.64	3.78

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the PCC's capital investment activity. The treasury management function ensures that the PCC's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of 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 PCC's treasury portfolio position with forward projections are summarised below. The table shows the actual 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 £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
External Debt				
Debt at 1 April	17,294	36,016	53,599	66,395
Expected change in Debt	18,720	17,583	12,796	7,690
Other long-term liabilities (OLTL)*	834	556	278	0
Actual gross debt at 31 March	36,850	54,155	66,673	74,085
The Capital Financing Requirement	58,027	71,753	75,760	77,597
Under / (over) borrowing	21,177	17,398	9,087	3,512

*OLTL relates to the Helicopter lease. This will be amended when the arrangements with NPAS have been finalised.

Within the prudential indicators there are a number of key indicators to ensure that the PCC operates within well defined limits. One of these is to ensure that its gross debt 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 2013/14 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Deputy Chief Executive and Treasurer reports that this prudential indicator has been complied with in the current year. He does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals for the precept and budget for 2013/14 and the approved MTFS.

3.2 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	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Debt	83,250	86,323	73,075	69,940
Other long term liabilities	834	556	278	0
Total	84,354	86,879	73,353	69,940

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

Authorised limit	2012/13 Estimate £'000	2013/14 Estimate £'000	2014/15 Estimate £'000	2015/16 Estimate £'000
Debt	85,520	88,323	75,075	71,940
Other long term liabilities	834	556	278	0
Total	86,354	88,879	75,353	71,940

3.3 Prospects for interest rates

The PCC is advised by Sector and part of their service is to assist the PCC in formulating a view on interest rates. The following table gives the Sector's latest central view.

%	Mar 2013	Jun 2013	Sep 2013	Dec 2013	Mar 2014	Jun 2014	Sep 2014	Dec 2014	Mar 2015	Jun 2015	Sep 2015	Dec 2015	Mar 2016
Bank Rate	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
3m LIBID	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
6m LIBID	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
12m LIBID	1.00	1.00	1.00	1.00	1.10	1.10	1.20	1.30	1.30	1.50	1.80	2.10	2.40
5yr PWLb	1.80	1.80	1.80	1.80	1.90	2.00	2.10	2.20	2.40	2.50	2.60	2.80	3.00
10yr PWLb	2.90	2.90	2.90	2.90	3.00	3.10	3.20	3.30	3.50	3.60	3.80	3.90	4.10
25yr PWLb	4.10	4.10	4.10	4.10	4.20	4.20	4.30	4.40	4.60	4.60	4.80	4.90	5.00
50yr PWLb	4.20	4.20	4.20	4.20	4.40	4.40	4.50	4.60	4.70	4.80	4.90	5.00	5.10

3.4 Borrowing strategy

The PCC is continuing to maintain 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 PCC's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2013/14 treasury operations. The Deputy Ceo and Treasurer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *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 the potential long term costs as a result of long term interest 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 shortterm low cost borrowing opportunities.*
- *The relative attractiveness of PWLB variable rate loans.*
- *Availability of short dated borrowing from on-PLB sources at lower than prevailing PWLB rates.*
- *Availability of long term fixed rate market loans 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 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.*

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 / 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 PCC is asked to approve the following treasury indicators and limits:

	2013/14 £'000	2014/15 £'000	2015/16 £'000
Interest rate exposures			
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	50,000	60,000	72,000
Limits on variable interest rates based on net debt	50,000	52,000	50,000
Maturity structure of fixed interest rate borrowing 2013/14			
	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%	

3.5 Policy on borrowing in advance of need

The PCC will not borrow more than or in advance of its needs 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.

3.6 Debt rescheduling

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

The reasons for any rescheduling to take place will include:

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

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

All rescheduling will be reported to the PCC at the earliest opportunity.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

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

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the PCC has clearly stipulated below the minimum acceptable credit quality of counterparties for inclusion on the lending list. 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 agency. Using the Sector ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Furthermore, the PCC's 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 the officers of the OPCC and the Force Finance Unit 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. This is fully integrated into the credit methodology provided by the advisors, Sector in producing its colour codings which show the varying degrees of suggested 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 diversification 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 5.3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the PCC's treasury management practices /schedules.

4.2 Creditworthiness policy

This PCC applies the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. 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 suggested duration for investments. The PCC will therefore use counterparties within the following durational bands:

- 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

The methodology is set out in 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 the PCC use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1 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. The PCC is 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 PCC's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the OPCC and the Force Finance Unit will be advised of information in movements in credit default swap spreads 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 supporting government will also be used in addition to data provided by Sector.

4.3 Country limits

The PCC will only allow the use of approved UK counterparties.

4.4 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 forecast to remain unchanged at 0.5% before starting to rise from quarter 1 of 2015. Bank Rate forecasts for financial year ends (March) are:

- 2012/13 0.50%
- 2013/14 0.50%
- 2014/15 0.75%
- 2015/16 1.75%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the 2% target rate set by Government.

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

2012/13	0.50%
2013/14	0.50%
2014/15	0.60%
2015/16	1.50%

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

The PCC's position is that moneys will not be lent for periods longer than 364 days.

For 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 in order to benefit from the compounding of interest.

4.5 Icelandic bank investments

All treasury management reports will include updates on the action being taken to recover monies invested with the UK subsidiaries of the Icelandic Banks, Heritable Bank and Kaupthing Singer and Friedlander (KSF) which collapsed in October 2008. The financial statements for 2012/13 will include details of the updated calculations of impairments based on the latest forecasts of dividends from the Administrators, Ernst and Young.

4.6 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 on rate above the 7-day LIBID rate.

4.7 End of year investment report

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

5 Appendices

(These can be appended to the report or omitted as required)

1. Interest rate forecasts
2. Economic background
3. Treasury management practice 1 – credit and counterparty risk management (opt
4. Treasury management scheme of delegation
5. The treasury management role of the section 151 officer

APPENDIX 5.1: Interest Rate Forecasts 2013 - 2016

(Note: These rates are based on the new certainty rate (minus 20bps) which has been accessible since 1 November 2012)

%	Mar 2013	Jun 2013	Sep 2013	Dec 2013	Mar 2014	Jun 2014	Sep 2014	Dec 2014	Mar 2015	Jun 2015	Sep 2015	Dec 2015	Mar 2016
Bank Rate	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
3m LIBID	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
6m LIBID	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
12m LIBID	1.00	1.00	1.00	1.00	1.10	1.10	1.20	1.30	1.30	1.50	1.80	2.10	2.40
5yr PWLB	1.80	1.80	1.80	1.80	1.90	2.00	2.10	2.20	2.40	2.50	2.60	2.80	3.00
10yr PWLB	2.90	2.90	2.90	2.90	3.00	3.10	3.20	3.30	3.50	3.60	3.80	3.90	4.10
25yr PWLB	4.10	4.10	4.10	4.10	4.20	4.20	4.30	4.40	4.60	4.60	4.80	4.90	5.00
50yr PWLB	4.20	4.20	4.20	4.20	4.40	4.40	4.50	4.60	4.70	4.80	4.90	5.00	5.10

APPENDIX 5.2: Economic Background

In its Inflation Report for February 2013, the Bank of England again lowered its forecasts for growth and pushed back the timing of recovery. It also raised its forecasts for inflation (peaking at 3.2% in Q3 this year) and again pushed back the timing of when inflation would fall back below the 2% target rate by eighteen months, to Q1 2016. The Bank has, therefore, continued its shift towards pessimism on the speed and strength of recovery, and it is now forecasting growth reaching about 1.9% in two years time.

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

(a) Maintenance of a portfolio of quantitative easing purchases of gilts of £375bn. This portfolio is currently only being supplemented by reinvestment of maturing sums and passing of interest payments received from the Treasury, back to the Treasury. The current Governor, Mervyn King views monetary policy initiatives by the MPC to now be at the limit of their effectiveness. However, the incoming Governor Mark Carney, due to take office in July, has made some comments that there is still further room for more action by the MPC. King's view is that the problems of the UK economy are now structural and need to be dealt with by supply side reforms and rebalancing.

(b) The Funding for Lending scheme launched in August will make available at least £80bn of cheap funding for banks, in order to boost lending to the "real economy", i.e. households and (non financial) companies. This initiative has succeeded in lowering bank borrowing rates on mortgages and loans, but at the same time has hit depositors hard due to reduced rates on savings. The full effect of this scheme, though, is still to be felt in terms of lending to small enterprises, but credit availability has improved for medium size enterprises.

There is still some concern that even this reduction in its forecasts for recovery could turn out to be optimistic. Since the recession bottomed out in 2008, despite radical action by the Bank to cut Bank Rate to 0.5% (reached in March 2009) and initiate £375bn of QE, the Bank has failed to stimulate a consistently strong recovery in economic growth. In fact, the current situation is:

(a) The return to positive growth of 1% in Q3 after three quarters of negative growth proved to be only an Olympics blip which washed out the negative figure in the previous quarter. However, forward looking surveys are currently indicating a resumption of weak growth in Q1 2013. GDP is still 3.3% below the peak in economic activity achieved prior to the start of the 2008 recession.

(b) 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).

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

(d) UK exporters are struggling to make significant progress in diversifying away from their dependence on markets in the EU and delaying the necessary rebalance the UK economy.

(e) The increase in forecasts for CPI inflation suggest a further erosion of consumer disposable income, which will inhibit consumer expenditure.

One factor which may already be priced in by financial markets is an increased likelihood that the UK will lose its AAA credit rating from. However, this may not make a significant difference for investors faced with other major western economies having already lost their AAA rating or likely to do so or even to be downgraded further.

The housing market is showing some weak signs of life (but from a low base) as a result of the recent lowering of mortgage rates and improvement in availability of credit.

Unemployment has also surprised by falling marginally, and total employment by rising slightly, despite the economy struggling to grow. However, some growth in employment has been due to self employment, part time working and jobs in sales / procurement as firms struggle to hold on to current levels of turnover, which may go some way to explaining the fall in UK productivity. Further, unemployment has remained relatively subdued given the economic environment. This may be due to labour hoarding, as companies retain staff so that when the upturn comes they are suitably staffed.

Sector's forecast for the first increase in Bank Rate unchanged, expected to be in Q1 2015. But this is dependent on the economy succeeding in attaining recovery to the growth rates forecast in the latest Inflation Report; otherwise it could slip further back if growth and recovery disappoint.

The start of 2013 has featured a bounce upwards in equity values as optimism that the troubles in the Eurozone have been addressed came to the fore. The likelihood of a break up of the Eurozone has diminished. However, commentators are far from convinced that the EU has done anything more than to kick fundamental economic problems and instability down the road and to delay dealing with the real, and huge, challenges facing Eurozone countries struggling with blown out government finances and economic recession. There is a long list of factors which could destabilise financial markets during 2013 and cause a renewal of gilts and sterling as safe havens:

US: The fiscal budget problems have only been partially dealt with. If no reasonable agreement were to be reached, swinging cuts in expenditure could plunge the US economy into recession and send shock waves around the world economy. Even if these problems are successfully dealt with, there are still concerns that the US will only achieve weak economic growth. The Federal Reserve has stated that it will not increase rates until mid-2015 at the earliest.

Spain: Unemployment has reached 26%, just as in Greece. It will take many years to replace the bombed out construction industry and to significantly reduce such a massive level of unemployment and the stock of 700,000 unsold homes. Government finances are looking in a parlous state, much of the banking industry is heavily exposed to property and the construction industry and is looking in need of major financial support. Regional governments are also seeking major financial support from central government.

Italy: The imminent general election and smoke filled room negotiations of how to cobble together a viable coalition government could make Berlusconi a king maker; but he is anti-austerity and anti bail out; not a positive combination in the current state of Italy's finances

Germany: The general election is due in September 2013. Angela Merkel is still expected to get the most votes but may need to rethink the composition of the ruling coalition. There is a small risk that a surprise result could unsettle investors.

France: GDP fell 0.3% in Q4 2012. The French fiscal budget is highly dependent on achieving 0.8% growth in 2013 now looking very unlikely. French funding requirement of €170.8bn, and a level of total debt to GDP in excess of 90% already could raise concerns.

Greece: Greece has dropped out of the headlines after its massive further bailout in December. However, it may only be time before it could, yet again, show that it is failing to hit fiscal targets.

Cyprus: This is only a small Eurozone country but has a massively over extended banking system, over five times the size of its own domestic GDP (similar to Ireland in 2009). And is currently struggling to meet the requirements to secure a Eurozone bailout.

In summary, the above issues could come to the fore during 2013 and lead to a recovery of the safe haven status of gilts and sterling. The loss of safe haven flows during Q4 2012 led to an increase in gilt yields and, therefore, PWLB rates. Figures have not been put to these factors in Sector's forecasts due to the difficulties in assessing the possible timing of such events. Officers will monitor the situation on an ongoing basis to identify and be prepared for significant falls in PWLB rates if such events were to occur.

The Monetary Policy Committee still holds QE as a tool to be used as a generator of recovery. An increase in the programme will raise the possibility that the duration of the programme could be lengthened, thus adding the pressure on interest rates, and maintaining the low levels for longer, but potentially increasing inflation risks further down the line.

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, resolution of the current crisis. Under this assumed scenario, growth within the Eurozone will be depressed for the next couple of years and this would also restrain UK growth, as the EU is our biggest export market.

PWLB forecasts are based around a balance of risks. Downside risks have already been covered. However, Sector have flagged 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 inherent to 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.
- An increase in the reversal of sterling's safe haven status on a further improvement in financial stresses in the Eurozone.
- Investors reverse derisking by moving money from government bonds into shares, in anticipation of a return to worldwide economic growth.
- UK credit rating downgrade.

Sector have commented on just how unpredictable PWLB rates and bond yields are, as the markets are experiencing exceptional levels of volatility, which are highly correlated to political developments (or lack of them) in the sovereign debt crisis.

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

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.

	* Minimum credit criteria / colour band	** Max % of total investments/ £ limit per institution	Max. maturity period
DMADF - UK Government DMADF - Treasury Bills	N/A N/A	100%/no limit	up to 1 year
Money market funds	AAA	100%/£10m	Liquid
Local authorities	N/A	100%/£15m	up to 1 year
Term deposits with banks and building societies	Blue/Orange Red Green No Colour	£15m £10m £10m	Up to 1 year Up to 6 months Up to 3 months Not for use

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 **	Greece	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 <i>Red</i> <i>Green</i>	In-house	100%	12 months
			100%	6 months
			100%	3 months

APPENDIX 5.4: Treasury management scheme of delegation

(i) Responsibilities of the PCC

- To receive and review reports on treasury management policies, practices and activities;
- To approve of 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 of the division of responsibilities;
- To receive and review regular monitoring reports and act on recommendations;
- To approve the selection of external service providers and agreeing terms of appointment.

(ii) Responsibility of the PCCCF0/Deputy Chief Executive and Treasurer

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

APPENDIX 5.5: The treasury management role of the section 151 officer**The S151 (responsible) officer**

- 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.

